Emerging markets watch central bank trinity

Abu Dhabi's US$ 13.6bn stimulus package boosts UAE stocks

ECB talks about ending stimulus

Fed will continue normalization, adding volatility to EM currencies

RBI rate hike spurs rupee and Sensex rally

INVESTMENT SUMMARY: The most liquid stock market in the Middle-East is rallying after the UAE unveiled a round of stimulus. Meanwhile, the Fed is expected to continue to hike interest rates, prompting more volatility of emerging market assets. The FAB Asset Allocation Committee meets this week and strategy remains unchanged until the meeting.

United Arab Emirates stocks rallied after His Highness Sheikh Mohammad bin Zayed Al Nahyan, the Crown Prince of Abu Dhabi, unveiled an AE$ 50 billion (US$ 13.6 billion) stimulus package aimed at helping small and medium enterprises, supporting new industries, encouraging tourism and making it easier to do business. The stimulus will be rolled out over three years.

The effect, however, was immediate. Abu Dhabi's stock index rose 1.1% after the announcement, ending the week up 1.25%, while Dubai's closed 2.6% higher for the week.

The announcement follows only weeks after the UAE Cabinet allowed foreigners to set up businesses outside free zones.

Both announcements help diversify the UAE's economy and **may support property prices.**

The property sector has already shown signs of stabilizing anyhow. Last week, Dubai's Land Department announced monthly sales figures that showed the total value of property units sold in May increased 12.88% compared to April. Year-to-date, however, the figure is still 26.4% behind the same period of 2017. Higher average oil prices and the stimulus and liberalization measures will accelerate growth in the UAE. **That should support stocks, especially in the construction and financial sectors, which are more sensitive to economic cycles. Dubai's stock market index trades at 8.25 times forward earnings and offers a dividend yield of 5.57%, making it very cheap. And Abu Dhabi's stock index trades at 11.60 times expected earnings with a dividend yield of 5.15%.**

As a comparison, the Stoxx 600 trades at 14.71 times forward earnings and offers a dividend yield of 3.46%, while the S&P 500 trades at 17.47 times earnings and yields 1.88%.

Outside the UAE, all eyes are on this week's meetings of the US, European and Japanese central banks.

Particular attention is being given to the ECB after Chief Economist Peter Praet suggested it is time to talk about ending quantitative easing. The euro rallied on the comments, spurring a sell-off in some emerging market currencies, particularly the Brazilian real.

The euro touched US$ 1.1800 on Thursday and the yield on the 10-year German bund rose six basis points. On Friday, however, the currency dropped to US$1.1769 and the 10-year bund yield dropped three basis points to 0.45%.

It's a catch-22 for the central bank. The Eurozone's inflation is over 1.5% and on track to reach the 2% ECB target. Unemployment in the Union is now at 8.5%, the lowest since 2009. Yet, just last week German factory orders came in at negative 2.5% when economists expected a positive print. That was days after the euro-area's own manufacturing measure showed a fourth successive decline. Now, Citigroup's euro-area economic surprise index is near its most negative since 2011. It has been seven years since economists were so bullish – and wrong – about Europe. Add turmoil in Italy to that. Last week, a government was finally formed around Prime Minister Giuseppe Conte, but it has 31-year old Eurosceptic Five Star leader Luigi Di Maio as labor and economic minister, and anti-immigration advocate Matteo Salvini as interior minister. Salvini has promised tax cuts while Di Maio wants to increase welfare expenses, a difficult combination in a country that has not had a fiscal surplus in more than two decades.

Conte said he was committed to the European Union last week but signaled higher spending plans. That raises the prospect of clashes with Germany and more talk of schism from the Eurozone, which could impact the single currency.

Praet's words may be just setting the stage for actual announcements of quantitative easing curbs in July or even later, depending on political and economic developments. The ECB is likely to keep its wait-and-see statement for now, which could force the euro to give back some gains and compress bund yields.

The Bank of Japan also meets this week but is unlikely to change its easing stance. The country grew 1.7% last year but the OECD expects it to expand only 1.2% in 2018.
Meanwhile, the Federal Reserve is expected to increase its benchmark rate by 25 basis points to 2%, the highest level since September 2008, on the eve of the Lehman Brothers bankruptcy. Unemployment in the US is at 3.8%, the lowest in 18 years. Core CPI, excluding food and energy, came in at 2.1% in April and is expected to show further increases when May numbers are revealed on Tuesday.
The strength of the US economy supports the Asset Allocation Committee's expectations of three rate hikes this year and two in 2019.
The two most recent US interest rate hike cycles were accompanied by gains in US stocks. Indeed, the equity gauge is up 3.94% this year, having rallied 1.62% only last week. At 17.4 times forward earnings, the index is close to the 17.3 five-year average for the measure and off highs of more than 20 times seen last year.
As rates rise, so will US Treasury yields. The yield on the 10-year bond closed at 2.95% last week, inching back toward the key level of 3% and having risen sharply from the 2.78% it hit on 29th May, amid the political impasse in Italy.
Rising Treasury yields have taken their toll on investment grade bonds. The Bank of America Merrill Lynch US Corporate Index is down 3.23% year to date, having dropped 0.26% last week.
If the yield on the 10-year US Treasury holds above 3% for a couple of weeks that movement could accelerate.

The biggest losers, however, have been emerging market currencies – which is consistent with what happened in the two most recent rising interest rate cycles in 1994 and 2004.

