



# Monthly Insights

22 May 2019

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## Preface

**Renewed trade tensions between the US and China are casting a shadow over growth prospects in most parts of the world. Indeed with the dispute morphing into a broader geopolitical stand-off markets are becoming concerned that the impact could be prolonged.**

**Global macro:** If it was not for the deteriorating US-China trade relationship in the last fortnight, the economic backdrop might appear to be improving with an array of economic data points in the last month providing some grounds for optimism.

**GCC macro:** Survey data for April showed a rise in output and new work in the UAE and Saudi Arabia, albeit with further price discounting by firms.

**MENA macro:** The Lebanese government hopes to implement an ambitious fiscal consolidation programme in 2019, but will face significant pushback in doing so.

**Pakistan:** Pakistan and the IMF have reached staff-level agreement for a new three-year extended fund facility to the tune of around USD 6bn, as Prime Minister Imran Khan seeks to turn the ailing economy around in the face of significant structural challenges.

**Emerging Markets:** India, currently, is facing a paradox. Investors are appreciating the prospect of another stable government (as per exit polls) even as they remain concerned about the economy which is showing signs of slowdown.

**Interest Rates:** Government bonds benefited from safe haven bid on the back of rising trade tensions.

**Credit Markets:** Narrowing benchmark yields boosted credit bonds higher even though credits spreads widened amid rising geopolitical risks.

**Currencies:** The dollar has gained ground over the course of the month, benefiting from safe haven bids as trade tensions continue to escalate.

**Equities:** Over the past month, global equities lost momentum as expectations of a US-China trade deal shifted from 'when' to 'if'. However, the losses were contained in most markets as central banks succeeded in recreating the 'goldilocks' environment similar to that in 2012-2017 and corporate earnings remained relatively strong.

**Commodities:** Oil prices are showing few signs of volatility and have settled into a narrow range. However, rather than reflecting market calm the absence of volatility is down to two significant and, for now, equally weighted forces of geopolitical risk and trade war.

*Timothy Fox*  
**Chief Economist & Head of Research**

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## Trade conflict renews concern over growth

If it was not for the deteriorating US-China trade relationship in the last fortnight, the economic backdrop might appear to be improving with an array of economic data points in the last month providing some grounds for optimism. However, the encouraging headlines belie a more complicated reality beneath the surface of the world economy. Not only do the recent rebounds in growth appear to be driven in part by transitory factors, the additional weight of renewed trade tensions reinforces their relatively fragile foundations.

The last month has provided some evidence that the world economy is stabilizing after the growth scare at the start of the year. Most prominently the US economy expanded by 3.2% on an annualised basis in Q1, almost twice as strong as the markets expected just a few weeks ago. US jobs growth also exceeded expectations, with the latest reading reinforcing thoughts of a 'goldilocks' economy which is not too hot and not too cold.

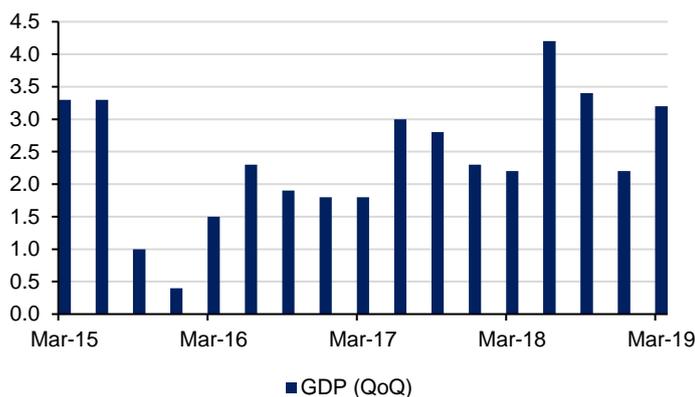
3.2% y/y after 3.4% in February. This echoed some of the strengths and weaknesses of the GDP report, where overall output rose strongly and to some extent was caused by transitory factors such as rising inventories, yet with inflationary pressures still largely absent in a 1.6% underlying price deflator.

## Eurozone GDP better than expected

It was not only the US that started producing better than expected data suddenly. The Eurozone also surprised positively with a 0.4% Q1 GDP growth rate, up from 0.2% q/q in the previous quarter. This benefited from an unexpected acceleration in Spanish GDP growth of 0.7% q/q and steady 0.3% q/q growth in France, with Italy also pulling out of recession. German real GDP was also 0.4% q/q in Q1, in line with expectations and the Eurozone growth figure. This is a marked improvement on the 0.0% recorded in Q4 2018, but the economy remains under pressure.

As with the U. S. the full Eurozone breakdown showed a pick-up in inventories, and as such the headline figures overstate the true health of the Eurozone economy. Likewise in the UK GDP was also better at 0.5% in Q1, but with an inventory build-up ahead of Brexit being largely responsible for that strength, and casting doubt about it being maintained into Q2. Japan too saw surprising strength in Q1, but here the source of the strength came from net exports, reflecting in large part a decline in imports. Combined with weaker personal consumption and business spending the omens from the Japanese data are not all good either.

### US economy expands 3.2% in Q1 2019

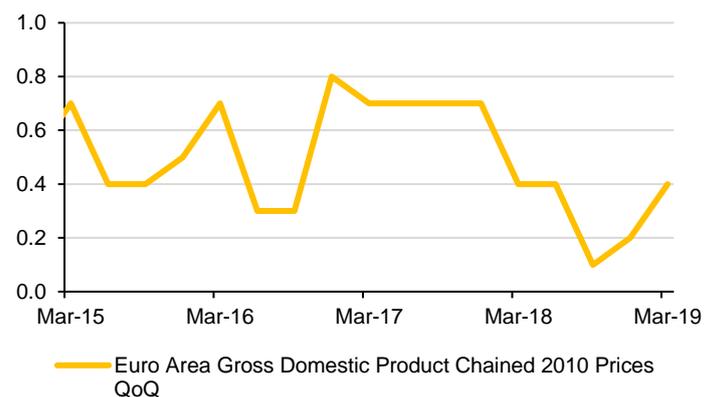


Source: Bloomberg, Emirates NBD Research

## US unemployment hits a 49 year low

While the drop in the unemployment rate to a 49 year low of 3.6% was one of the main headlines from the April employment report, it was actually one of the weaker aspects of it. This was because it was caused by a massive 490,000 fall in the labour force in April, more than outweighing the 103,000 decline in the household measure of employment. Nonetheless the other components of the report were more encouraging. With a 263k gain in non-farm payrolls after 16k in upward revisions, Q2 is beginning very firmly keeping the 6-month trend above 200k, and with gains for both the goods and services sectors. The workweek and hours-worked data slipped back, however, while wages were unchanged from March at

### Eurozone GDP recovers in Q1 2019

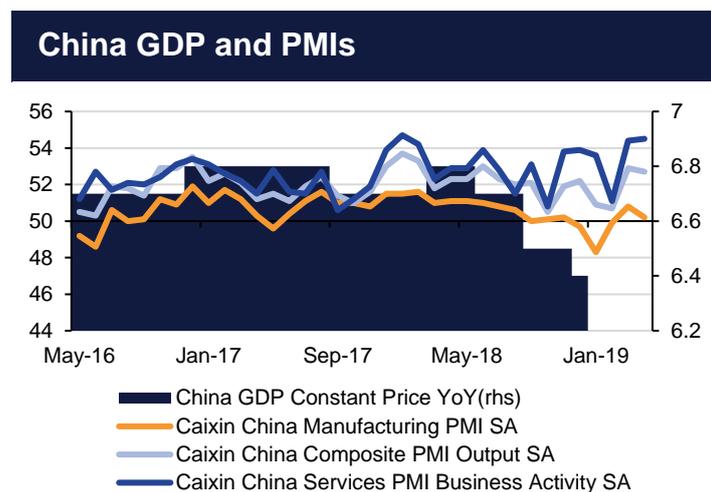


Source: Bloomberg, Emirates NBD Research

**Not only do the recent rebounds in growth appear to be driven in part by transitory factors, the additional weight of renewed trade tensions reinforces their relatively fragile foundations**

## Markets initially encouraged by Chinese data

Beyond the quarterly GDP reports, the evidence from more contemporaneous monthly purchasing manager's (PMI) data was much sketchier. Markets took heart from the Chinese growth rate of 6.4% a month ago, and this was quickly followed by improvements in Chinese PMI readings above 50 suggesting that stimulus measures are starting to work. However, those bounces in activity have to some extent petered out showing that sustaining these recoveries is going to be a lot harder. US ISM (Institute of Supply Management) data and PMI readings have also shown more volatility of late as they have in Eurozone and the UK. This more mixed monthly data is also apparent in the GCC (see GCC Macro), where recovering headline PMI data has also been observed in the UAE and in Saudi Arabia whilst beneath the surface the components of the surveys reveal challenging labour markets and difficult pricing conditions. Furthermore the global composite PMI index showed the global expansion slowing to a three-month low in April, while the measure new export measures also fell for the fifth consecutive month.



Source: Bloomberg, Emirates NBD Research

Thus while the recoveries in headline GDP might appear heartening, hinting at a world economy that is starting to stabilize, there still appears to be a lot more work to do to make recovery sustainable. Into this uncertain mix came the resumption of the US-China trade dispute posing its own threat to bullish markets and confidence in a global growth.

## Trump threatens additional tariffs

A key part of investors' expectations of a recovery in the global economy this year was linked to hopes of a positive outcome to the US-China trade dispute. However, President Donald Trump's tweets a fortnight ago, threatening to escalate tariffs on Chinese imports put a big question mark over this assumption, and the implementation of that threat has crystallised many of those fears.

On 10th May the US hiked tariffs on USD 200bn of Chinese imports to 25% as talks between the two countries ended without a resolution. The US also indicated it was preparing to introduce tariffs on another USD 300bn of imports from China, releasing a list of

goods that could see tariffs of up to 25% imposed by the end of June if no deal is reached by then. This would effectively cover all remaining Chinese exports to the US that are currently not being taxed and would likely push up the cost of many household goods for US consumers.

A few days later China retaliated announcing it would increase tariffs on USD 60bn worth of imports from the US from 1st June, including on computers, agricultural products, LNG and toothpaste. While President Trump said that he feels the trade talks will still be successful, the 4% drop in the S&P500 index in the last fortnight tells a different story. This does at least appear to be concentrating President Trump's mind. Amidst an escalation of trade wars with China, in which the telecom firm Huawei was specifically targeted as a national threat, Trump at least deferred a decision on tariffs on EU and Japanese autos and spare parts by 180 days. The US government also reached an agreement with Canada and Mexico regarding tariffs on steel and aluminium imposed last year, showing that he does not want to fight trade battles on multiple fronts.

It is frequently observed that there are no winners in a trade war, but President Trump would seem to view it as a matter of relative strength rather than a zero sum game, feeling emboldened in his stance on China by the recent record highs in the stock market, the strong headline growth in US GDP and the historic low unemployment rate. His approval ratings are also around the highest seen during his presidency, which may all be giving him the impression that he has much less to lose than his opponents.

## Trade risks come at critical time for world economy

There are numerous measures of the estimated cost of the trade dispute on consumers, on the US economy and on the broader world, with think-tanks, banks and global institutions all projecting their various scenarios of the hit to growth. There is a risk, however, that such economic models do not capture the full extent of the damage to business and consumer confidence and psychology, the impact on global supply chains and trade flows, and investment. When added to the difficulties that already exist in terms of sustaining recent growth improvements, it is easy to see how the latest twist in the trade dispute could increase recession risks for some economies or at least act as a further check on already sluggish growth. With some signs that world trade volumes were already contracting before the latest trade reversals, this dispute has clearly come at a critical moment.

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## Key Economic Forecasts - Global

| US                   | 2014 | 2015 | 2016 | 2017 | 2018f | 2019f |
|----------------------|------|------|------|------|-------|-------|
| Real GDP %           | 2.6  | 2.9  | 1.5  | 2.2  | 2.7   | 2.5   |
| Current A/C % GDP    | -2.1 | -2.4 | -2.4 | -2.3 | -3.0  | -2.5  |
| Budget Balance % GDP | -2.7 | -2.6 | -3.1 | -3.4 | -3.5  | -4.7  |
| CPI %                | 1.6  | 0.1  | 1.3  | 2.1  | 2.5   | 2.3   |
| Eurozone             |      |      |      |      |       |       |
| Real GDP %           | 1.3  | 2.1  | 1.8  | 2.4  | 1.9   | 1.5   |
| Current A/C % GDP    | 2.4  | 3.2  | 3.3  | 3.5  | 3.2   | 3.0   |
| Budget Balance % GDP | -2.5 | -2.0 | -1.5 | -0.9 | -0.7  | -0.9  |
| CPI %                | 0.4  | 0.0  | 0.2  | 1.5  | 1.7   | 1.5   |
| UK                   |      |      |      |      |       |       |
| Real GDP %           | 3.1  | 2.3  | 1.9  | 1.7  | 1.3   | 1.5   |
| Current A/C % GDP    | -5.3 | -5.2 | -5.8 | -3.9 | -3.5  | -3.3  |
| Budget Balance % GDP | -5.3 | -4.1 | -2.9 | -1.8 | -1.4  | -1.6  |
| CPI %                | 1.5  | 0.0  | 0.7  | 2.7  | 2.5   | 2.1   |
| Japan                |      |      |      |      |       |       |
| Real GDP %           | 0.4  | 1.4  | 0.9  | 1.8  | 0.8   | 1.0   |
| Current A/C % GDP    | 0.8  | 3.1  | 3.8  | 4.0  | 3.6   | 3.6   |
| Budget Balance % GDP | -7.7 | -6.7 | -5.7 | -3.5 | -3.2  | -3.5  |
| CPI %                | 2.7  | 0.8  | -0.1 | 0.5  | 1.0   | 1.0   |
| China                |      |      |      |      |       |       |
| Real GDP %           | 7.3  | 6.9  | 6.7  | 6.9  | 6.6   | 6.3   |
| Current A/C % GDP    | 2.3  | 2.8  | 1.8  | 1.3  | 0.4   | 0.1   |
| Budget Balance % GDP | -1.8 | -3.4 | -3.8 | -3.7 | -3.6  | -4.0  |
| CPI %                | 2.0  | 1.4  | 2.0  | 1.6  | 2.1   | 2.3   |
| India*               |      |      |      |      |       |       |
| Real GDP %           | 6.4  | 7.4  | 8.2  | 7.1  | 7.3   | 7.0   |
| Current A/C % GDP    | -1.4 | -1.1 | -0.6 | -1.5 | -2.0  | -2.5  |
| Budget Balance % GDP | -4.3 | -3.5 | -3.7 | -3.9 | -3.5  | -3.6  |
| CPI %                | 6.7  | 4.9  | 5.0  | 3.3  | 3.9   | 3.5   |

Source: Bloomberg, Emirates NBD Research

\*For India the data refers to fiscal year (April – March)

## GCC Macro : Green Shoots?

The Saudi Arabia PMI was unchanged last month at 56.8 while the UAE PMI rose to a 16-month high of 57.6. However, **the relatively strong headline reading does not capture the consistent decline in selling prices (and thus margin pressures)** that have supported growth in output and new work in recent months. The rebound in the volume of activity has also not translated into private sector job growth in a meaningful way; the average employment index in the UAE year-to-date is in contraction territory, while for Saudi Arabia it is only fractionally above the neutral 50-level. There has also been very little evidence of wage growth in either country this year.

