



Interest Rates Monitor - April 2019

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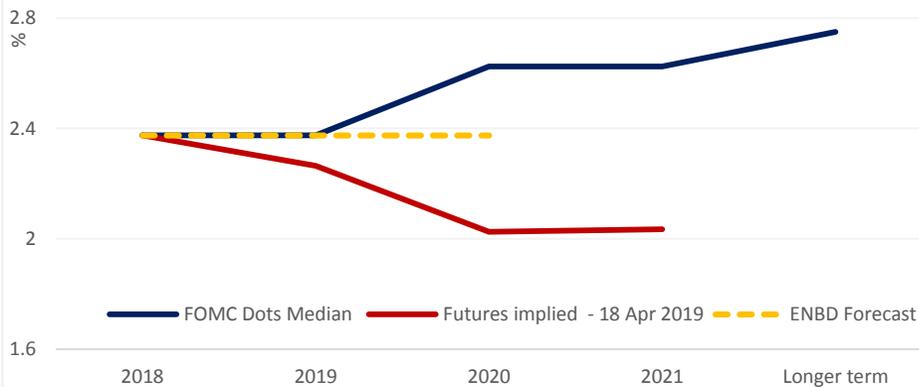
MARKETS DIVERGING FROM THE FEDERAL RESERVE



HIGHLIGHTS

- Analysts' composite expectations for 2019 GDP growth in the US is 2.4% versus the Fed's expectation of 2.1%. For the unemployment rate, the expectation is 3.7% versus the Fed's 3.8% and for core PCE is 1.9% versus the Fed's 1.8%.
- Nevertheless, market implied probability reflects higher chance of the next Fed move being a rate cut instead of a rate hike. In fact future funds implied forward rate indicates 46% probability of at least one rate cut and 9% probability of two rate cuts before the end of this year.

DOT PLOT VERSUS FUTURES IMPLIED



Source: Bloomberg, Emirates NBD Research

US INTEREST RATE PROBABILITY

Meeting	Hike Pro	Cut Prob	1.75 - 2.00	2.00 - 2.25	2.25 - 2.50
5/1/2019	0.00%	0.50%	0.00%	0.50%	99.50%
6/19/2019	0.00%	6.20%	0.00%	6.20%	93.80%
7/31/2019	0.00%	10.20%	0.30%	9.90%	89.80%
9/18/2019	0.00%	28.10%	2.20%	25.80%	71.90%
10/30/2019	0.00%	32.50%	3.60%	28.60%	67.50%
12/11/2019	0.00%	46.40%	8.80%	36.70%	53.60%
1/29/2020	0.00%	53.60%	12.50%	38.90%	46.40%

US ECONOMIC DATA FORECAST

	2019	2020	2021
Survey consensus			
Real GDP (YoY %)	2.4	1.9	1.8
Core PCE (YoY %)	1.9	2.0	2.1
Unemployment %	3.7	3.6	4.0
Federal Reserve			
Real GDP (YoY %)	2.1	1.9	1.8
Core PCE (YoY %)	1.8	2.0	2.0
Unemployment %	3.7	3.8	3.9

Source: Bloomberg, Emirates NBD Research

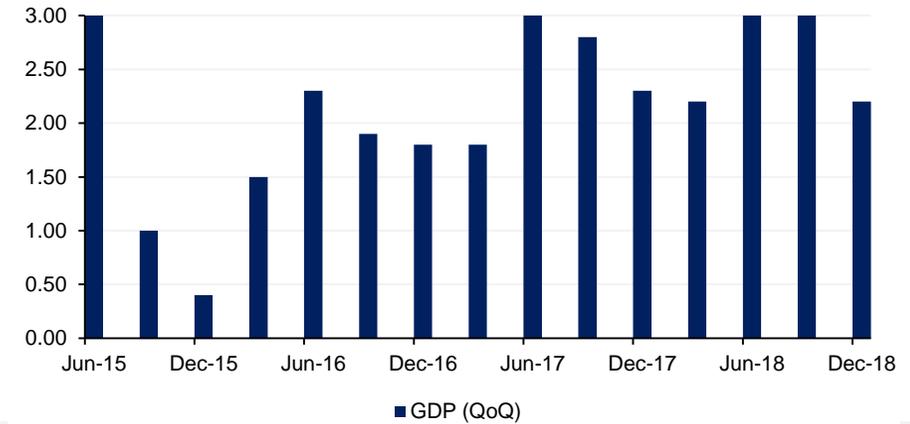
KEY ECONOMIC DATA IN THE US



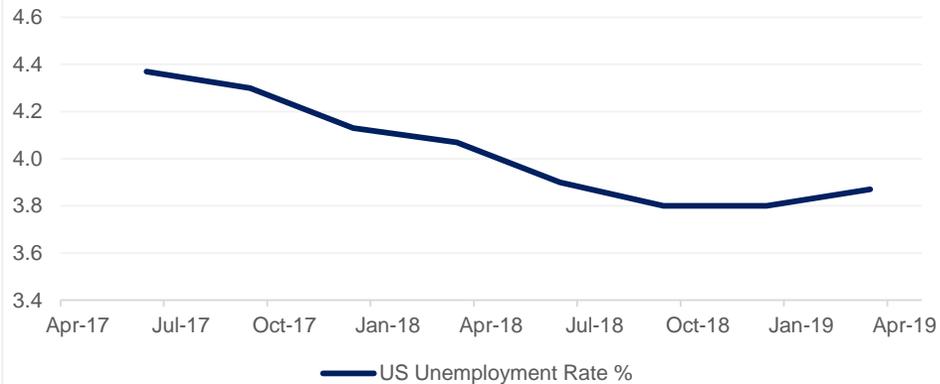
HIGHLIGHTS

- GDP growth in the US is amongst the highest in the developed world. Core inflation is not too far from the Fed's target of 2%.
- The unemployment rate held steady in March at 3.87%. Nonfarm payrolls increased 196k in March, slightly above the consensus estimate of 177k, following a 33k gain in February. The previous two months were revised up by 14k on net. After revisions, the average pace of job gains in the last three months was 180k -- still well above most estimates of trend.

