

Economic and Interest Rate Outlook

The Year Ahead



December 2014

Economic and Interest Rate Outlook

Global Economy – Policy shift

- ❖ In the US the pace of economic growth has picked up
 - > In ending QE, the FED has taken the first step towards normalization of the monetary policy
 - > In near-term, lower commodity prices & a stronger USD should keep inflation in check
 - > 3% growth expected in 2015 on stronger consumption and business investment
 - > The FED is expected to raise short term interest rates from mid-2015
 - > In the FOMC meeting held on December 17th, the Fed decided to keep the Fed Funds Target Rate at 0.25%. The committee reaffirmed that it was on course to raise interest rates given the right economic parameters

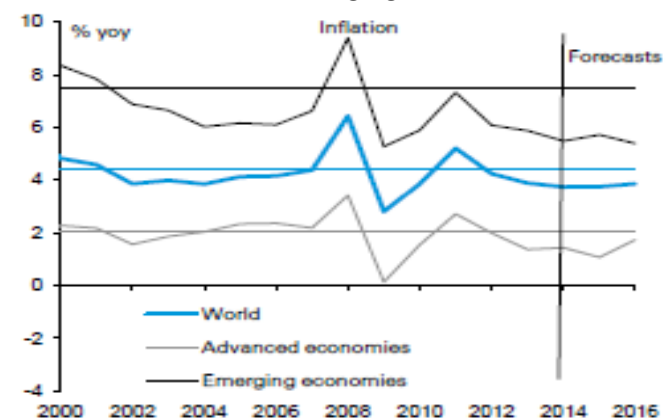
Growth momentum is positive but remains below trend



Source: DB Research

- ❖ Eurozone growth is expected to be low
 - > Growth came to a halt in Q2, mainly on account of weak investment and exports
 - > Euro area inflation forecasts according to Bloomberg are 0.9% for 2015 and 1.4% for 2016
 - > The ECB is expected to engage in sovereign QE in the coming months to counter the threat of deflation

Global Inflation to rise modestly through 2016

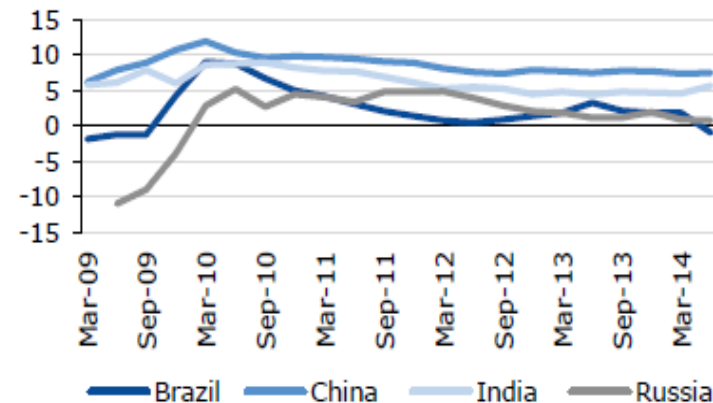


Source: DB Research

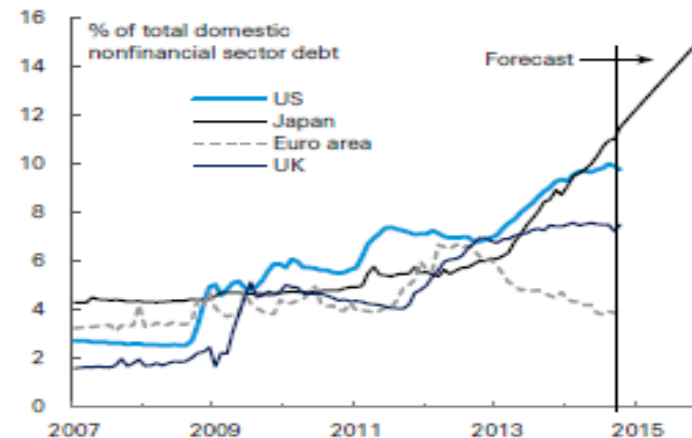
Global Economy – Policy shift

- ❖ Japan slid into a recession and Abe won two-thirds majority in a snap election to put the reforms agenda back on track
 - > BOJ announced additional asset purchases in November
- ❖ EM growth likely to slow but will remain at a healthy level of 4.5%-5.0%
 - > Growth momentum to follow the rest of the world higher in coming months
 - > In China, while some recent data has been weak, exports are showing traction and credit easing and lower rates should facilitate the ongoing implementation of economic reforms
 - Growth is expected at 6.8% in 2015.
 - > India is set to replace China as Asia's fastest growing economy in 2016

BRIC GDP growth rates



Monetary base in G4



Note: Japan assumes JPY6.67trn monthly rise (JPY80trn annual rise) in monetary base.

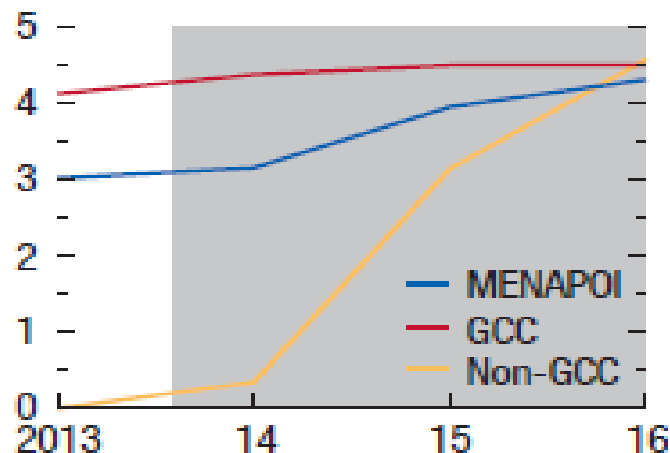
Source: DB Research

GCC: Growing despite falling oil prices

- ❖ In the GCC growth picked up slightly in the second half of 2013 and into 2014, driven by higher production and government spending
 - > Oil exporters from the GCC face fiscal adjustments challenges on the back of falling oil prices
 - > Inflation is expected to remain contained in the GCC, in light of softening global food prices and pegged exchange rates
 - > Oil prices have come off significantly since OPEC decided on Nov.27 to maintain output levels
 - > OPEC Countries cut its production forecast for 2015 by about 300,000 barrels a day to 28.9 million, the least since 2003.