**In the UAE, the lack of private sector employment and wage growth suggests continued weakness in household consumption in the first few months of this year.** GDP data show that private consumption accounted for just 30.1% of total real GDP in 2018, down from 49% in 2010. Bank loan data points to softness in household consumption in Q1 2019. Although overall private sector credit growth accelerated in H2 2018, it has slowed again to 3.5% y/y in February and March 2019. Moreover, the growth in private sector credit this year has been due to business and industry; loans to individuals have contracted on an annual basis in Q1 2019.

**The picture for Saudi Arabia is a little more encouraging.**

**Private sector credit growth reached 3.0% y/y in March.** While this is not a high rate of growth relative to pre-2016 levels, it is an improvement from 2017-2018. The value of residential mortgages from banks more than doubled y/y in March 2019. Data on consumer loans is only available through Q4 2018, with H2 2018 showing growth in this component following contraction in 2017.

**Point of sale transactions also continue to grow robustly,** with the average growth in the three months to March reaching 25.0% y/y. While this is partly due to the growth in card spending relative to cash, it does suggest that consumers in the Kingdom are spending more than they were in 2016-2017.

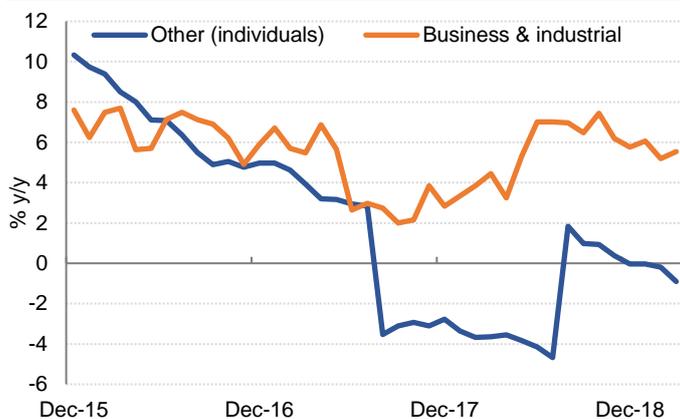
### Saudi Arabia: Point of sale transactions (3m ma)



Source: Haver Analytics, Emirates NBD Research

**Saudi Arabia's budget position has also improved sharply,** with the first surplus in nearly five years recorded in Q1 2019. Oil revenues jumped nearly 50% y/y even as oil production cuts took effect, with the finance minister attributing this to "royalties, tax, dividends and special dividends" from Aramco. Non-oil revenues also rose more than 45% y/y, resulting in total budget revenue growth of 47.6%. This was sharply higher than expenditure growth of just 8.5% y/y in Q1, resulting a surplus of SAR 27.8bn or around 3.6% of GDP. The component of spending which grew the most in Q1 2019 was subsidies, followed by general goods & services. Wage growth was relatively contained at 7.9% y/y, although this was off a high annual base.

### UAE private sector credit growth by borrower



Source: Haver Analytics, Emirates NBD Research

**Survey data for April showed a rise in output and new work in the UAE and Saudi Arabia, albeit with further price discounting by firms**

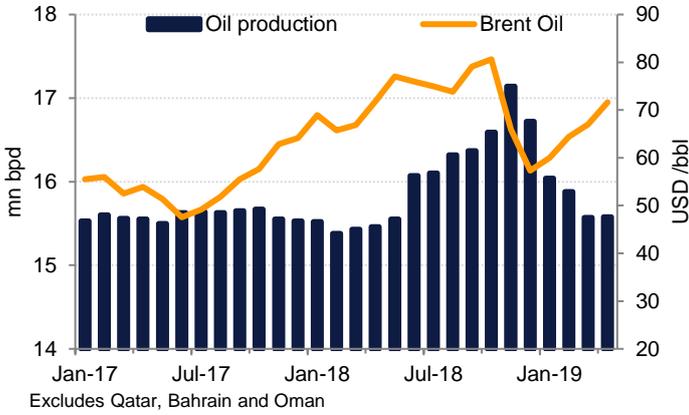
The IMF expects a significant deterioration in the fiscal position for the rest of the year, forecasting a -7% of GDP budget deficit, and suggested the kingdom consider raising VAT from the current 5% to further boost non-oil revenues. We think the deficit is more likely to reach -5.5% GDP this year, which is manageable in our view.

Finally, the monetary survey showed that **SAMA's net foreign assets rose by USD 15bn in March**, more than offsetting the declines in January and February. With balance of payments data not yet available for Q1, it's unclear what was behind the increase. Aramco issued USD 12bn in debt in April, so we expect the reserves position would have increased again last month.

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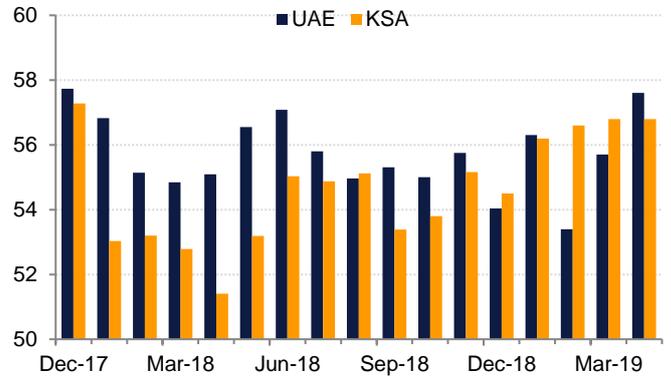
## GCC in Pictures

### GCC Oil Production and Oil Price



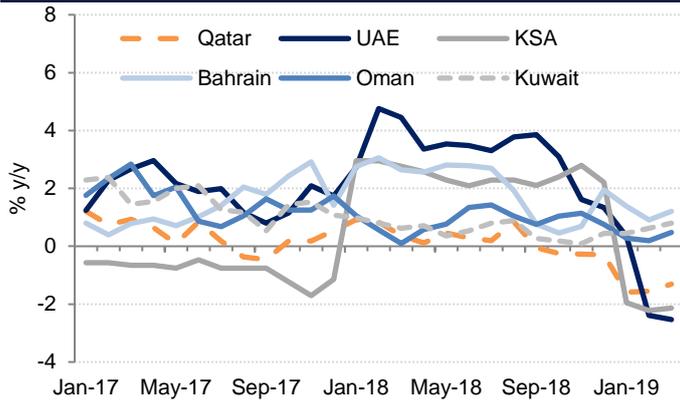
Source: Bloomberg, Emirates NBD Research

### Purchasing Managers' Index



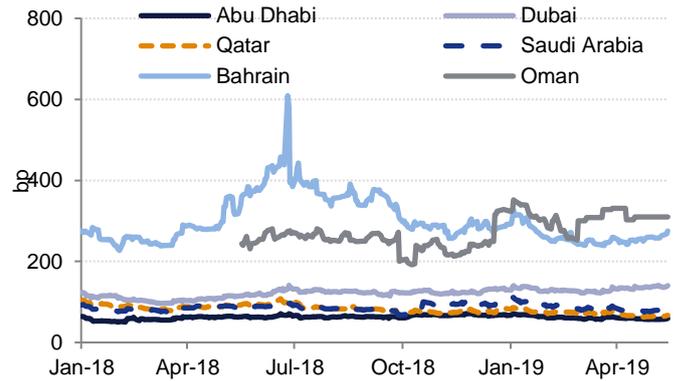
Source: IHS Markit, Emirates NBD Research

### Inflation



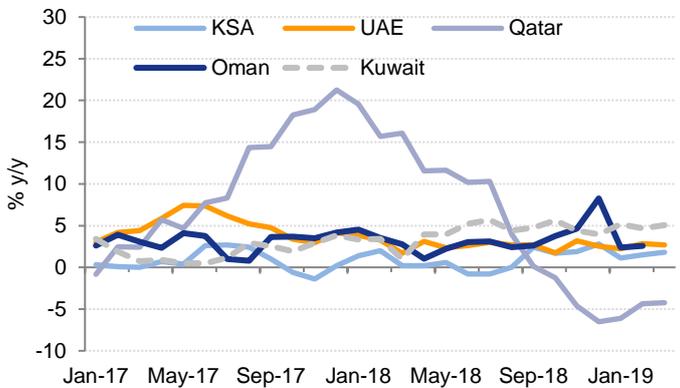
Source: Haver Analytics, Emirates NBD Research

### CDS Spreads



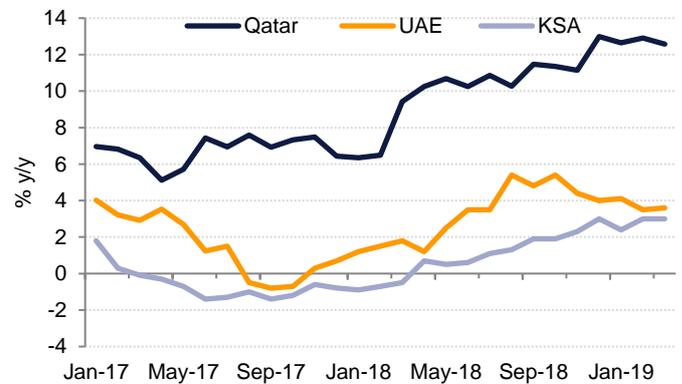
Source: Bloomberg

### 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

## Key Economic Forecasts - GCC

| United Arab Emirates           | 2016  | 2017  | 2018e | 2019f | 2020f |
|--------------------------------|-------|-------|-------|-------|-------|
| Nominal GDP \$bn               | 357.3 | 378.0 | 414.5 |       |       |
| Real GDP %                     | 3.0   | 0.8   | 1.7   |       |       |
| Current A/C % GDP              | 3.7   | 7.0   | 7.1   |       |       |
| Budget Balance % GDP           | -2.0  | -1.6  | -1.6  |       |       |
| CPI %                          | 1.6   | 2.0   | 3.1   | 1.5   | 2.0   |
| Saudi Arabia                   |       |       |       |       |       |
| Nominal GDP \$bn               | 644.9 | 688.6 | 782.5 | 791.2 | 823.8 |
| Real GDP %                     | 1.7   | -0.7  | 2.2   | 2.0   | 1.6   |
| Current A/C % GDP              | -3.7  | 1.5   | 9.2   | 6.0   | 5.8   |
| Budget Balance % GDP           | -12.9 | -9.2  | -4.6  | -5.5  | -5.5  |
| CPI %                          | 2.1   | -0.8  | 2.5   | 2.0   | 2.0   |
| Qatar                          |       |       |       |       |       |
| Nominal GDP \$bn               | 151.7 | 166.9 | 192.0 | 193.3 | 205.8 |
| Real GDP %                     | 1.8   | 1.1   | 1.3   | 3.5   | 4.0   |
| Current A/C % GDP              | -5.5  | 3.8   | 10.2  | 5.7   | 5.0   |
| Budget Balance % GDP           | -9.2  | -5.8  | -0.3  | 1.0   | 1.0   |
| CPI %                          | 2.7   | 0.4   | 0.2   | 1.5   | 2.0   |
| Kuwait                         |       |       |       |       |       |
| Nominal GDP \$bn               | 109.4 | 119.5 | 141.6 | 141.0 | 147.1 |
| Real GDP %                     | 2.9   | -3.5  | 1.2   | 0.9   | 2.0   |
| Current A/C % GDP              | -4.6  | 5.9   | 12.9  | 7.2   | 12.3  |
| Budget Balance % GDP           | -13.9 | -9.0  | -2.9  | -7.9  | -9.1  |
| CPI %                          | 3.2   | 1.6   | 0.6   | 1.0   | 1.5   |
| Oman                           |       |       |       |       |       |
| Nominal GDP \$bn               | 65.9  | 70.7  | 79.2  | 79.7  | 82.7  |
| Real GDP %                     | 5.0   | -0.9  | 2.1   | 2.4   | 2.7   |
| Current A/C % GDP              | -18.8 | -15.2 | -5.8  | -7.3  | -6.3  |
| Budget Balance % GDP           | -20.9 | -13.8 | -9.0  | -8.1  | -7.2  |
| CPI %                          | 1.1   | 1.6   | 0.9   | 1.5   | 2.5   |
| Bahrain                        |       |       |       |       |       |
| Nominal GDP \$bn               | 32.3  | 35.4  | 37.7  | 39.0  | 40.6  |
| Real GDP %                     | 3.5   | 3.8   | 1.8   | 2.0   | 2.4   |
| Current A/C % GDP              | -4.6  | -4.5  | -5.9  | -6.3  | -6.1  |
| Budget Balance % GDP           | -13.5 | -10.0 | -6.8  | 0.0   | -6.4  |
| CPI %                          | 2.8   | 1.4   | 2.1   | 2.5   | 2.5   |
| GCC (Nominal GDP weighted avg) |       |       |       |       |       |
| Nominal GDP \$bn               | 429   | 456   | 515   | 523   | 545   |
| Real GDP %                     | 2.3   | -0.3  | 1.9   | 2.4   | 2.5   |
| Current A/C % GDP              | -2.8  | 2.6   | 8.1   | 4.8   | 4.9   |
| Budget Balance % GDP           | -10.1 | -7.1  | -3.5  | -3.1  | -3.7  |
| CPI %                          | 2.1   | 0.4   | 2.1   | 1.7   | 2.0   |

Source: Haver Analytics, National sources, Emirates NBD Research

## MENA Macro : Lebanon nears budget resolution

While the Lebanese government was yet to finalise and publish their 2019 budget at the time of writing on May 21, it had reportedly agreed on most items the previous night, with a deficit target of just 7.6% of GDP, down from around 11% in 2018.