US GDP QoQ %

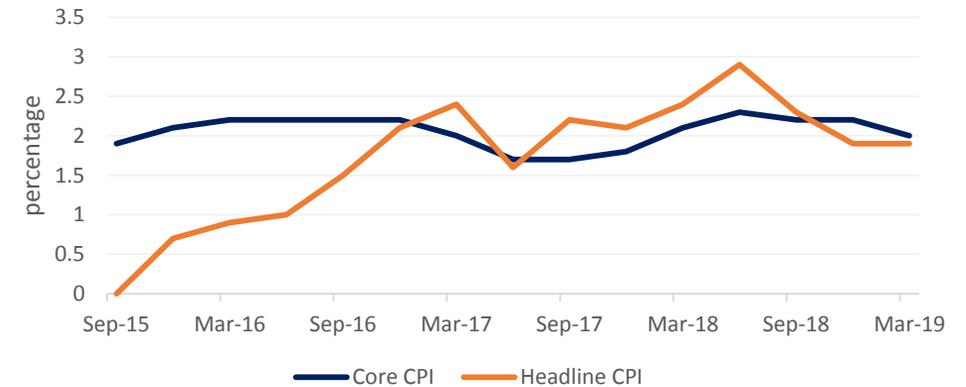


US UNEMPLOYMENT RATE %



Source: Bloomberg, Emirates NBD Research

CORE INFLATION IS ABOVE THE FED'S TARGET



Source: Bloomberg, Emirates NBD Research

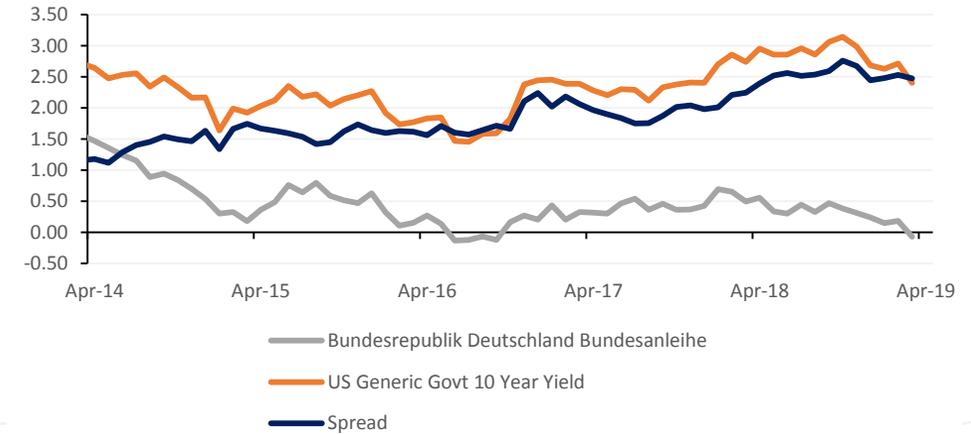
US TREASURY YIELDS UNDERPINNED BY STRONG INTERNATIONAL AND DOMESTIC BID



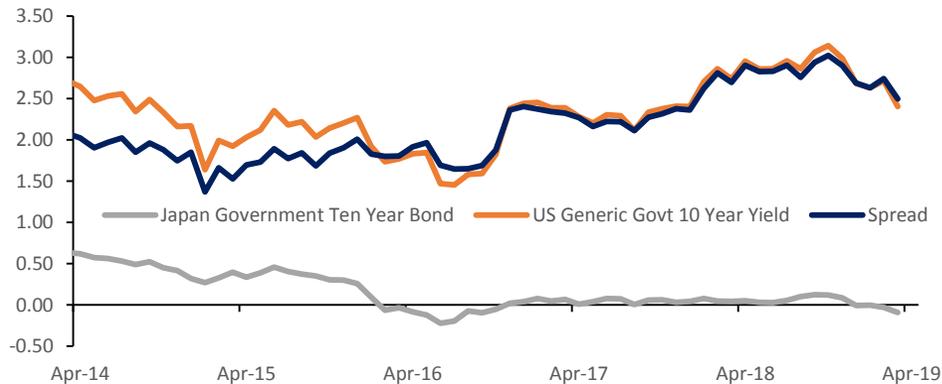
HIGHLIGHTS

- At 2.56%, the yield on 10yr USTs is amongst the highest in the developed world.
- Strong credit rating, ample liquidity and good total return underpin strong demand for USTs which will likely keep a lid on UST yields.
- Besides US treasuries being in demand because of the USD still being the dominant reserve currency, currently they are also one of the most attractive investment options.