The MSCI Emerging Market Currencies index is down 0.7% this year, having lost 0.33% last week as investors used the prospects of reduced easing in Europe as an excuse to exit developing countries. The PIMCO Emerging Markets Advantage Local Currency Bond Index is faring worse, down 4.71% this year and having dropped 1.2% last week.
Last week's move was mostly driven by the Brazilian real, which dropped 1.51%. The currency rout in Latin America's largest economy is only the latest of a string. The Brazilian central bank so far has refused to take the same tack as other victims, such as Turkey, Indonesia and India, which raised interest rates in response to outflows.

Unlike Brazil's central bank the Reserve Bank of India took the cue and raised its repurchase rate by 25 basis points last week to 6.25%, a move hardly anyone expected. While Indian inflation was running at a high 4.58% in April – with some predicting an even higher print in May – the price rise has been pushed mostly by oil prices. In other words, the increase in prices is not a result of stronger demand in the economy.
Were it not for the rupee depreciation, the central bank may have looked beyond the oil-price-rooted inflation. However, the central bank needed to restore confidence after spending 3.2% of its foreign reserves in less than two months defending the currency.
That move mirrored the recent decision by the Turkish central bank to increase rates by an unexpected 125 basis points, a move it repeated last week and which helped support a 5.4% rally in the lira over the past two weeks.
It worked for India too. The rupee finished the week at R$ 67.5075 per US$ 1, up 0.66%. The stock market also responded to the move and the Sensex index closed the week up 0.87%. The rally may have been counterintuitive, given that the rate hike may slow the country's economy and reduce company earnings.
India-focused funds, however, have suffered the worst outflows of large emerging markets this year. **The RBI's move may reverse that, and is therefore bullish for Indian stocks. Furthermore, technical analysis suggests there is room for the Sensex to rally further, as the index has found support at the 50-day moving average recently and that measure is still trending upward.**

SMALL TALK

Godolphin won its first Epsom Derby with three-year old Masar.

Online prediction website Ladbrokes places the highest odds on Brazil, Germany, France and Spain being the semi-finalists in the World Cup.

Alain.Marckus@bankfab.com

Christofer.Langner@fgb.ae

Disclaimer:

This report has been prepared and issued by Products & Services - Wealth & Private Banking ("P&S-WPB") of First Abu Dhabi PJSC ("FAB") outlining particular services provided by P&S-WPB and does not constitute or form part of any offer or invitation to sell, or any solicitation of any offer to purchase or subscribe for, any shares in FAB or otherwise or a recommendation for a particular person to enter into any transaction or to adopt any strategy nor shall it or any part of it form the basis of or be relied on in connection with any contract therefore. This report is incomplete without reference to, and should be viewed solely in conjunction with the associated oral briefing provided by P&S-WPB. The report is proprietary to P&S-WPB and may not be disclosed to any third party or used for any other purpose without the prior written consent of P&S-WPB. The information in this report reflects prevailing conditions and our views as of this date, which are accordingly subject to change. In preparing this report, we have relied upon and assumed, without independent verification, the accuracy and completeness of all the information available from public sources or which was otherwise reviewed by us. In addition, our analysis are not and do not purport to be appraisals of the assets, stock or business of the recipient. Even when this presentation contains a kind of appraisal, it should be considered preliminary, suitable only for the purpose described herein and not be disclosed or otherwise used without the prior written consent of P&S-WPB. FAB clients may already hold positions in the assets subject to this report and may accordingly benefit from the buying or selling of such assets as referred to in this report. This document does not purport to set out any advice, recommendation or representation on the suitability of any investment, transaction or product (as referred to in this document or otherwise), for potential purchasers. Potential purchasers should determine for themselves the relevance of the information contained in this document and the decision to purchase any investment contained herein should be based on such investigation and analysis as they themselves deem necessary. Before entering into any transaction potential purchasers should ensure that they fully understand the potential risks and rewards of that transaction (including, without limitation, all financial, legal, regulatory, tax and accounting consequences of entering into the transaction and an understanding as to how the transaction will perform under changing conditions) and that they independently determine that the transaction is appropriate for them given their objectives, experience, financial and operational resources and other relevant circumstances. Potential purchasers should consider consulting with such advisers and experts as they deem necessary to assist them in making these determinations and should not rely on FAB for such purposes. FAB is acting solely in the capacity of a potential arm's-length contractual counterparty and not as a financial adviser or fiduciary in any transaction unless we have otherwise expressly agreed so to act in writing. FAB does not provide any accounting, tax, regulatory or legal advice. FAB is licensed by the Central Bank of the UAE.

London: *FAB London Branch is Authorized by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from FAB London branch on request. Registered in England & Wales: Company No: FC009142: VAT No: GB245 3301 91.*

Paris: *FAB Paris Branch is licensed by the French Prudential Control Authority as a credit institution. FAB Paris is registered in France under the company number: RCS Paris B 314 939 547.*

Switzerland: *This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. Certain services and products are subject to legal restrictions and cannot be offered world-wide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are currently as of the date of this report, and are subject to change without notice. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. At any time the First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. First Abu Dhabi Bank PJSC expressly prohibits the distribution and transfer of this document to third parties for any reason. First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law. The "Directives on the Independence of Financial Research", issued by the Board of Directors of the Swiss Bankers Association (SBA) do not apply.*

Singapore: *First Abu Dhabi Bank P.J.S.C., Singapore Branch is regulated by the Monetary Authority of Singapore and holds a Wholesale Bank license.*