There is little doubt that the economic pressures on Lebanon necessitate some swingeing structural reforms, and Prime Minister Saad al-Hariri had previously promised a 'budget that may be the most austere in the history of Lebanon.' Nevertheless, with widespread protest even before the budget was announced, this target will likely prove overly ambitious, and we expect the budget shortfall to be in the region of 9.0% of GDP.

### Greater resolution to deal with debt problem

With soaring public debt levels of over 150% of GDP – among the highest in the world – Lebanon has long been in need of some drastic fiscal adjustment, especially since debt levels started expanding more rapidly than GDP. However, it has for much of the past decade lacked a strong and stable administration capable of implementing this. The nine-month lag between elections in May last year and the eventual formation of a government, combined with the subsequent delay to passing a budget and anaemic economic growth, has seen bond yields and CDS spreads soar as investor perceptions soured. In January, Moody's downgraded its credit rating for Lebanon deeper into junk territory.

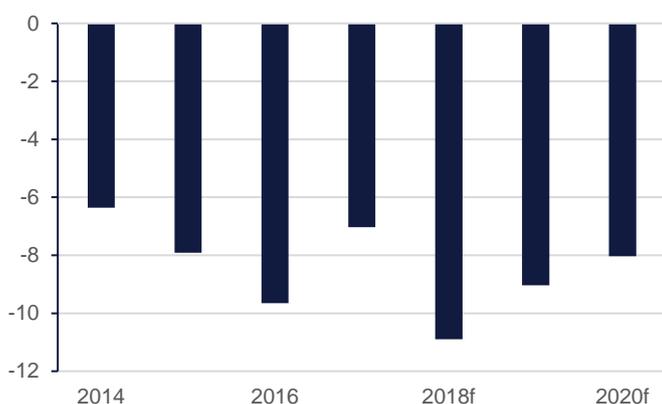
mooted 3.4 point deduction in the deficit through both hiking taxes and cutting expenditure, and such actions should release the crucial USD 11bn promised in international aid promised at the CEDRE conference in Paris last year. However, the austerity drive will be painful in the short term, and will likely serve to keep growth low in 2019 – we forecast real GDP growth of just 0.8%, compared to an estimated 0.9% last year. Further, the reforms will be met by significant pushback.

### Popular pushback inevitable

The depth of the upcoming adjustments has been well signposted over the preceding months, and even before the budget was finalised there have been increasing protests. Retired soldiers in particular have been making their opposition felt owing to planned adjustments to their pensions, with numerous street protests, and picketing of the central bank. Teachers have also been staging protests, and with bonus months' pay for civil servants due to be scrapped under the new budget, more pushback seems inevitable. Given the fragile nature of Lebanon's government, some concessions are likely, making the 7.6% of GDP deficit target ambitious.

Nevertheless, so long as the government implements sufficient reforms to unlock the USD 11bn, reassure anxious investors, and stabilise debt levels, we would expect a steady improvement in Lebanon's macroeconomic fundamentals over the coming years.

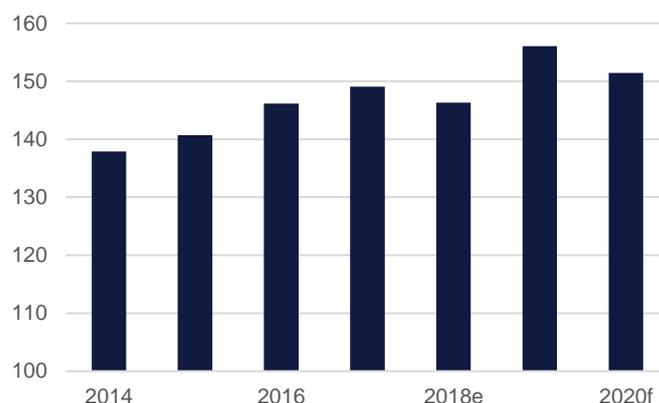
#### Budget balance, % GDP



Source: Haver Analytics, Emirates NBD Research

There does now seem to be greater political will to enact the necessary reforms than has been seen in the past, and the initial drafts of the budget confirm this. The government plans to effect its

#### Public debt, % GDP



Source: Haver Analytics, Emirates NBD Research

***The economic pressures on Lebanon necessitate some swingeing structural reforms, and Prime Minister Saad al-Hariri had previously promised a 'budget that may be the most austere in the history of Lebanon'***

## **Electricity reform is vital**

Aside from reforms to compensation, key to bringing down the deficit is reform of the electricity sector. The state-owned Electricité du Liban (EdL) accounted for 16.4% of government expenditure over January-November last year, and around a quarter of the budget deficit. At the same time, the firm's crumbling infrastructure is not fit for purpose, unable to cater for Lebanon's power needs. On April 17, parliament passed amendments seeking to improve the sector, pledging to generate sufficient power by next year for 24-hour electricity, and to develop new power plants over the next six years. The sector's reform would not only help in deficit reduction, but also support economic growth as reliable energy would make Lebanon a more attractive proposition for investment.

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## Key Economic Forecasts – Non-GCC Oil Importers

| <b>Egypt*</b>                           | <b>2016</b> | <b>2017</b> | <b>2018e</b> | <b>2019f</b> | <b>2020f</b> |
|---|-------------|-------------|--------------|--------------|--------------|
| Nominal GDP \$bn                        | 332.4       | 225.8       | 241.5        | 295.3        | 339.8        |
| Real GDP %                              | 4.3         | 4.1         | 5.3          | 5.3          | 5.7          |
| Current A/C % GDP                       | -6.0        | -6.4        | -2.5         | -2.0         | -1.8         |
| Budget Balance % GDP                    | -12.05      | -10.83      | -9.84        | -8.51        | -7.20        |
| CPI %                                   | 13.7        | 29.6        | 14.4         | 12.5         | 12.0         |
| <b>Jordan</b>                           |             |             |              |              |              |
| Nominal GDP \$bn                        | 39.2        | 40.7        | 41.7         | 43.2         | 44.6         |
| Real GDP %                              | 2.1         | 2.1         | 2.0          | 2.8          | 2.7          |
| Current A/C % GDP                       | -9.4        | -10.6       | -7.1         | -6.6         | -6.4         |
| Budget Balance % GDP                    | -3.2        | -2.7        | -2.7         | -2.5         | -2.2         |
| CPI %                                   | -0.8        | 3.3         | 4.5          | 3.2          | 2.4          |
| <b>Lebanon</b>                          |             |             |              |              |              |
| Nominal GDP \$bn                        | 51.1        | 52.1        | 62.7         | 66.8         | 71.2         |
| Real GDP %                              | 1.6         | 0.6         | 0.9          | 0.8          | 1.3          |
| Current A/C % GDP                       | -20.5       | -23.3       | -20.3        | -20.0        | -20.5        |
| Budget Balance % GDP                    | -9.6        | -7.0        | -10.9        | -9.0         | -8.0         |
| CPI %                                   | -0.8        | 4.5         | 6.1          | 3.5          | 3.5          |
| <b>Morocco</b>                          |             |             |              |              |              |
| Nominal GDP \$bn                        | 103.3       | 109.6       | 118.5        | 120.2        | 125.7        |
| Real GDP %                              | 1.1         | 4.1         | 3.0          | 2.7          | 3.0          |
| Current A/C % GDP                       | -4.0        | -3.4        | -3.3         | -3.2         | -2.9         |
| Budget Balance % GDP                    | -4.2        | -3.5        | -3.7         | -3.4         | -3.0         |
| CPI %                                   | 1.6         | 0.8         | 1.8          | 1.6          | 1.5          |
| <b>Tunisia</b>                          |             |             |              |              |              |
| Nominal GDP \$bn                        | 41.7        | 36.8        | 34.5         | 30.6         | 30.6         |
| Real GDP %                              | 1.0         | 1.7         | 2.5          | 2.7          | 3.0          |
| Current A/C % GDP                       | -8.9        | -11.1       | -11.1        | -9.4         | -8.9         |
| Budget Balance % GDP                    | -6.2        | -6.7        | -4.8         | -4.6         | -4.1         |
| CPI %                                   | 3.7         | 5.3         | 7.4          | 6.8          | 5.5          |
| <b>Oil Importers (GDP weighted avg)</b> |             |             |              |              |              |
| Nominal GDP \$bn                        | 223.8       | 147.8       | 158.8        | 195.9        | 227.6        |
| Real GDP %                              | 3.07        | 3.35        | 3.74         | 3.86         | 4.29         |
| Current A/C % GDP                       | -7.4        | -8.3        | -5.9         | -5.2         | -4.9         |
| Budget Balance % GDP                    | -9.4        | -7.7        | -7.6         | -6.8         | -5.9         |
| CPI %                                   | 8.5         | 15.8        | 9.1          | 8.0          | 7.8          |

Source: Haver Analytics, National sources, Emirates NBD Research

\*Egypt data refers to fiscal year (July-June)

## Key Economic Forecasts – Non-GCC Oil Exporters

|   | 2016  | 2017  | 2018e | 2019f | 2020f |
|---|-------|-------|-------|-------|-------|
| <b>Algeria</b>                          |       |       |       |       |       |
| Nominal GDP \$bn                        | 160.2 | 167.6 | 165.6 | 168.2 | 174.6 |
| Real GDP %                              | 3.2   | 0.4   | 1.8   | 2.3   | 2.1   |
| Current A/C % GDP                       | -12.3 | -13.2 | -8.9  | -7.5  | -6.5  |
| Budget Balance % GDP                    | -13.1 | -6.6  | -6.9  | -8.4  | -7.6  |
| CPI %                                   | 5.8   | 6.0   | 3.5   | 4.4   | 6.0   |
| <b>Iran</b>                             |       |       |       |       |       |
| Nominal GDP \$bn                        | 441.8 | 446.9 | 433.4 | 494.1 | 586.2 |
| Real GDP %                              | 12.4  | 3.3   | -1.9  | -4.0  | 3.8   |
| Current A/C % GDP                       | 3.7   | 3.5   | 3.7   | -0.2  | -1.3  |
| Budget Balance % GDP                    | -4.8  | -5.1  | -4.1  | -4.2  | -3.7  |
| CPI %                                   | 8.7   | 10.0  | 21.0  | 31.2  | 17.5  |
| <b>Iraq</b>                             |       |       |       |       |       |
| Nominal GDP \$bn                        | 165.2 | 166.2 | 218.7 | 246.9 | 254.6 |
| Real GDP %                              | 9.6   | 1.0   | 2.0   | 4.2   | 4.1   |
| Current A/C % GDP                       | 1.3   | 8.1   | 13.9  | 8.5   | 7.3   |
| Budget Balance % GDP                    | -14.3 | -6.7  | -4.3  | -4.0  | -3.7  |
| CPI %                                   | 1.3   | 0.7   | 0.4   | 1.0   | 1.1   |
| <b>Libya</b>                            |       |       |       |       |       |
| Nominal GDP \$bn                        | 43.6  | 63.3  | 76.1  | 88.2  | 104.2 |
| Real GDP %                              | -6.9  | 34.8  | 7.6   | 5.4   | 10.4  |
| Current A/C % GDP                       | -10.2 | -9.5  | -2.1  | -2.6  | -2.9  |
| Budget Balance % GDP                    | -18.1 | -10.6 | -7.1  | -6.3  | -5.9  |
| CPI %                                   | 9.5   | 25.0  | 11.5  | 10.0  | 8.5   |
| <b>Oil Exporters (GDP weighted avg)</b> |       |       |       |       |       |
| Nominal GDP \$bn                        | 312.4 | 307.4 | 300.7 | 342.1 | 402.2 |
| Real GDP %                              | 8.7   | 5.3   | 0.8   | -0.4  | 4.2   |
| Current A/C % GDP                       | 0.5   | 0.2   | 2.8   | -0.5  | -0.6  |
| Budget Balance % GDP                    | -7.9  | -7.8  | -6.1  | -4.7  | -4.4  |
| CPI %                                   | 6.1   | 8.2   | 12.4  | 17.6  | 10.8  |

## Special Focus : Pakistan

**Pakistan and the IMF have reached staff-level agreement for a new three-year extended fund facility to the tune of around USD 6bn, as Prime Minister Imran Khan seeks to turn the ailing economy around in the face of significant structural challenges.**

The agreement, Pakistan's 21st since 1959, will take the total drawn from the fund over the period to roughly USD 20bn, with the most recent arrangement prior to this one completed just three years ago. That was judged a partial success, but conditions deteriorated in the subsequent period as difficult policy decisions were not acted on. While Prime Minister Imran Khan has a relatively strong mandate and a simple majority at present, it remains to be seen whether he has sufficient political capital to deliver the reforms necessary to put Pakistan on a sustainable long-term footing.

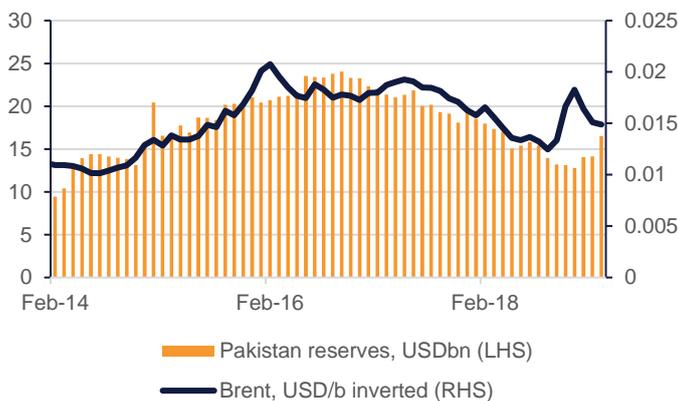
### Multiple devaluations drives PKR/USD to new lows



Source: Bloomberg, Emirates NBD Research

There has been a modest rebound in reserves since, aided by support from the Gulf. Islamabad secured commitments from both Saudi Arabia and the UAE - in the form of deposits at the State Bank of Pakistan and deferred oil payments - to the value of USD 6bn. China has also provided support. However, while this alleviated some of the immediate pressure on the economy, Pakistan remains constrained by the need to reduce economic imbalances and foster sustainable, inclusive growth. The USD 6bn to be provided by the IMF over a three-year period will help shore up reserves, but it is the policy anchor it provides, and the boost to investor perceptions that meeting the programme's targets brings, which will make the more meaningful difference. Indeed, the Fund acknowledges that ongoing 'financing support from Pakistan's international partners will be critical.'