10 YR USTs YIELD 2.5% MORE THAN BUNDS



10YR USTs YIELD 2.5% MORE THAN JGBs



Source: Bloomberg, Emirates NBD Research

USTs VERSUS US IG CORP INDEX YIELDS



Source: Bloomberg, Emirates NBD Research

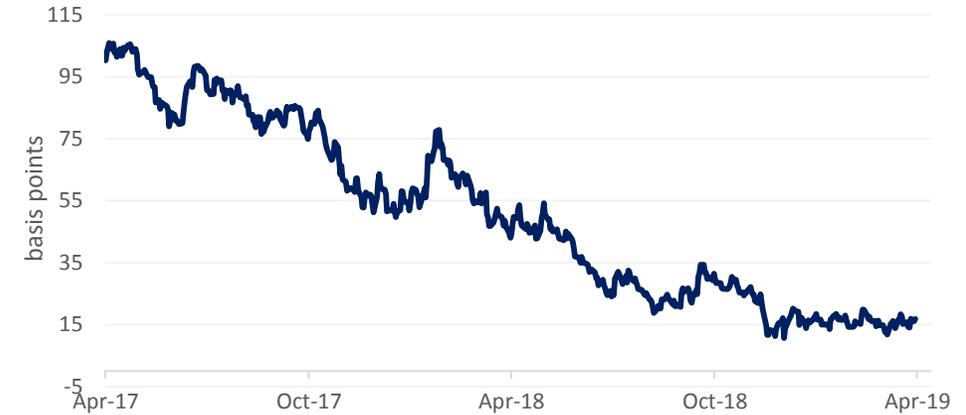
UST YIELD CURVE LIKELY TO REMAIN RANGE-BOUND



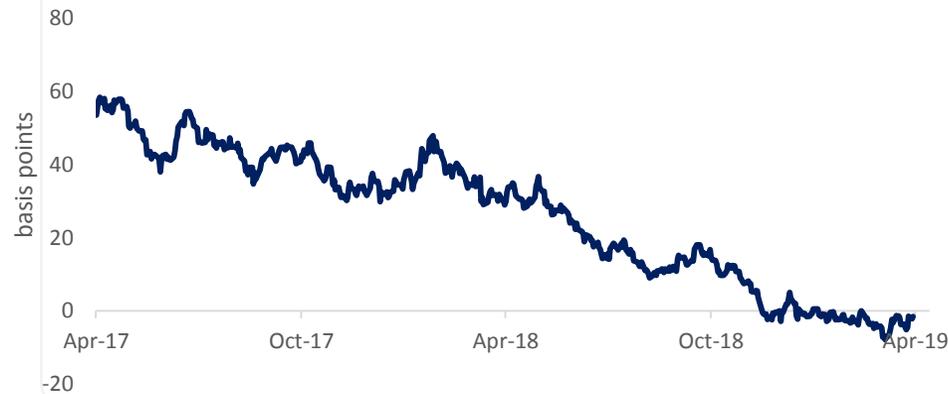
HIGHLIGHTS

- Short end yields are unlikely to move much over the next quarter as the Fed approaches end of its tightening cycle.
- Deceleration of global growth and muted inflation pressures will likely keep yields in the long end also muted.
- In addition, the Fed is reducing quantum of balance sheet tightening which in turn will take away one of the factors that could have cause yield curve steepening.