### Higher oil prices weigh on reserves



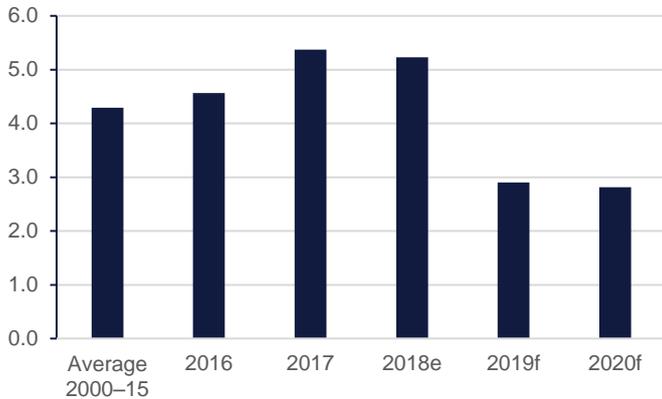
Source: Bloomberg, Emirates NBD Research

### A reluctant return to the IMF

Elected in August 2018, in the midst of last year's EM rout, Khan was initially reluctant to turn to the IMF once more, despite the fragile state of the Pakistani economy. However, deteriorating conditions eventually forced his hand even despite winning some support from friendly countries. Elevated oil prices and imports related to massive Chinese infrastructure projects inflicted considerable external payments pressure as FDI fell and exports lagged – despite six devaluations to the rupee over the course of 2018 resulting in a markedly cheaper currency. Reserves fell to just two months' import cover earlier this year.

**The agreement, Pakistan's 21st since 1959, will take the total drawn from the fund over the period to roughly USD 20bn, with the most recent arrangement prior to this one completed just three years ago**

## Real GDP growth will lag as programme implemented



Source: IMF forecasts, Emirates NBD Research

## Reforms will induce inflationary pressures

Some of the finer details of the agreement with the IMF have not yet been released, but the missive published upon the signing of the staff level agreement states that ‘an ambitious structural reform agenda will supplement economic policies to rekindle economic growth and improve living standards.’ It goes on to say that the programme will support growth through ‘reducing domestic and external imbalances, improving the business environment, strengthening institutions, increasing transparency, and protecting social spending.’ This is familiar language to any IMF agreement, and in practice will likely entail hiking taxes and slashing subsidies in a bid to draw down the fiscal deficit. Improvements to the business environment will also be sought, through cutting red tape and rooting out corruption.

already at levels last seen in 2014. This will weigh on households’ spending power, even despite an aim to ‘rekindle economic growth and improve living standards’. As such, in the near term, real GDP growth will likely lag, and the IMF projects an expansion of just 2.9% in 2019, compared to 5.7% in 2017 and an estimated 5.2% in 2018.

## Is this time the last time?

Whether or not Pakistan can emerge from its cycle of partial recoveries followed by new IMF deals as conditions deteriorate once more will depend on the strength and depth of the reforms implemented this time around. The appointment of ex-IMF economist Reza Baqir as the new State Bank of Pakistan governor at the start of the week will support the view that this time will be different. However, as mentioned, implementing deep structural reforms will impact on households, and could see significant political pushback; opposition parties have been vocally opposed to the deal. Disillusionment could be particularly pronounced given Khan came to power on a manifesto promising an Islamic welfare state in Pakistan, which he will now be hard-pressed to deliver given the new restrictions on spending.

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## Pakistan CPI inflation, % y/y



Source: Haver Analytics, Emirates NBD Research

One of the standout points contained in the press release is that the upcoming 2019/20 budget should aim for a primary deficit of just 0.6% of GDP, which would represent significant progress given that the current fiscal year (ending June) is projected to see a primary deficit equivalent to 1.9% of GDP. It also calls for a ‘market-determined exchange rate’ which if implemented could result in even greater currency depreciation. The net result of these efforts is likely to be a renewed spike in inflation, which at 8.8% in April is

## Emerging Markets

India, currently, is facing a paradox. Investors are appreciating the prospect of another stable government (as per exit polls) even as they remain concerned about the economy which is showing signs of slowdown. Further concern stems from indications of a weak monsoon, signs of a weakening global economy and a sustained increase in oil prices.

### Elections 2019

The results of 2019 general elections will be a key determinant in the performance of Indian assets. The early signs from exit polls post the completion of voting indicate that the incumbent Prime Minister Narendra Modi will return with a stable majority. The scale of victory could be similar to the one he enjoyed last time or in the optimistic scenario even larger than the one he enjoyed in 2014. General election results in India are a critical catalyst as the scale and direction provides a clear indication of the kind and speed of economic reforms possible. All this becomes even more important at a time when the domestic economy is going through a period of loss of momentum.

Indian equity markets have largely been stable over the period of voting. This indicates that investors were already pricing in a stable government led by the incumbent Prime Minister. However, with the exit polls indicating a bigger victory, the markets have rallied substantially. This in turn increases the risk of a sharp reversal should the actual results not be as strong as those indicated by the exit polls.

the evident rural distress. With consumer demand from the rural parts already showing signs of weakness, a weak monsoon would make it even worse which would be a bigger drag on the economy. For the record, agriculture accounts of 15% of GVA.

The India Meteorological Department's (IMD) 1st Stage Long Run forecast for 2019 Southwest monsoon season (June-September) predicts monsoon rainfall to be near normal at 96% of Long Period Average (LPA), with a model error of +/- 5%. The 5 category probability distribution indicates 51% probability of a normal to excess monsoon in 2019, with the expectation of rainfall being well distributed.

### Macroeconomic data and Earnings – Signs of worry

The high frequency data releases over the past month highlights the challenges for the new government. The PMIs data declined sequentially, industrial production data saw the lowest reading in 21 months and auto sales were lower as well.

The Nikkei India Manufacturing PMI for the month of April 2019 came in at 51.8. This was the lowest reading since August 2018. However, it must be noted that the agency highlighted political uncertainty as one of the reasons weighing on the reading. The Nikkei India Services PMI also declined to its lowest level since September 2018 at 51.0.

The industrial production data for March 2019 saw a decline of -0.1% y/y. It was the first negative reading since June 2017. The decline was broad-based with both capital goods and consumer durables dropping y/y.

On the trade front, India's trade deficit in April widened to a five month high of USD 15.3bn. The trend was similar as seen in other data point with non-oil exports dropping 8.6% m/m. Manufacturing exports showed a similar trajectory. Imports excluding oil and gold declined -0.7% m/m.

Keeping all this in mind, it was no surprise to see consensus FY 2020 earnings estimate being revised downwards. Over the past month, the same has been lowered by 1%. The current expectation is for earnings for Nifty index to grow at 27% y/y.

### Returns during elections (%)

|      | -1M  | +1W  | +1M   | +3M  | +1Y  |
|------|------|------|-------|------|------|
| 1999 | 0.2  | 7.4  | -2.0  | 16.1 | -7.7 |
| 2004 | -6.9 | -8.4 | -11.8 | -6.1 | 16.5 |
| 2009 | 5.4  | 15.4 | 22.1  | 24.7 | 38.7 |
| 2014 | 5.8  | 2.2  | 5.9   | 9.4  | 16.0 |

Source: Bloomberg

### Monsoons 2019

India has always been reliant on monsoon rains given their impact on crop levels and inflation. This year the importance of monsoon rains is magnified as a significant shortfall would further accentuate

***Investors are appreciating the prospect of another stable government (as per exit polls) even as they remain concerned about the economy which is showing signs of slowdown***

Overall, it is safe to say that growth has hit a soft patch. The Bloomberg India Monthly GDP tracker shows a drop in average monthly growth to an estimated 8.4% in Q4 FY 2019 from 10.6% in Q3 FY 2019. The monthly tracker for the rural economy also points to a slump to average monthly growth of 3.3% in Q4 FY 2019, down from 7.6% in fiscal Q3 FY 2019.

## **RBI – Easing to continue**

With inflation remaining benign, the focus of the Reserve Bank of India is likely to firmly remain on growth. India's CPI for April 2019 accelerated to 2.92% y/y. While this was the highest reading in six months, it was still well below the Reserve Bank of India's median target of 4%. The uptick was driven by sharp increase in food prices of +0.9% m/m. Importantly, core inflation (excluding food and fuel) eased to a 18-month low of 4.55% y/y.

In addition to low domestic inflation, the RBI is also expected to utilize the room provided by developed market central banks who have turned decisively dovish. We expect the RBI to cut interest rates by as much as 50 bps over the next six months.

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## Interest Rates

### US Rates

Economic data releases in the US surprised on the upside last month. Annualised 1Q GDP came in at 3.2% versus expectations of 2.3% and noticeably higher than the 2.2% recorded in 4Q2018. Core CPI in April increased to 2.1% from 2.0% in the previous month and although average hourly earnings (YoY) dropped a tad to 1.2%, unemployment rate reached a fifty year low of 3.6% from 3.8% in March.

Nevertheless, escalating trade tensions and increasing pressure on the Federal Reserve from the US President Trump for a rate cut continues to convince market participants that the current US rate hike cycle is over. In fact market implied probability of rate cuts reflects a 75% chance of at least one rate cut and a 23% probability of two rate cuts before the end of this year.

The UST yield curve flattened with 2yr-5yr spread getting deeper in the negative territory at -2bps and the 2yr-10yr spread narrowing 2bps to 19bps now.

### UST yield and swap curves

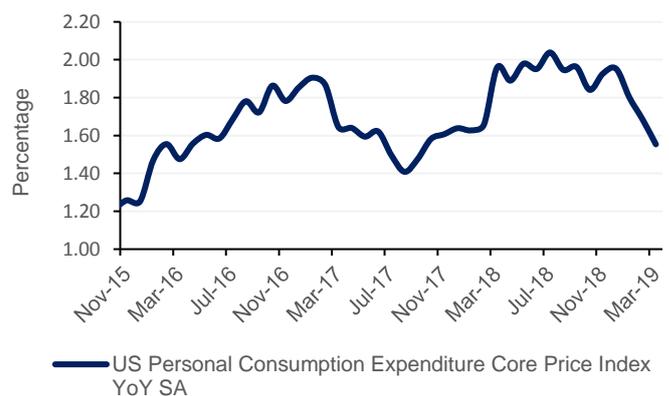


Source: Bloomberg, Emirates NBD

The USD swap curve is also inverted in tenures up to 2 years and is flat in the belly validating market expectation of a rate cut rather than a rate hike to be the next move.

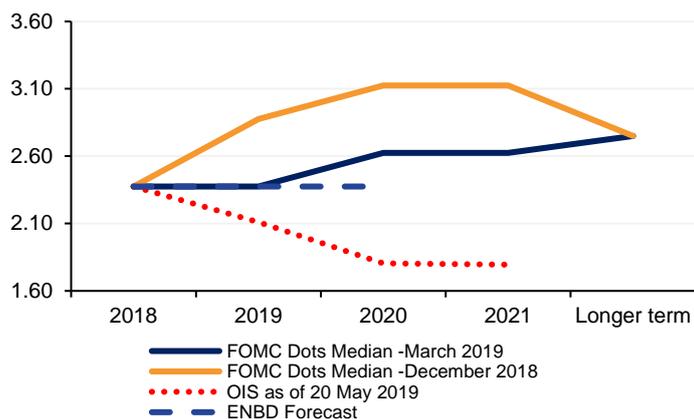
With Fed's preferred gauge of inflation, the PCE deflator, clearly showing signs of slowing and recent increase in trade tensions, we think the Fed will soon come under pressure to abandon its 2020 rate hike projection.

### US PCE Deflator %



Source: Bloomberg, Emirates NBD

### Rate hikes - dot plot vs mkt expectations



Source: Bloomberg, Emirates NBD

Minutes of the May FOMC meetings will be released this week. So far, the FOMC has attributed muted inflation to transitory factors with officials continuing to expect inflation to reach near the committee's target over the next few months. Any change in the committee's view on inflation will probably be the most critical factor for us to review our rates forecast going forward.

### Yield Curve Inversion

The muddy outlook on the US-China trade talks has weighed on investor sentiment over the last two weeks. The safe haven bid on the back of rising uncertainty pushed government bonds in the developed world higher. Yields on 2yr, 5yr, 10yr and 30yr USTs closed the month significantly lower at 2.22% (-16bps, m/m), 2.20% (-18bps), 2.41% (-18bps) and 2.83% (-16bps, m/m) respectively.

**The safe haven bid on the back of rising uncertainty pushed government bonds in the developed world higher**

The US economy remains strong on most measures and we don't foresee risk of recession any time soon. In such environment, we expect the yield on 10yr USTs to fluctuate between 2.40% and 2.80% for most of this year with a bias towards the lower end of this range in the next few months.

## Global Rates

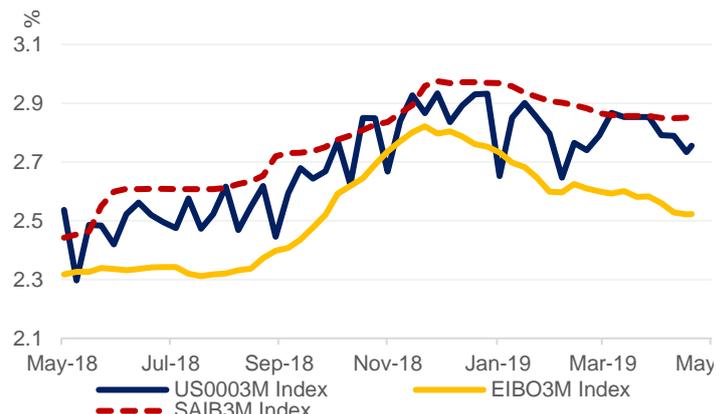
Final eurozone inflation data in April confirmed core rate rising from 0.8% to 1.3%, probably getting a boost from the Easter timing. In the UK, preliminary estimate of 1Q GDP came in at 1.8%, its highest in over twelve months compared with 1.4% in the previous quarter. However, despite the positive economic data, much in sync with their US counterparts, European and UK sovereign bonds were also pushed higher by the safe haven bid.

Yields on 10yr UK gilts fell 14bps to 1.05%, also partly owing to the news that the cross-party Brexit talks had broken down. Yields on German Bunds became negative for all short to medium term tenures. During the month the 10yr Bund yields fell 10bps to -0.08%.

In the shorter dated space, EIBOR rates have softened 10-15bps across tenures reflecting improved liquidity as CD deposits at the CBUAE reduced to facilitate easier lending to the corporate sector. This has caused the EIBOR-LIBOR spread to narrow.

In contrast, SAIBOR spreads over LIBOR reflect a widening bias with 3m SAIBOR over LIBOR trailing at 33bps compared with 25bps last month.

### 3m EIBOR / SAIBOR / LIBOR rates



Source: Bloomberg, Emirates NBD

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### 10Yr Government Bond Yields

|         | Yield % | 1M chg | 3M chg | 12M chg |
|---------|---------|--------|--------|---------|
| US      | 2.41    | -18    | -27    | -64     |
| UK      | 1.05    | -14    | -15    | -42     |
| Germany | -0.08   | -10    | -21    | -60     |
| Japan   | -0.05   | -2     | 0      | -9      |
| Russia  | 4.21    | -15    | -49    | -71     |
| Brazil  | 4.99    | -23    | -28    | -46     |
| Turkey  | 7.93    | -4     | +100   | +73     |

Source: Bloomberg as at 21 May 2019, Emirates NBD

European Parliament elections are unlikely to have any bearing on economic policymaking in the near term. The bigger risk in the Eurozone centres more on Greek and Italian economies. The EC's updated forecast showed Italy's budget deficit rising to 3.5% of GDP next year, above the previously-agreed level and its largest since 2011. This in turn has increased the risk that Italy gets placed in an EU disciplinary procedure later this year. Yield on 10yr Italian BTPs increased 9bps during the month to 2.69%.

## GCC Local Rates

Stable oil prices supported ample liquidity in the local GCC banking systems, however, rising political uncertainty is denting investor confidence causing SAR and AED IRS spreads over USD to widen during the month. SAR and AED 5yr IRS spreads are currently at 61bps and 66bps respectively, circa 5 bps higher than where they were mid last month.

## Interest Rate Forecasts

| USD Swaps Forecasts     |           |       |       |       | Forwards |    |     |
|-------------------------|-----------|-------|-------|-------|----------|----|-----|
|                         | Current   | 3M    | 6M    | 12M   | 3M       | 6M | 12M |
| 2y                      | 2.28      | 2.30  | 2.30  | 2.10  |          |    |     |
| 10y                     | 2.36      | 2.40  | 2.40  | 2.50  |          |    |     |
| 2s10s (bp)              | 8         | 10    | 10    | 40    |          |    |     |
| US Treasuries Forecasts |           |       |       |       |          |    |     |
| 2y                      | 2.22      | 2.20  | 2.20  | 2.00  |          |    |     |
| 10y                     | 2.41      | 2.44  | 2.44  | 2.45  |          |    |     |
| 2s10s (bp)              | 19        | 24    | 24    | 45    |          |    |     |
| 3M Libor                |           |       |       |       |          |    |     |
| 3m                      | 2.52      | 2.55  | 2.60  | 2.35  |          |    |     |
| 3M Eibor                |           |       |       |       |          |    |     |
| 3m                      | 2.77      | 2.80  | 2.80  | 2.60  |          |    |     |
| Policy Rate Forecasts   |           |       |       |       |          |    |     |
|                         | Current % | 3M    | 6M    | 12M   |          |    |     |
| FED (Upper Band)        | 2.50      | 2.50  | 2.50  | 2.25  |          |    |     |
| ECB                     | 0.00      | 0.00  | 0.00  | 0.00  |          |    |     |
| BoE                     | 0.75      | 0.75  | 0.75  | 1.00  |          |    |     |
| 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  | 1.50  |          |    |     |
| RBI (repo)              | 6.00      | 5.75  | 5.50  | 5.50  |          |    |     |
| SAMA (reverse repo)     | 2.50      | 2.50  | 2.50  | 2.25  |          |    |     |
| UAE (1W repo)           | 2.75      | 2.75  | 2.75  | 2.50  |          |    |     |
| CBK (o/n repo rate)     | 2.50      | 2.50  | 2.50  | 2.25  |          |    |     |
| QCB (repo rate)         | 2.50      | 2.50  | 2.50  | 2.25  |          |    |     |
| CBB (o/n depo)          | 2.50      | 2.50  | 2.50  | 2.25  |          |    |     |
| CBO (o/n repo)          | 3.00      | 3.00  | 3.00  | 2.75  |          |    |     |
| CBE (o/n depo)          | 15.75     | 15.75 | 15.75 | 13.75 |          |    |     |

Source: Bloomberg, Emirates NBD Research  
As at 21 May 2019

### Global Bonds

Credit bonds had a constructive month as benchmark yields narrowed amid rising uncertainty around global trade. Yields on 2yr, 5yr, 10yr and 30yrs USTs closed the month significantly lower at 2.22% (-16bps, m/m), 2.20% (-18bps), 2.41% (-18bps) and 2.83% (-16bps, m/m) respectively.

Economic data from major economies was largely in line with expectations, however, volatility in credit markets was high with several risks such as a) negative headlines around the US-China trade talks; b) Unresolved Brexit situation, c) Iran sanctions and d) rising concerns about political conflict in the Gulf region etc. weighing on investor sentiment. Credit default swap spreads on US IG and Euro Main increased to 64bps (+6bps, m/m) and 66bps (+7bps) respectively.

Though credit spreads widened by 8bps to 118bps, monthly total return on US IG corporate bond index was a gain of 0.66%. Similarly, Euro aggregate bond index had a monthly gain of 0.46% even though credit spreads widened 5bps to 80bps.

#### Option Adjusted Credit Spreads OAS (bps)

|            | OAS | 1M chg | 3M chg | 12M chg |
|------------|-----|--------|--------|---------|
| US IG Corp | 118 | +8     | -6     | +9      |
| US HY Corp | 389 | +35    | -5     | +52     |
| EUR IG Agg | 80  | +5     | -5     | +18     |
| USD EM Agg | 297 | +15    | +9     | +28     |

Source: Bloomberg as at 21 May 2019, Emirates NBD

S&P recently commented that the downside risk for EM corporates is currently lower than historical trend with only 14% of rated names having a negative outlook or being on rating watch negative compared with historical average of circa 20%. Nevertheless, Emerging Markets underperformed developed markets mainly as credit spreads widened 16bps to 298bps amid fears of trade wars. Total monthly return on the EM USD bond index was merely 0.36%.

Though trade war fears are keeping investors on the edge, the increasing expectations of supportive central banks and possible interest rate cuts are boosting the case for continued investment in credit bonds.

### GCC Bonds – Secondary Market

Boosted by falling UST yields, GCC bonds closed the month higher albeit with substantial inter-month volatility. Evolving political developments and the US increasing deployment of military forces in the Gulf region are making investors nervous.

That said, average yield on **Bloomberg Barclays GCC bond index** is currently at 4.0%, circa 5bps lower than the 4.05% in mid-April. The benefit of benchmark yield tightening was somewhat negated by 11bps widening in credit spreads over the month to 169bps.

#### Bbg Barclays GCC Bond Index - OAS



Source: Bloomberg, Emirates NBD

Even though crude climbed after Saudi Arabia and other key producers in OPEC signaled their intention to keep oil supplies constrained for the rest of the year, demand for credit protection increased amid the rising political concerns. Rating agency Moody's stated that Qatar, Kuwait and Bahrain will likely be significantly affected should Iran follow through on its threat to close off the Strait of Hormuz. In response, five-year CDS spread on GCC sovereigns increased during the month with Abu Dhabi, Saudi Arabia and Qatar 5yr CDS closing at 62bps (+5bps), 93bps (+16bps) and 70bps (+6bps) respectively.

Moody's affirmed Kuwait's rating at Aa2/stable on the back of Kuwait's exceptionally large sovereign wealth fund that has assets worth circa 370% of GDP. The yield on KUWAIB 27s narrowed 22bps during the month to 3.08% even though 5yr CDS spreads increased 4bps to 65bps.

**Boosted by falling UST yields, GCC bonds closed the month higher albeit with substantial inter-month volatility**

Fitch affirmed Saudi Arabia's rating at A+/stable citing the sovereign's strong balance sheet and improving budget dynamics. Also IMF recently commended KSA on ongoing financial reforms. Nevertheless, Z-spread on KSA curve widened between 10bps to 22bps across tenures with KSA 29s closing at yield of 3.80% and Z-spread of 144 bps (+15bps, m/m). Also while the KSA sovereign yield curve inched down a tad, yield on government owned Aramco bonds increased during the month, thereby narrowing the gap between the two. Yield on ARAMCO 49s and ARAMCO 39s increased to 4.65% (+11bps) and 4.55% (+10bps) respectively.

S&P revised the outlook on Oman's BB rating to negative citing risks relating to increasing sovereign debt and sizeable fiscal deficits which are likely to continue until 2022. The yield on Oman bonds due in 2028 at 6.63% remains higher than Bahrain's similar-maturity debt yield at 6.29%.

Bahrain's plan to tap international markets for new bonds created incremental demand for default protection, causing its 5yr CDS spread to increase by 28bps to 288bps. Longer dated Bahrain bonds suffered in tandem with yield on BHRAIN 44s increasing 45bps to 6.93% during the month. In contrast, shorter dated Bahrain bonds held ground well. Spread on BHRAIN 21s reduced 35bps to 4.47% as the country disclosed that it will receive about USD 2.3 bn this year under the five-year support package from its neighbors. Bahrain will receive USD 1.761 bn in 2020, USD 1.846 bn in 2021, USD 1.421 bn in 2022, and USD 650 mn in 2023 under the same package. As per recent government statements, Bahrain forecasts a budget deficit of 4.7% of GDP this year, compared with 6.2% in 2018 and sees the shortfall narrowing to 3.9% in 2020.

Qatari real estate firm, Ezdan Holdings, plans to reverse its earlier decision to turn itself into a private company from a public shareholding firm. The likelihood of continued disclosure as a listed entity vs if had been made private company lifted investor sentiment on the name, causing credit spreads on ERESQD 21s to tighten by 86bps to 9.39%.

Fitch affirmed Abu Dhabi based TAQA's rating at A with stable outlook reflecting TAQA's strategic importance to its majority owner, the AA/stable rated Abu Dhabi government. TAQA's standalone credit profile is indicative of "b" rating reflecting its subordinated cash flow from domestic operations and high deconsolidated leverage. TAQAUH 21s closed at yield of 3.02% (-10bps, m/m) even though Z-spread widened 10bps to 77bps.

Fitch upgraded Kuwait Energy to B- from CCC with stable outlook after the completion of its acquisition by the Hong Kong-listed United Energy Group Ltd (UEG). The yield on KUWAIE 19s tightened another 142bps to 11.03%, easily making it one of the top performing bond in the region last month.

As per media reports, merger talks between A3 rated Dubai Islamic Bank and A rated Noor Bank (Fitch) are progressing well with likely appointment of HSBC and Barclays as advisors.

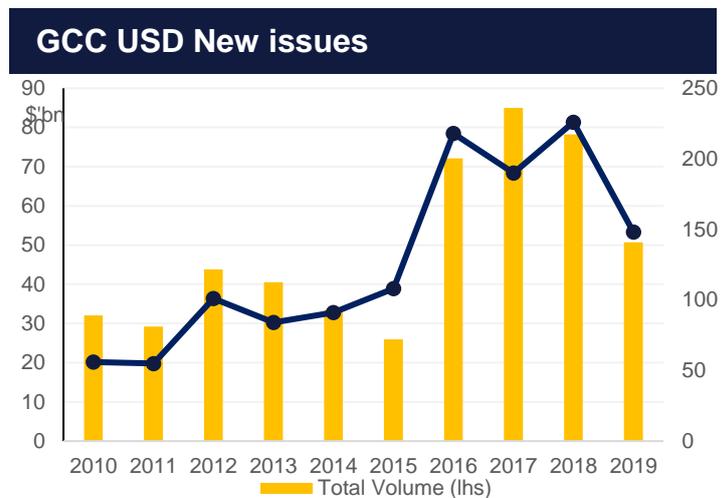
## GCC Bonds - Primary Market

GCC primary market saw issuance of a green sukuk by Majid Al Futtaim that priced USD 600 million in 10yr sukuk at MS+220bps equating to a yield of 4.64%, against an order book of USD 2.8

billion. The sukuk is the largest green sukuk to be listed on a stock exchange.

Also during the month, Saudi Telecom that is 70% owned by the KSA's Public Investment Fund, priced USD 1.2 billion in 10yr sukuk at MS + 135bps, 20bps tighter than initial guidance amid an order book exceeding USD 4.5 billion.

YTD total new issues in the GCC have reached the USD 50.6 bn mark with the government sector accounting for 42% of the total followed by Financials (30%), Energy (24%) and others (4%). Geographically, KSA dominated the scene, accounting for 42% of the total followed by Qatar (32%), UAE (23%) and Oman and Bahrain accounting for the balance.



Source: Bloomberg, Emirates NBD

GCC local currency markets are also picking up pace with total outstanding across the six currencies reaching circa equivalent of USD 170 billion compared with circa USD 326 billion in the fixed rate USD denominated bonds.

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## Currencies

### Dollar gains as trade friction escalates

The dollar has gained ground over the course of the month with renewed strength catalyzed by two principal drivers. Firstly, escalating trade tensions between the U.S. and China have caused a resurgence of risk aversion, and the resultant safe haven bids have helped the USD gain against most of the rival G10 currencies. Secondly, the Federal Reserve has been less dovish than expected and while the market had been anticipating the possibility of an interest rate cut in 2019, the Fed is not acknowledging this. The ISM and Markit PMIs indicate that the pace of growth may be moderating. However, the indices are still in expansionary territory, the labour market remains healthy and better than expected Q1 growth of 3.2% demonstrates that the U.S. economy is still outperforming others overall.



As we approach the end of Q2 2019, appetite for the USD is likely to be determined by the outcome of the trade disputes between the U.S. and China. Escalation in tensions are likely to result in further appreciation of the dollar, while any easing or resolution is likely to result in the dollar being sold. The real question is whether there is a formal outcome or rather a prolonged stand-off lacking a resolution and keeping the USD underpinned.

Currently the Dollar Index is trading at 98.034, with the risk of retesting the 2019 highs of 98.330. Of technical significance is that

the 50-day moving average (97.261) and the 76.4% one-year Fibonacci retracement (97.118) have provided support over the last month. While the price remains above these levels, further gains seem the path of least resistance.