2yr10yr UST SPREAD

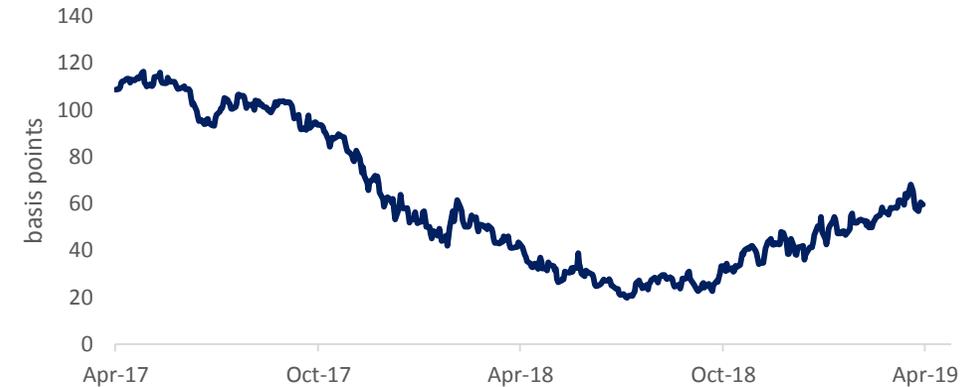


2yr5yr UST SPREAD



Source: Bloomberg, Emirates NBD Research

5yr30yr UST SPREAD



Source: Bloomberg, Emirates NBD Research

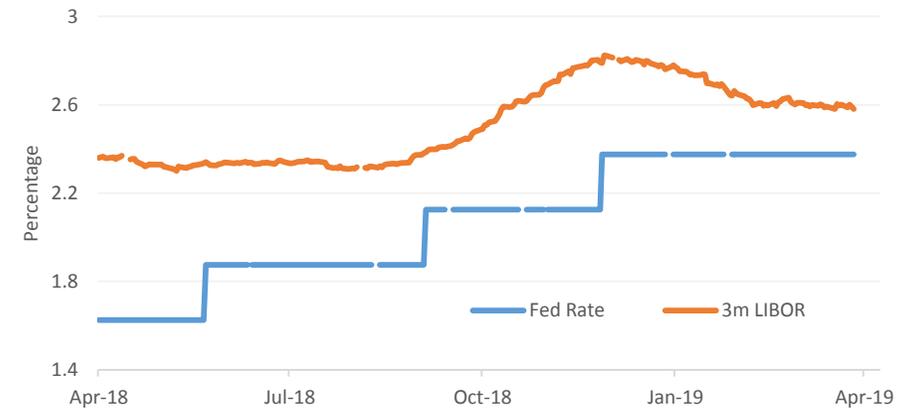
US INTERBANK RATES : SWAP SPREADS TURNINGS NEGATIVE



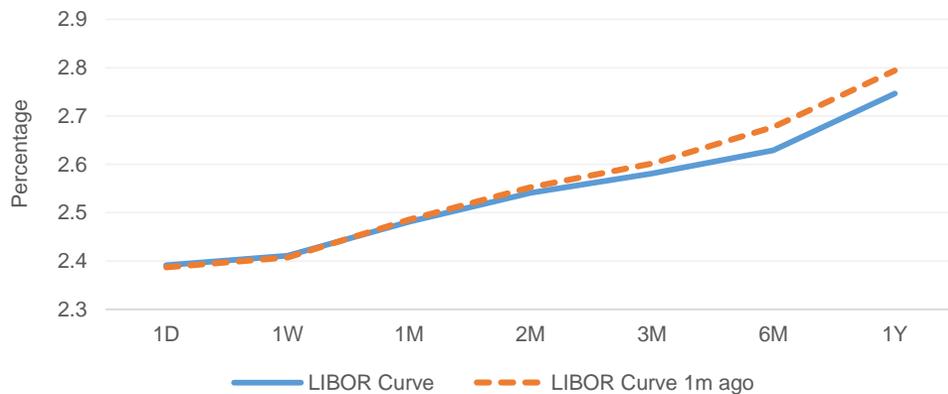
HIGHLIGHTS

- LIBOR curve continued to shift downwards last month in response to the Fed's pause on rate hikes.
- Varying demand supply dynamics have caused swap rates to fall below the treasury yield curve in the 1yr to 3yr tenures and in the long end beyond 10yrs.
- The yield on 10yr USTs remain capped at lower level than the swap rates mainly due to high demand for 10yr USTs from international investors including the emerging market central banks.

FED TARGET RATE VERSUS 3M LIBOR

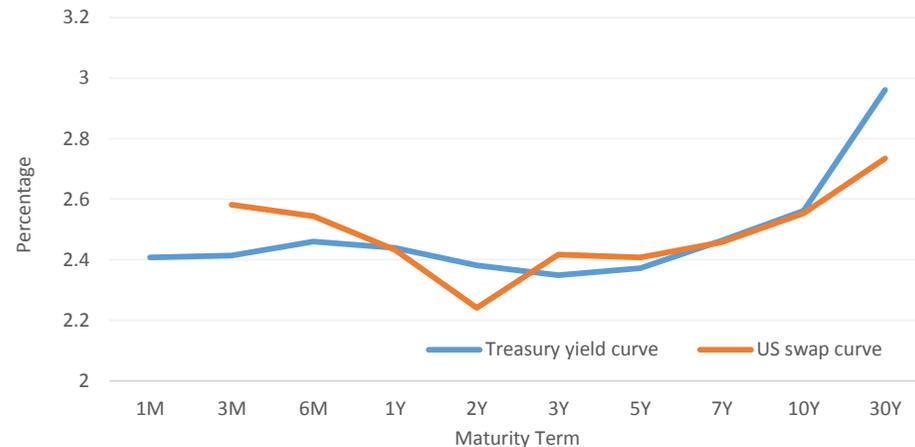


LIBOR CURVE



Source: Bloomberg, Emirates NBD Research

SWAP RATES LOWER THAN UST YIELDS



Source: Bloomberg, Emirates NBD Research

DIRHAM POLICY RATES GENERALLY FOLLOW USD RATES



HIGHLIGHTS

- Given Dirham's peg to the dollar, policy rates in the UAE, mainly the CBUAE's repo rate, generally move in tandem with the Fed target rate.
- The UAE central bank has some flexibility to affect the liquidity in the banking system via altering the amount and interest rate offered on Certificates of Deposit.
- CBUAE's repo rate and CD rates have remained largely unchanged in the last quarter and forecasted to remain so in the near future. That said, EIBOR rates are visibly more volatile than the Repo rate.

CBUAE REPO RATE FOLLOWS THE FED

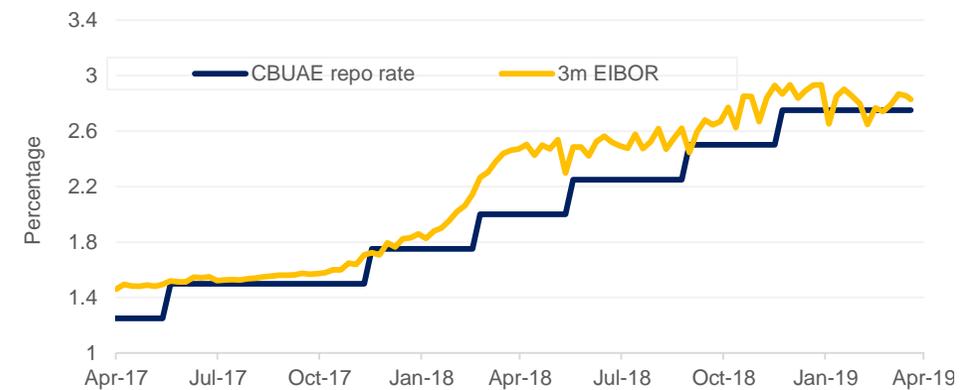


Source: Bloomberg, Emirates NBD Research

CBUAE CD RATES

CB UAE CD Rates	Jan-19	Apr-19
1W	2.25	2.25
1M	2.27	2.35
2M	2.29	2.36
3M	2.32	2.37
6M	2.41	2.42
9M	2.45	2.44
12M	2.52	2.46