### Euro weighed by global tensions

Previous threats from President Trump to impose auto tariffs on Eurozone exports to the U.S. have kept the common currency under pressure and despite his announcement that a decision has been deferred for six months, the current environment has restrained the euro's potential for a relief rally. Economic confidence in the eurozone's largest economies has been waning. This means that despite the improvement in Q1 2019 Eurozone aggregate GDP, improving to 0.4% q/q from 0.2% the previous quarter, the ECB is likely to remain cautious and focused on ensuring that policy remains supportive of an economic rebound. As a result, it is highly unlikely that the ECB will raise interest rates in 2019 and as a result the euro is unlikely to get much support from a shifting in bias.



**Escalation in tensions are likely to result in further appreciation of the dollar, while any easing or resolution is likely to result in the dollar being sold**

Looking forward, the euro also remains vulnerable to other geopolitical events, including the EU elections later this week. Should populist movements achieve a breakthrough at the polls, it is likely to result in renewed euro vulnerability as investor nerves about the impact on policymaking will build.

As we go to print, EURUSD is trading at 1.1155, and is on target for a third month below the 50-month moving average (1.1322). This in combination with resistance now found at the formerly supportive 23.6% five-year Fibonacci retracement (1.1203), makes the price vulnerable. As a result of these developments, we have revised down our Q2 2019 forecast for EURUSD to 1.13 from 1.15.

### Brexit concerns resurface to hit GBP

GBP has remained volatile and pressured over the last month. The source of this pressure relates mostly to politics as UK economic data have largely been steady. Brexit uncertainty was initially calmed by the extension of the Brexit deadline until October 31<sup>st</sup> 2019. In addition to this, Q1 2019 GDP data was encouraging showing that the economy expanded 0.5% q/q (1.8% y/y) compared with 0.2% q/q (1.4% y/y) the previous quarter. Furthermore, the Bank of England has taken a relatively hawkish tone, with Governor Mark Carney announcing that should the data meet the BOE's forecasts, "more, and more frequent interest-rate increases than the market expects", would occur.

Despite these factors, the pound has faltered due to a reappraisal of what a delayed Brexit could actually mean. With mounting pressure on the PM to resign (which she has agreed to do if her Withdrawal Deal does not pass through Parliament on its fourth attempt in June), there is the risk of her being replaced by a leader more in favour of a no-deal Brexit. Also the stronger the Brexit party performs in EU elections this week, the momentum will shift further towards an eventual no-deal Brexit, keeping GBP under pressure.



Source: Bloomberg

GBPUSD is currently trading at 1.2716, levels not seen since January 2019 and is approaching the 23.6% one-year Fibonacci

retracement (1.2689). A break and daily close below this support may result in further declines towards 1.25. While this remains a risk, it is noteworthy that the price has posted a daily decline for eight sessions now. During this decline several key support zones have failed and become resistance levels. This includes the 100-day moving average (1.3015), the 200-day moving average and 50% one year Fibonacci retracement (1.2957 and 1.2967 respectively) and the 38.2% one-year Fibonacci retracement (1.2843). Despite this, analysis of the 14-day Relative Strength Indicator is showing that at 28.26, GBPUSD may be oversold and thus a short reprieve may be in order as sellers lock in profits from shorts. Accordingly given the latest Brexit developments and risks to PM May's government, we have adjusted our GBPUSD forecasts to reflect a more bearish outlook.

### JPY appreciation stems from risk aversion

The yen's status as a safe haven bid has resulted in JPY appreciation during this period of heightened risk aversion. Over the last month USDJPY has fallen from levels above 112, to as low as 109.02 before recovering to its present level of 110.18. Recent economic data has shown that inflationary pressures remain all but absent and the Bank of Japan remains far from its 2.0% y/y target. In addition, while GDP data has been more encouraging recently, with 0.5% q/q (2.5% y/y) growth in Q1 2019, such data is misleading as consumption and business investment declined during this period. This weakens the growth outlook for Japan and means that the BOJ's ultra-loose monetary policy is likely to remain in place for some time to come, especially if the government moves ahead to raise the Consumption Tax later this year which seems likely.

### AUD kept down under by shift in policy

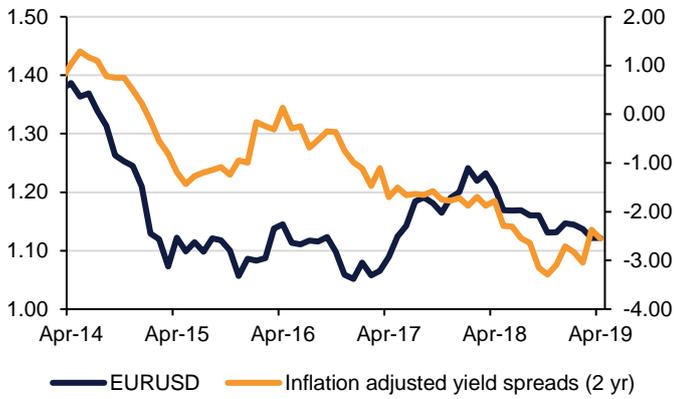
While the AUD experienced some relief following the surprise election victory of Scott Morrison's Liberal Party of Australia, following public expectations of tax cuts and support for the property market, the relief was short lived. Despite policy makers leaving interest rates unchanged at 1.50% at the RBA's May meeting, the AUD weakened in the aftermath of the release of the meeting minutes. The minutes had a clear bias towards further easing of monetary policy, such the market has raised expectations of a rate cut to a new record low of 1.25% in 2019 following comments from RBA Governor Lowe. Lowe stated that that a lower cash rate would be supportive of employment growth and that the most recent data showed the labour market was unlikely to improve (the unemployment rate rose from 5.1% to 5.2% in April). As it stands, the OIS has priced in a 70.1% chance of a rate cut at the June meeting.

As we go to print, AUDUSD is trading 0.39% lower at 0.68809, on target for a seventh day of declines with the risk of testing the 0% five-year Fibonacci retracement of 0.6741 in the medium term. This increasingly dovish shift in monetary policy has caused us to reconsider our forecasts to account for a weaker AUD in the short term.

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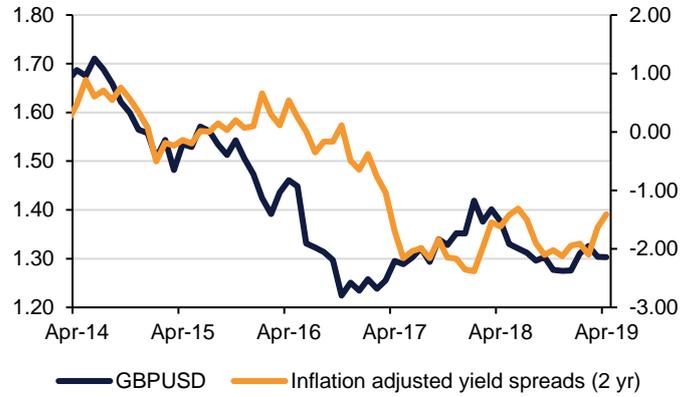
## FX-Major Currency Pairs & Real Interest Rates

### Interest Rate Differentials-EUR



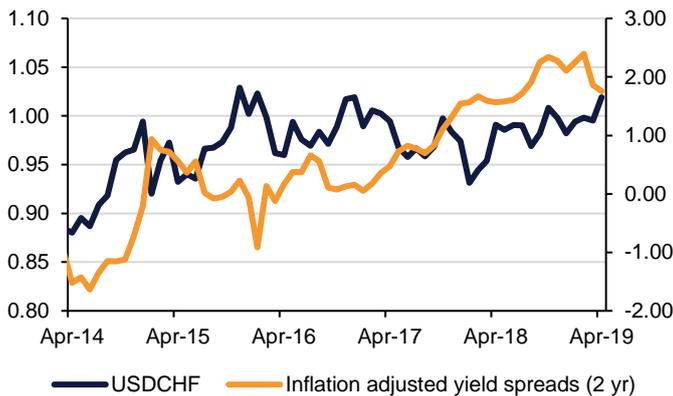
Source: Bloomberg, Emirates NBD Research

### Interest Rate Differentials-GBP



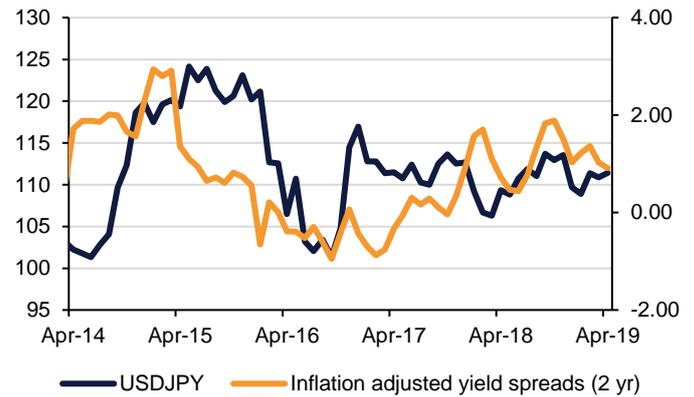
Source: Bloomberg, Emirates NBD Research

### Interest Rate Differentials-CHF



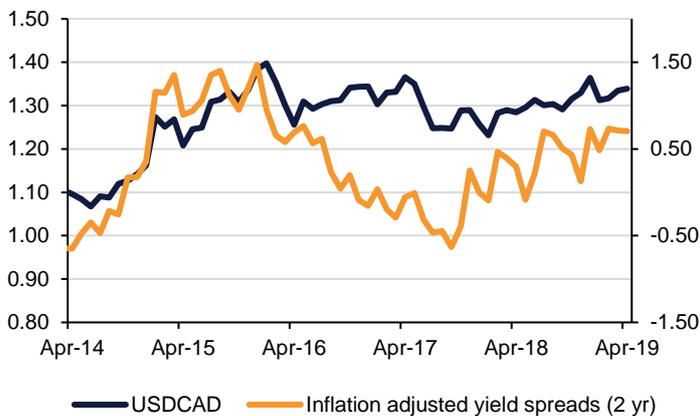
Source: Bloomberg, Emirates NBD Research

### Interest Rate Differentials-JPY



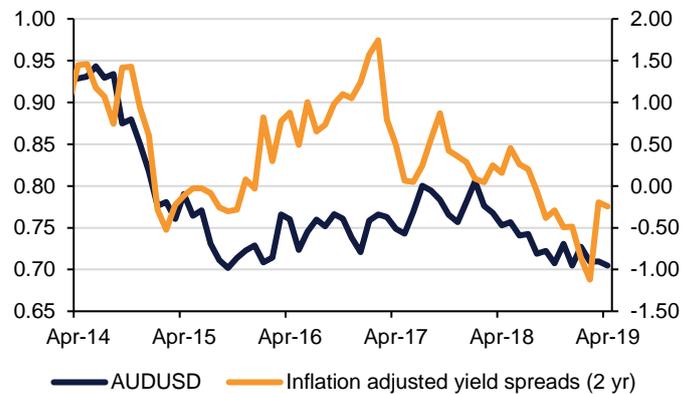
Source: Bloomberg, Emirates NBD Research

### Interest Rate Differentials-CAD



Source: Bloomberg, Emirates NBD Research

### Interest Rate Differentials-AUD



Source: Bloomberg, Emirates NBD Research

## FX Forecasts

| FX Forecasts - Major    |         |         |         |         |         | Forwards |         |         |
|-------------------------|---------|---------|---------|---------|---------|----------|---------|---------|
|                         | 21-May  | Q2 2019 | Q3 2019 | Q4 2019 | Q1 2020 | 3m       | 6m      | 12m     |
| EUR/USD                 | 1.1161  | 1.1300  | 1.1600  | 1.2000  | 1.2200  | 1.1247   | 1.1333  | 1.1501  |
| USD/JPY                 | 110.50  | 113.00  | 112.00  | 110.00  | 110.00  | 109.71   | 108.92  | 107.39  |
| USD/CHF                 | 1.0111  | 1.0000  | 0.9800  | 0.9700  | 0.9500  | 1.0024   | 0.9938  | 0.9776  |
| GBP/USD                 | 1.2706  | 1.2800  | 1.3200  | 1.3800  | 1.4300  | 1.2765   | 1.2820  | 1.2916  |
| AUD/USD                 | 0.6883  | 0.6900  | 0.7200  | 0.7400  | 0.7700  | 0.6901   | 0.6919  | 0.6951  |
| NZD/USD                 | 0.6507  | 0.6600  | 0.6900  | 0.7100  | 0.7300  | 0.6521   | 0.6534  | 0.6557  |
| USD/CAD                 | 1.3406  | 1.3000  | 1.2600  | 1.2500  | 1.2200  | 1.3377   | 1.3354  | 1.3318  |
| EUR/GBP                 | 0.8784  | 0.8828  | 0.8788  | 0.8696  | 0.8531  | 0.8811   | 0.8840  | 0.8904  |
| EUR/JPY                 | 123.33  | 127.69  | 129.92  | 132.00  | 134.20  | 123.33   | 123.33  | 123.33  |
| EUR/CHF                 | 1.1285  | 1.1300  | 1.1368  | 1.1640  | 1.1590  | 1.1274   | 1.1263  | 1.1242  |
| FX Forecasts - Emerging |         |         |         |         |         | Forwards |         |         |
|                         | 21-May  | Q2 2019 | Q3 2019 | Q4 2019 | Q1 2020 | 3m       | 6m      | 12m     |
| USD/SAR*                | 3.7502  | 3.7500  | 3.7500  | 3.7500  | 3.7500  | 3.7523   | 3.7539  | 3.7576  |
| USD/AED*                | 3.6730  | 3.6730  | 3.6730  | 3.6730  | 3.6730  | 3.6737   | 3.6746  | 3.6766  |
| USD/KWD                 | 0.3045  | 0.3020  | 0.3020  | 0.3020  | 0.3020  | 0.3045   | 0.3046  | --      |
| USD/OMR*                | 0.3850  | 0.3850  | 0.3850  | 0.3850  | 0.3850  | 0.3856   | 0.3863  | 0.3882  |
| USD/BHD*                | 0.3770  | 0.3770  | 0.3770  | 0.3770  | 0.3770  | 0.3761   | 0.3761  | 0.3781  |
| USD/QAR*                | 3.6592  | 3.6400  | 3.6400  | 3.6400  | 3.6400  | 3.6572   | 3.6560  | 3.6535  |
| USD/EGP                 | 17.0200 | 17.0000 | 17.5000 | 17.7500 | 17.7500 | 17.4850  | 17.9650 | 18.9350 |
| USD/INR                 | 69.723  | 70.000  | 70.000  | 68.000  | 67.000  | 70.7900  | 71.6000 | 73.0800 |
| USD/CNY                 | 6.9020  | 6.9000  | 7.0000  | 7.1000  | 7.2000  | 6.9444   | 6.9564  | 6.9785  |
| USD/SGD                 | 1.3770  | 1.3500  | 1.3200  | 1.3000  | 1.2900  | 1.3788   | 1.3768  | 1.3730  |
| FX Forecasts - MENA     |         |         |         |         |         |          |         |         |
|                         | 21-May  | Q2 2019 | Q3 2019 | Q4 2019 | Q1 2020 |          |         |         |
| USD/MAD                 | 9.6906  | 9.7000  | 9.8000  | 9.8000  | 9.9000  |          |         |         |
| USD/TND                 | 2.9927  | 3.0000  | 3.0500  | 3.1000  | 3.1000  |          |         |         |
| USD/TRY                 | 6.0644  | 6.2000  | 6.3000  | 6.4000  | 6.5000  |          |         |         |

Data as of 21 May 2019

Source: Bloomberg, Emirates NBD Research

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## Equities

Over the past month, global equities lost momentum as expectations of a US-China trade deal shifted from 'when' to 'if'. However, the losses were contained in most markets as central banks succeeded in recreating the 'goldilocks' environment similar to that in 2012-2017 and corporate earnings remained relatively strong. More so when the losses are seen relative to sharp gains in the first four months of 2019.

Overall, the MSCI All Country index lost -3.3% 1m to trim their year to date gains to 10.7%. The decline was broad based with all sub-indices closing in negative territory. The MSCI G7 index, the MSCI Emerging Market index and the MSCI Frontier Market index dropped -2.6% 1m, -9.0% 1m and -2.2% 1m respectively. Within emerging market complex, Chinese and Turkish equities led the losses with the Shanghai Composite index and the Borsa Istanbul 100 index losing -11.0% 1m each. While the losses in China were a reflection of recalibration of expectations, the decline in Turkey was driven more by political developments. Within the MENA region, most market closed sharply lower as the benefit of funds from foreign investors on account of inclusion in broad emerging market indices were offset by increase in geopolitical tensions. The DFM index and the Tadawul dropped -10.0% 1m and -7.4% 1m respectively.

The Q1 2019 corporate earnings season has been positively resilient. According to FactSet, with 90% of S&P 500 companies having reported, the blended earnings decline stands at -0.5%. While this would be the first y/y earnings decline since Q2 2016, the magnitude is much lower than the -4.0% y/y drop anticipated at the end of Q1 2019. The trend is similar in European equities. According to I/B/E/S data from Refinitiv, with 43% of Euro Stoxx 600 companies having reported, the blended earnings growth for Q1 2019 is expected to be -2.2%. However, this is higher than the -1.5% y/y decline forecast at the end of Q1 2019. In GCC, the direction was more mixed. According to market data, aggregate earnings for companies listed on the DFM index grew +1.6% y/y in Q1 2019 while they dropped -9.7% y/y for companies listed on the Tadawul.

Looking ahead, it seems that markets are still too sanguine about the possibility of no-deal between the US and China. The recent decision of the US government on Huawei probably lengthens the negotiations period at the very least. It appears that investors' are distracted by diversionary tactics of the US President following comments over progress and/or delay in trade wars with the Eurozone, Canada and Mexico. Additionally, the spike in geopolitical tensions and mixed economic data poses further challenges. Considering these factors, the near-term direction of

equities appears fraught with risk even after taking into account reduced election induced political risks in emerging markets of India, Indonesia and South Africa.

### Challenges

The immediate impediment to the year-to-date rally of global equities comes from the breakdown in the US and China trade negotiations. The commentary from officials of both sides and developments thereafter suggest that probability of the worst-case scenario playing out remains in the realms of possibility. Simply put, this implies additional strain on both the US consumer as well as businesses at a time when there are enough indications that the economy is slowing down anyways. In terms of GDP growth, US may see its growth weaken by as much as 50 bps while Chinese economy may slow down by 150 bps. Further, the non-linear impact could see tightening of financial conditions, lack of clarity hitting business confidence and cutback in capital expenditure. Moreover the impact will not remain limited to only these two economies but will spread across geographies.

A look at China's trade history with the US provides clues as to why China could be unwilling to capitulate to US demands. While in absolute terms, China exports to the US are nearly four times as that of US exports to China, as a percentage of GDP China's exports to the US has declined from 7.6% in 2007 to 3.6% now. Further, the size of Chinese economy relative to that of the US economy has grown from 20% to 65% in the same period which in turn highlights the growing clout of China in the global economy.

Investors' are anticipating that in case the trade negotiations go awry becomes a reality, central banks will step in and accelerate monetary easing. However, such steps generally have a lagging impact which in turn increases volatility in the interim. It is worth highlighting, from equities perspective, that Chinese companies only derive 2% of their revenues from the US compared to 6% derived by US companies from China.

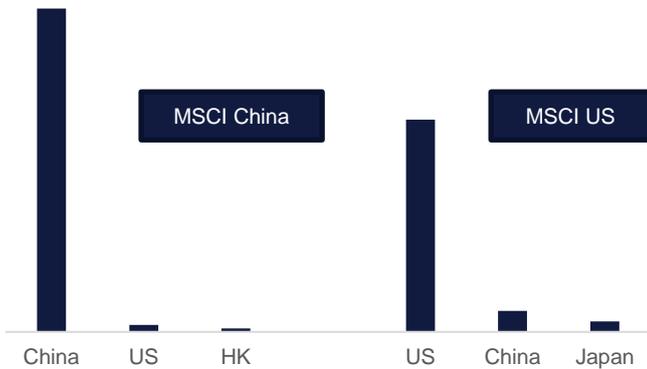
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***Over the past month, global equities lost momentum as expectations of a US-China trade deal shifted from 'when' to 'if'***

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added that the debt is well disbursed and that banks and financial institutions have sizeable loss-absorbing buffers.

## Revenue source by country



Source: Fact Set, April 2019

### Short term

At the moment, the challenges for equity markets over the short term stems from geopolitical risks (including elections) across economies including that from the US, Eurozone and the Middle East. In the recent past these risks have not affected markets over a longer period of time as the intensity ebbed. Having said that, none of these risks (example Brexit) which have remained on the horizon for a long period of time saw any resolution either.

All such issues carry the potential of triggering a sharp reversal in investor sentiment. More so at a time when multiple tailwinds are slowing turning into headwinds. These include the pace of economic growth and trajectory of corporate earnings.

### Medium term

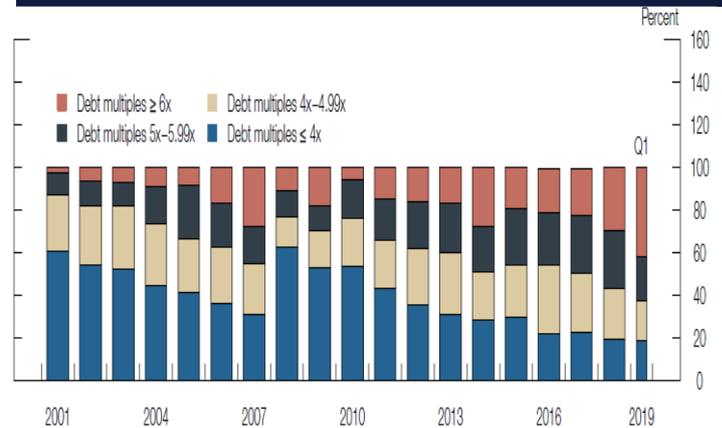
A lurking risk for multiple asset classes including equities remains the sharp rise in corporate debt which is being fueled in part by low levels of interest rates. The Fed Chair Jerome Powell also referred to the potential challenge when he spoke at the Financial Markets conference earlier this week.

According to the Federal Reserve's Financial Stability Report of May 2019, the outstanding debt of non-financial businesses has outpaced nominal GDP growth over the last decade. Importantly, the report highlights that the debt in recent years has been concentrated among riskier firms. The data in the report shows that non-financial business debt as a percentage of GDP currently stands at historically high levels of 73%.

Worryingly, the credit standards for new leveraged loans appeared to have deteriorated over the last six months. The share of newly issued large loans to corporations with high leverage (defined as those with a debt-to-EBITDA ratio above 6) increased in the last six months and now exceeds the previous peak levels seen in 2007 and 2014.

Obviously, this leaves businesses and financial firms vulnerable to a tightening in financial conditions, unexpected increases in borrowing costs or simply a downturn in economic activity which in turn would impact profitability. Having said that, the Fed Chairman said that the debt levels do not possess the threat of a bubble and that the overall funding risk in the financial system is moderate. He

## Distribution of large institutional loan volumes

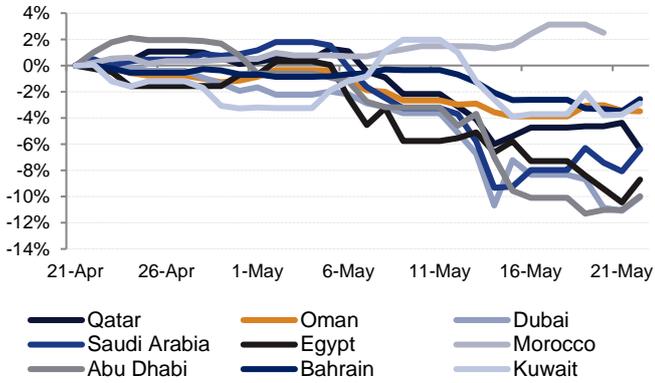


Source: S&P Global, Leveraged Commentary & Data

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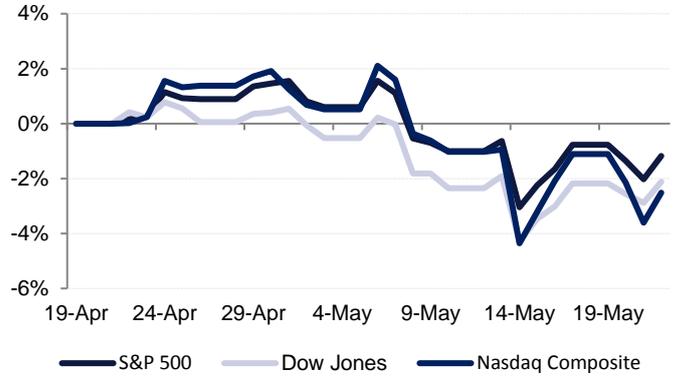
## Major Equity Markets

### MENA Equity Markets



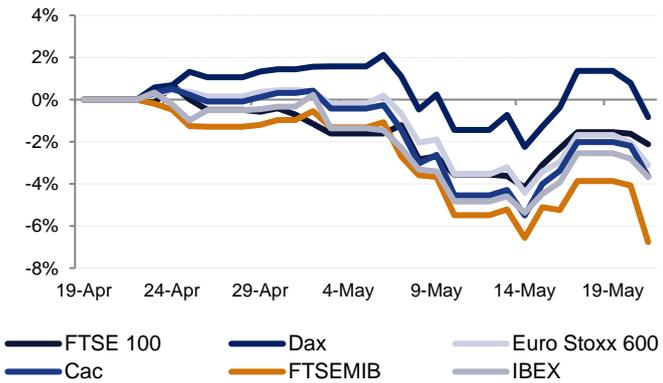
Source: Bloomberg, Emirates NBD Research

### US Equity Markets



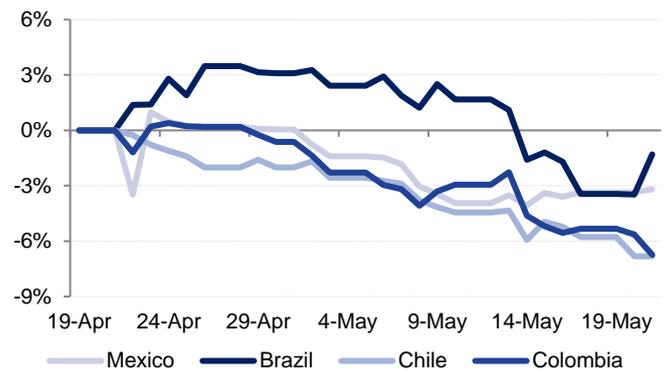
Source: Bloomberg, Emirates NBD Research

### European Equity Markets



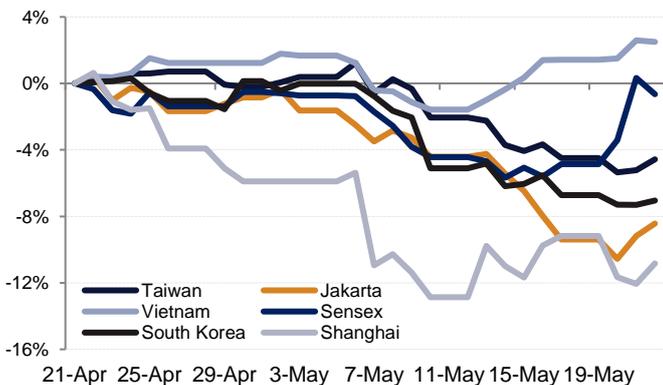
Source: Bloomberg, Emirates NBD Research

### Latin American Equity Markets



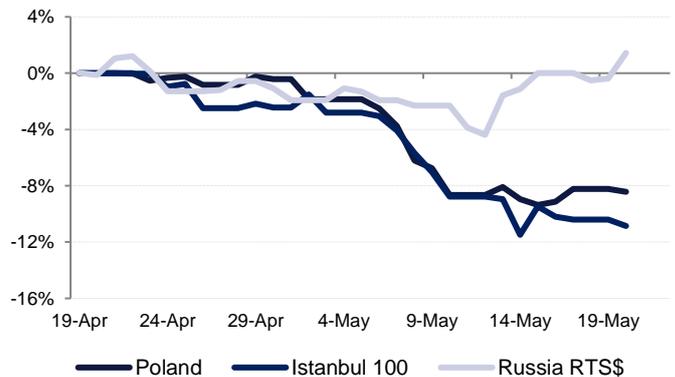
Source: Bloomberg, Emirates NBD Research

### Asian Emerging Equity Markets



Source: Bloomberg, Emirates NBD Research

### Emerging Europe Equity Markets



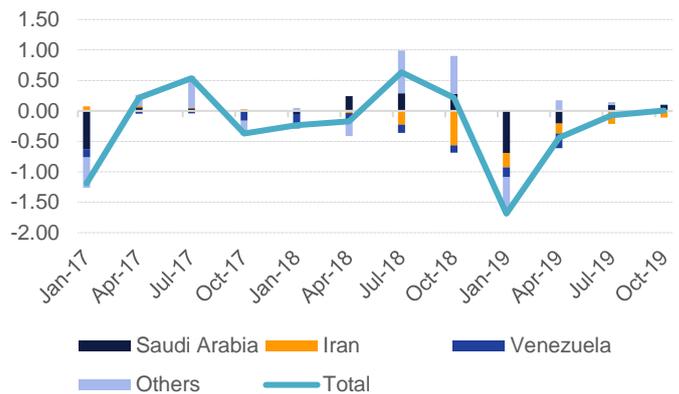
Source: Bloomberg, Emirates NBD Research

## Commodities

Oil prices have oscillated in the past month as supportive geopolitical factors have contended with downward pressure stemming from an escalating trade war. Both dynamics are significant and could easily push crude prices in opposite directions but for now they appear relatively balanced against each other. This has led to relatively stable crude oil prices although the calm could be abruptly ended if one of these forces becomes more dominant.

of the year, although compliance with targets may move close to 100% compared with the high level of over-compliance producers have reached so far this year. Nevertheless, commentary from OPEC ministers, and Saudi Arabia in particular, points to production restraint being in place in the medium term.