3M EIBOR MORE VOLATILE THAN THE REPO RATE



Source: Bloomberg, Emirates NBD Research

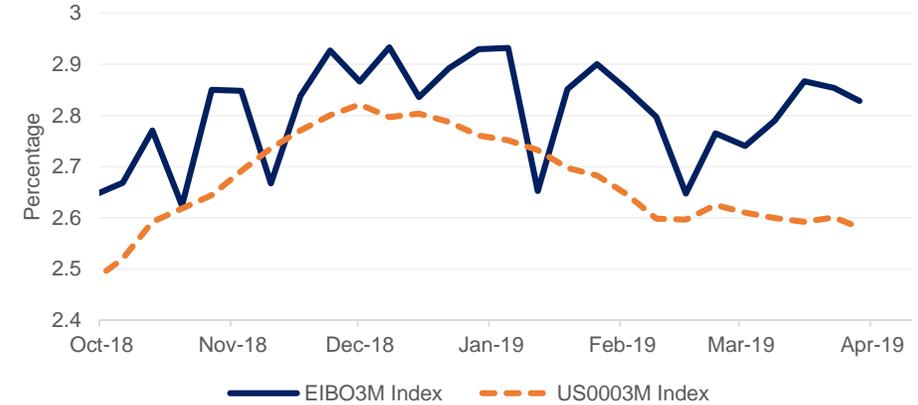
RECENT INCREASE IN 3M EIBOR SPREAD OVER LIBOR IS LIKELY TO REVERSE



HIGHLIGHTS

- The dirham interbank rates, EIBOR rates, are set by averaging the rates submitted by 8 panel banks (ENBD, FAB, ADCB, HSBC, StanChart, Mashreq, CBD and UNB) after excluding the two highest and two lowest rates.
- 3m EIBOR – LIBOR spread touched 36bps last week alluding to liquidity in the commercial banks space being tight.
- The EIBOR curve has flattened with spread between O/N and 1yr rate declining from 158bps in February to 95bps now.

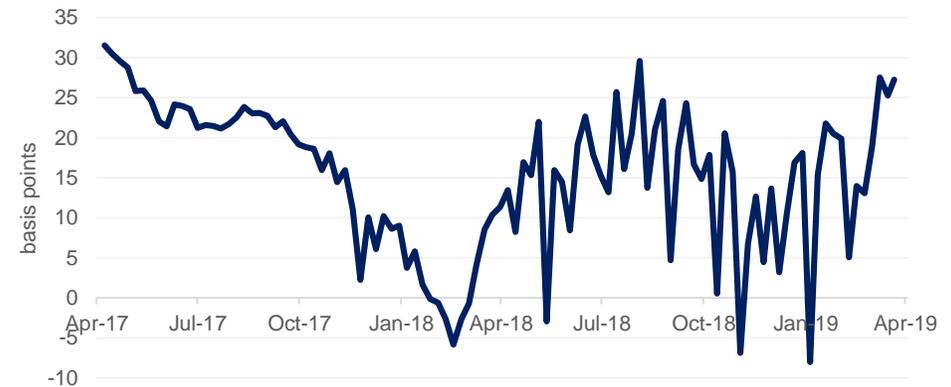
3 m EIBOR VERSUS LIBOR RATE



EIBOR CURVE FLATTENING

	21-Apr-19	11-Mar-19	11-Feb-19
O/N	2.14	2.03	1.89
1W	2.38	2.29	2.39
1M	2.59	2.58	2.61
3M	2.85	2.76	2.85
6M	2.98	3.07	3.14
1Y	3.09	3.35	3.47