### OPEC output sinks in Q1



Source: EIKON, Emirates NBD Research.

Geopolitical risk tends to be ephemeral in terms of supporting crude oil markets and only translate into structurally higher prices if production or exports are actually impacted. The civil war in Libya and the imposition of US sanctions on Iran in 2012 for example seriously disrupted flows and thus allowed prices to be sustained at more than USD 100/b for Brent markets. Should the recent tension between the US and Iran resolve without tension some of the recent gains in crude prices will likely dissipate.

### Trade war flaring up again

The geopolitical tension centered on the Middle East, however, has had to contend with much broader uncertainty over whether a trade war between the US and China will escalate and severely disrupt the global economy. A trade deal between the two largest economies appeared close earlier in 2019 but in recent weeks hostile rhetoric and higher tariffs from both sides has eroded market confidence, taking commodity and crude oil prices down with it.

### Oil volatility at low levels



Source: EIKON, Emirates NBD Research.

Crude oil prices lurched higher in late April thanks to the US administration choosing to enforce sanctions on Iran in full and not offer any additional waivers to importers of Iranian crude. Brent futures hit their highest level for 2019 (USD 74.57/b) on the back of the US announcement. The effect of strictly enforced US sanctions on Iran's oil production and exports will tighten markets over the coming months as buyers seek alternatives and shun the country's crude. Exports out of Iran are likely to plummet and were reportedly below 1m b/d in April this year compared with 2.6m b/d in April 2018.

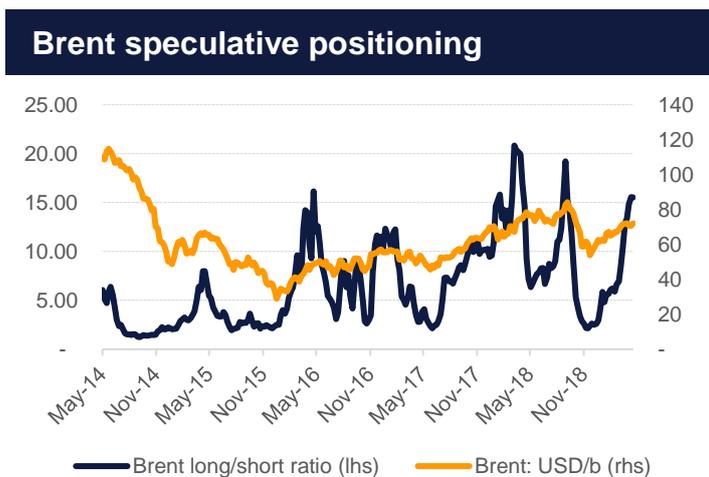
More recently, escalating tension between the US and Iran and attacks on oil infrastructure in Gulf producers have exerted an upward pull on prices. While there has been no direct impact on production or exports the threat of conflict interrupting flows of crude oil, products and LNG out of the Gulf will help to keep a supportive bid under hydrocarbon prices in the near term.

The heightened geopolitical atmosphere is acting as an accelerant to a fundamentally supported market. Crude balances were already tight thanks to OPEC+ production restraint. As per its latest market assessment, OPEC+ is likely to keep cuts in place in the second half

**The heightened geopolitical atmosphere is acting as an accelerant to a fundamentally supported market**

The prospect of a trade deal, along with OPEC+ cuts, are in our view one of the factors that have helped oil prices to rally since the start of 2019. We do note, however, that major forecasting agencies such as the IMF or World Bank have been downgrading their global growth projections for 2019 largely due to factors apart from trade. With a trade war now looking more rather than less likely, the risks to growth, and commodity demand, are much more strongly on the downside. Already the IEA has cut its oil demand growth projection for 2019 thanks to a soft Q1 in major consuming nations. The imposition of new higher tariff rates could see forecasts for oil demand growth cut further over the rest of the year.

The downside risks to oil consumption from a trade war escalating appear to us more concrete than disruptions to exports related to geopolitical risk. Hence, the potential for a downward correction from prices in their current range of USD 70/b – USD 75/b for Brent futures appears high should tensions in the Middle East ease. The scale of the correction could be sharp considering how investors have positioned themselves in crude oil. Net speculative length in Brent futures and options as a share of total open interest is close to 15%, not far off levels last seen in September 2018 ahead of the major sell-off in crude.



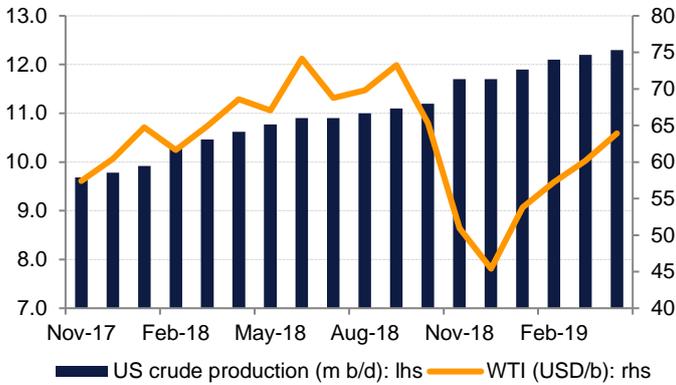
Source: EIKON, Emirates NBD Research.

Oil prices are showing few signs of volatility but we would characterize this stability as fragile. The risk of a policy error either on the geopolitical or trade war front could send prices sharply higher or lower. However, if tension on trade or geopolitics dissipates, we still maintain our view for a slower pace of oil demand growth this year and an increase in output from OPEC+ in H2, weighing on prices by the end of the year.

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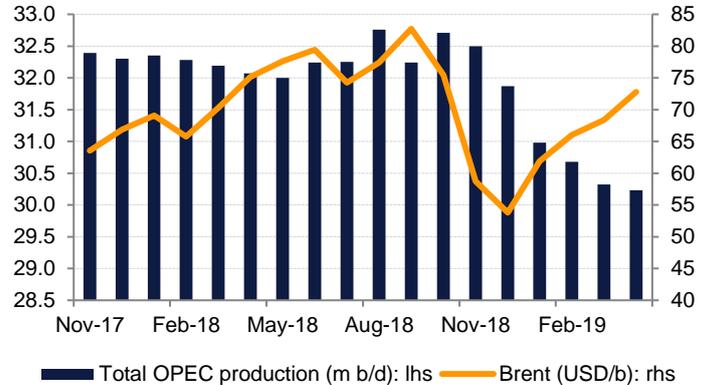
## Major Commodities Markets

### US oil production and price



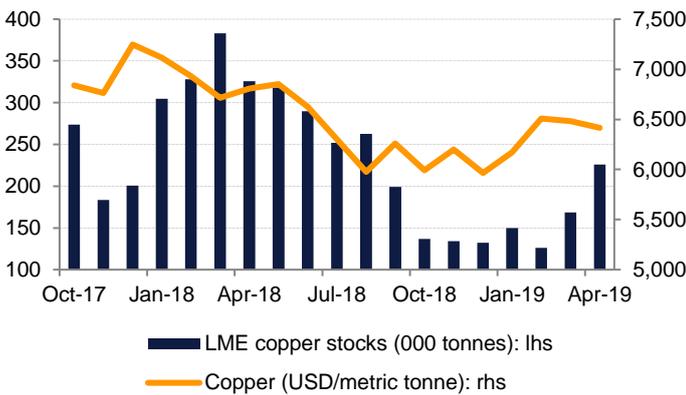
Source: EIKON, Emirates NBD Research

### International oil production and price



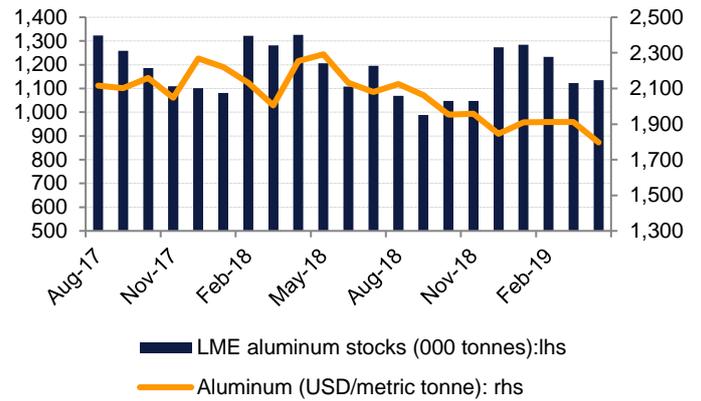
Source: EIKON, Emirates NBD Research

### Copper stocks and price



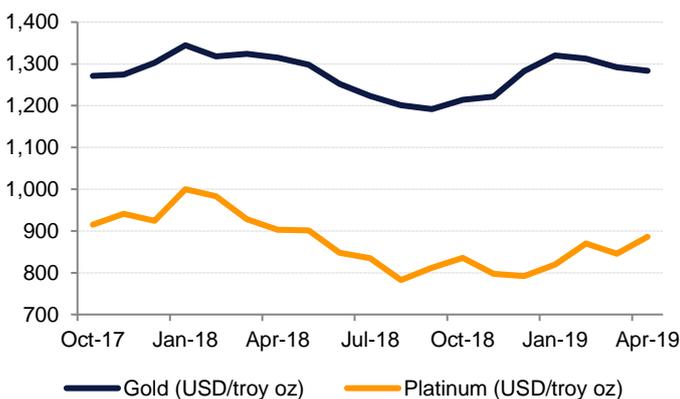
Source: EIKON, Emirates NBD Research

### Aluminum stocks and price



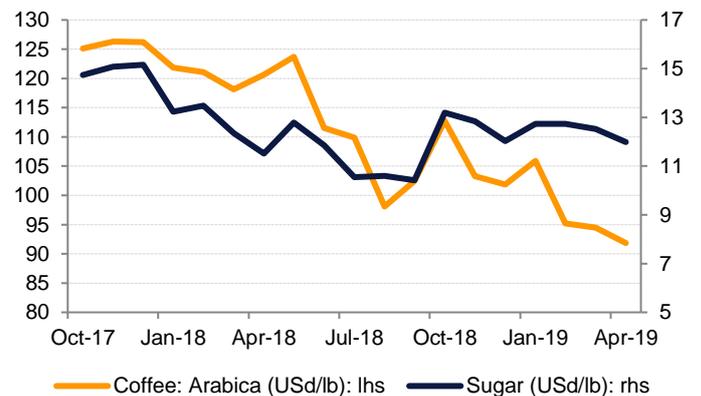
Source: EIKON, Emirates NBD Research

### Precious metals prices



Source: EIKON, Emirates NBD Research

### Agriculture prices



Source: EIKON, Emirates NBD Research

## Commodity Forecasts

| Global commodity prices |           |           |           |                        |           |           |           |
|-------------------------|-----------|-----------|-----------|------------------------|-----------|-----------|-----------|
|                         | Last      | 2019Q1    | Q2        | Q3                     | Q4        | 2018      | 2019      |
| <b>Energy</b>           |           |           |           |                        |           |           |           |
| WTI                     | 62.58     | 54.90     | 57.50     | 60.00                  | 60.00     | 64.76     | 58.10     |
| Brent                   | 71.71     | 63.83     | 67.50     | 67.50                  | 63.00     | 71.53     | 65.46     |
| <b>Precious metals</b>  |           |           |           | <b>Precious metals</b> |           |           |           |
| Gold                    | 1,273.09  | 1,303.24  | 1,350.00  | 1,350.00               | 1,380.00  | 1,268.85  | 1,345.81  |
| Silver                  | 14.41     | 15.56     | 15.25     | 15.50                  | 15.00     | 15.69     | 15.33     |
| Platinum                | 810.78    | 819.98    | 900.00    | 950.00                 | 950.00    | 877.68    | 904.99    |
| Palladium               | 1,319.51  | 1,430.88  | 1,375.00  | 1,275.00               | 1,200.00  | 1,027.51  | 1,320.22  |
| <b>Base metals</b>      |           |           |           |                        |           |           |           |
| Aluminum                | 1,799.50  | 1,883.23  | 1,950.00  | 1,900.00               | 1,850.00  | 2,114.59  | 1,895.81  |
| Copper                  | 5,997.50  | 6,218.64  | 6,250.00  | 6,500.00               | 6,575.00  | 6,547.63  | 6,385.91  |
| Lead                    | 1,811.00  | 2,048.80  | 2,057.89  | 2,130.33               | 2,151.96  | 2,249.46  | 2,097.25  |
| Nickel                  | 11,990.00 | 12,468.29 | 12,500.00 | 12,750.00              | 13,250.00 | 13,182.34 | 12,742.07 |
| Tin                     | 19,420.00 | 20,950.95 | 20,750.00 | 20,750.00              | 20,500.00 | 20,081.72 | 20,737.74 |
| Zinc                    | 2,567.00  | 2,683.67  | 2,694.91  | 2,784.38               | 2,811.04  | 2,895.11  | 2,743.50  |
| Iron Ore                | 96.56     | 82.69     | 75.00     | 65.00                  | 60.00     | 69.41     | 70.67     |

Prices as of 22 May 2019. Note: prices are average of time period unless indicated otherwise.  
Source: EIKON, Emirates NBD Research

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