3 m EIBOR – LIBOR SPREAD SPIKE



Source: Bloomberg, Emirates NBD Research

Source: Bloomberg, Emirates NBD Research

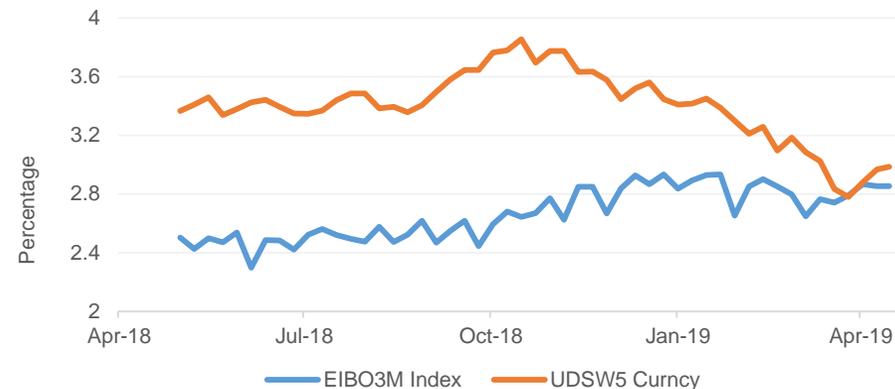
SWAP RATES DECLINING IN RESPONSE TO THE FED'S FORBEARANCE ON RATE HIKES



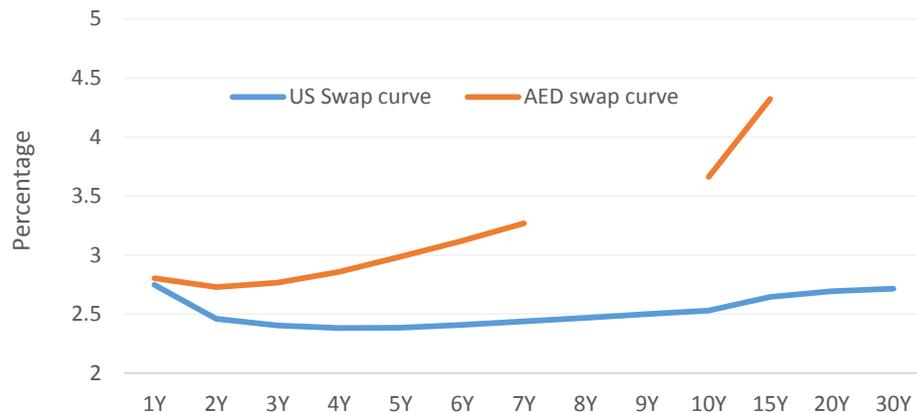
HIGHLIGHTS

- Patient approach from the Fed on rate hikes has caused demand for interest rate hedging to fall, thereby causing interest rate swap curves to shift downwards.
- Though swap rates should generally move in sync with interest rate expectations, the relationship is not linear. Swap rates get materially affected by a) Demand supply dynamics – including demand from corporate clients to hedge; b) Speculation – since it needs minimal upfront funding; and c) Counterparty risk – though this is largely negated these days with presence of centralized clearing counterparties.

3m EIBOR VS. 5yr AED SWAP RATE



AED USD SWAP CURVES



Source: Bloomberg, Emirates NBD Research

3m LIBOR VS. 5yr USD SWAP RATE



Source: Bloomberg, Emirates NBD Research

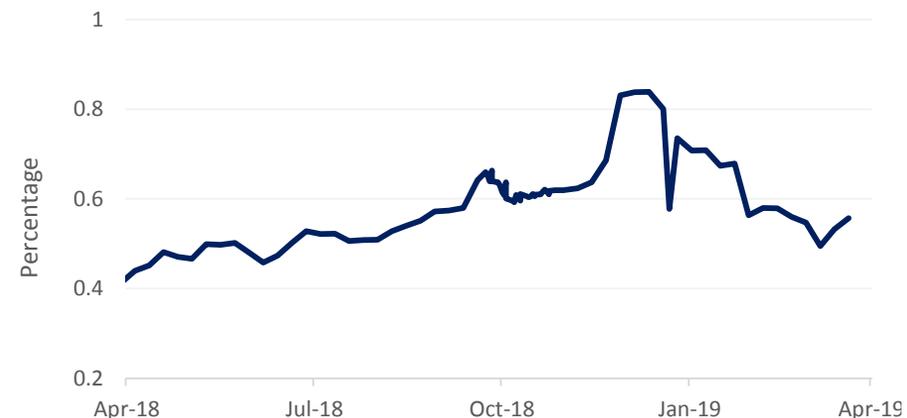
DECLINING DIRHAM SWAP SPREAD OVER THE USD SWAP CURVE



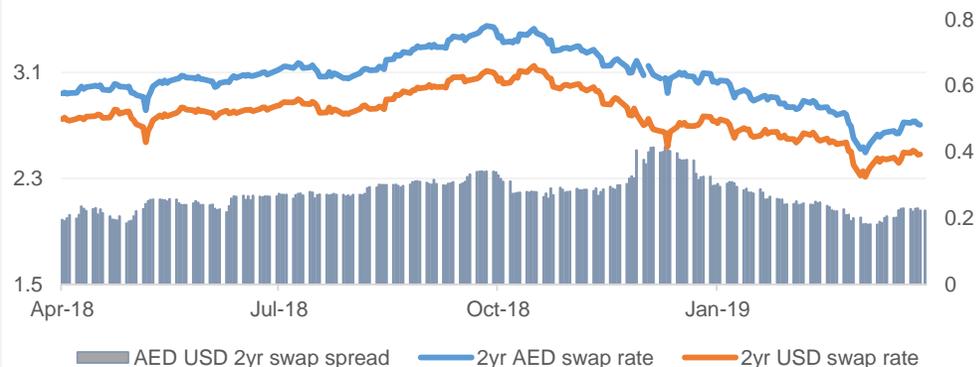
HIGHLIGHTS

- Slower loan growth in the region on the back of slowing economic growth has caused overall reduction in the amount that is borrowed and which in turn may have needed hedging. This in turn has caused the dirham swap curve to shift downwards faster than the USD swap curve, thereby causing the spread of dirham swap over the USD curve to narrow.
- The 2yr AED USD swap spread has fallen from 43bps in early January this year to 27bps now. For the 5yr tenure the Dirham swap spread over the 5yr USD swap rate has narrowed from 84bps to 58bps.

5yr AED VS. USD SWAP SPREAD

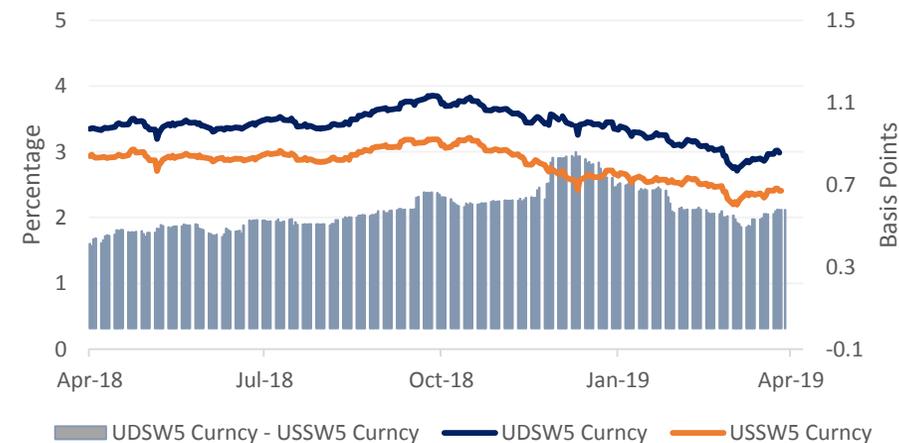


2yr AED USD SWAP RATES



Source: Bloomberg, Emirates NBD Research

5yr AED USD SWAP RATES



Source: Bloomberg, Emirates NBD Research

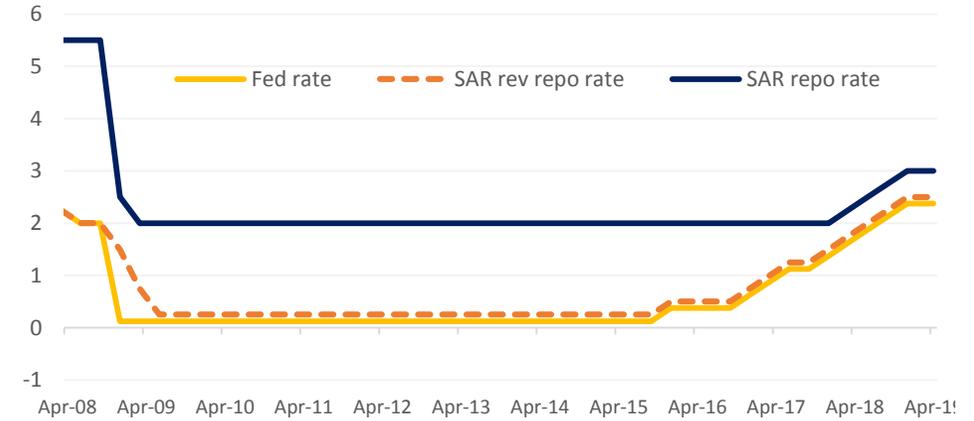
SAUDI RIYAL RATES



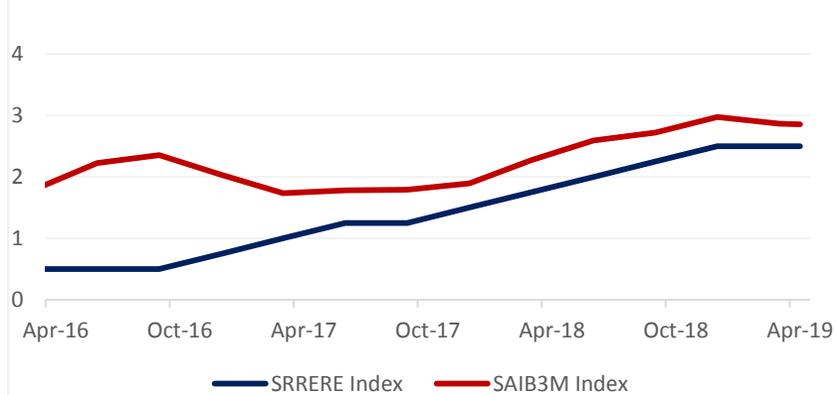
HIGHLIGHTS

- Very much like in the UAE, policy rates in the Saudi Arabia move in tandem with the Fed target rate.
- In absence of efficient local currency capital markets to affect the amount of cash in the system, GCC central banks tend to have separate deposit and lending rates instead of just one target rate.
- SAMA exercises some flexibility by altering the spread between the repo and the reverse repo rates.
- Lower oil prices at the beginning of this year compared with last year probably contributed to the increase in SAIBOR spreads over LIBOR in Q1.

SAMA TARGET RATES



SAR REVERSE REPO RATE VS. 3m SAIBOR



Source: Bloomberg, Emirates NBD Research

3m SAIBOR VS. LIBOR



Source: Bloomberg, Emirates NBD Research

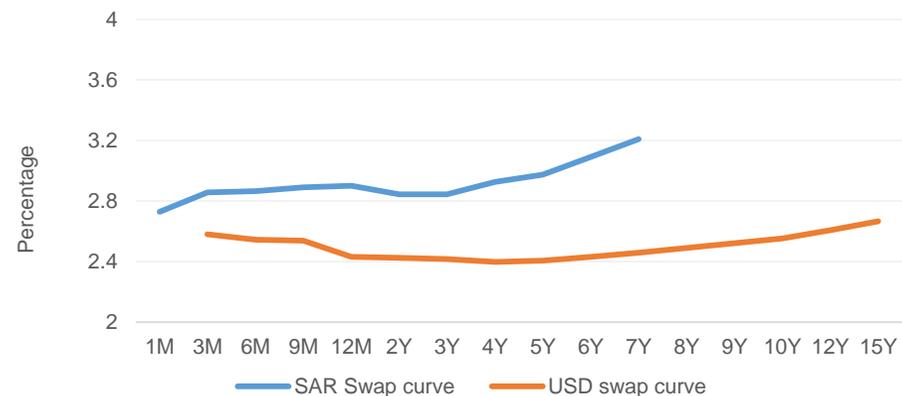
SWAP RATES BEING AFFECTED BY FALLING DEMAND FOR HEDGING



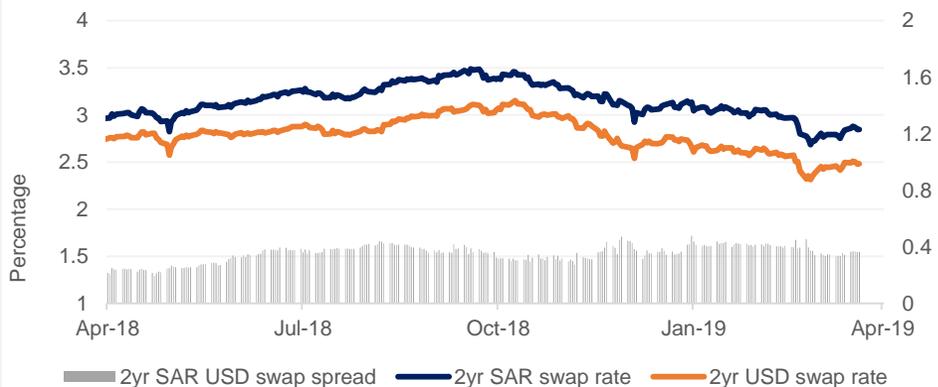
HIGHLIGHTS

- Over 43% of the total \$47 billion raised in the bond market by GCC issuers came from Saudi Arabia. These large deals have helped to keep the demand for interest rate hedging in the KSA alive. Nevertheless overall decline in loan growth has affected hedging demand negatively and contributed to reduction in SAR swap spread over the USD rates.
- The 2yr SAR USD swap spread has fallen from 44bps in early January this year to 36bps now. For the 5yr tenure the SAR swap spread over the 5yr USD swap rate has narrowed from 88bps to 56bps now.

SAR USD SWAP CURVES



2yr SAR vs USD SWAP RATES

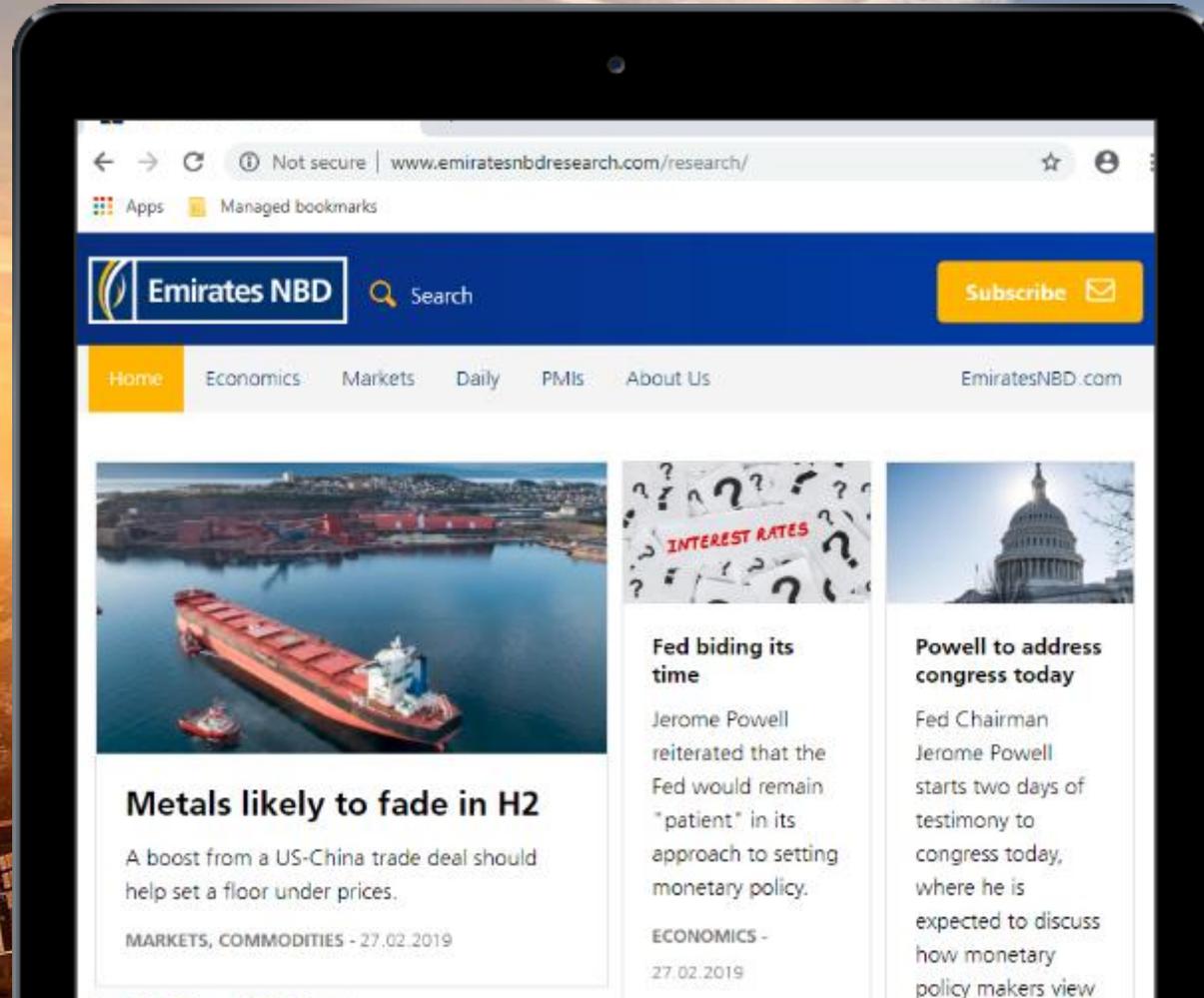


Source: Bloomberg, Emirates NBD Research

5yr SAR vs USD SWAP RATES



Source: Bloomberg, Emirates NBD Research



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