- ❖ IMF projects the GCC countries to grow at an average of about 4.5% in 2014–15 as of Oct 2014
 - > Non-oil GDP growth is estimated at 6% and oil GDP projected to grow at 1%
 - > Rising public government capital expenditure and ample private credit expansion support domestic investment

Overall Real GDP Growth(% change)



Source: IMF

Oil prices have collapsed (Brent USD)



Source: Bloomberg

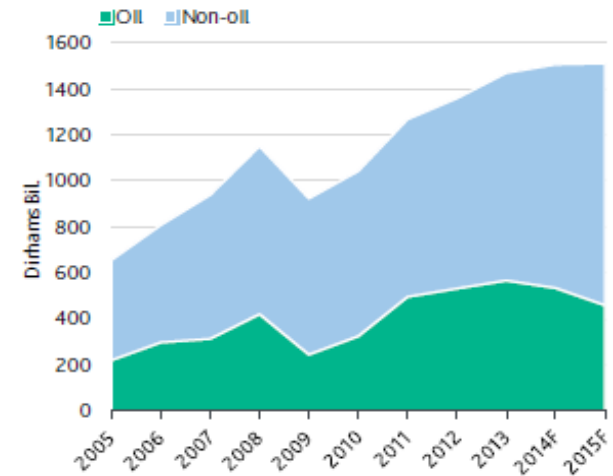
GCC: Growing despite falling oil prices

- ❖ UAE's Real GDP growth is estimated at 4.3% for 2014.
 - > UAE's economy is dominated by the oil sector (38.9% of GDP in 2013). However it is much more diversified than other oil producers such as Kuwait, Qatar and Saudi Arabia. It is ranked 12 out of 144 countries in the World Economic Forum's Competitiveness Index
 - > Developed capital markets, an open business environment as well as a large stock of foreign assets have helped neutralize part of the volatility from oil price cycles
 - > The non-hydrocarbon sector growth is expected to slow in 2015 because of:
 - lower capital expenditure by the public sector, moderate population growth and stabilizing demand from GCC countries

- ❖ Qatar's economy expanded by 5.7% in 2Q14
 - > Driven by strong non-oil activity, particularly electricity, construction, trading, transport, hospitality and financial sectors
 - > Hydrocarbon sector, which accounts for 50% of the economy shrank by 2.2%

- ❖ KSA's GDP growth slipped to an annual rate of 3.8% in 2Q14
 - > Slower growth because of lower oil prices
 - > According to the IMF, Saudi Arabia is expected to run a central government fiscal deficit as early as 2015

UAE: Oil vs Non Oil Sector contribution to GDP

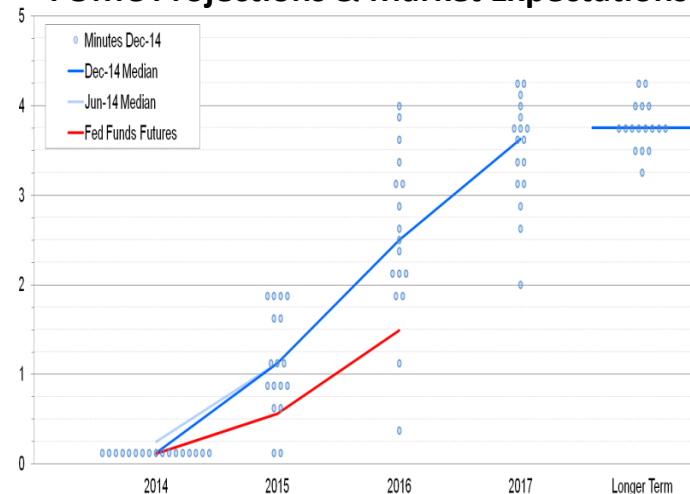


Source: Moody's

Diverging Monetary Policies

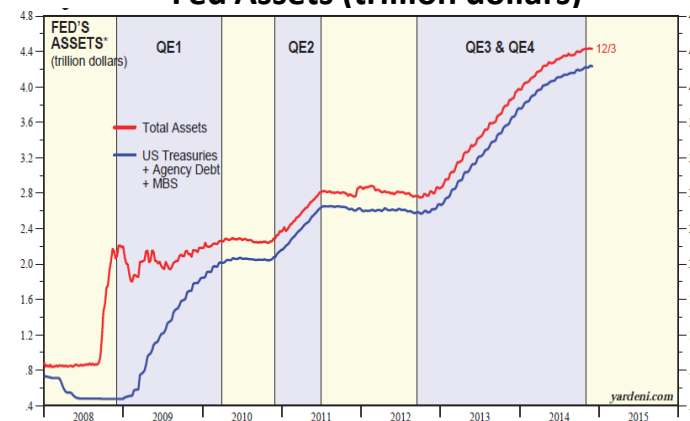
- ❖ Fed ended asset purchases in October and normalization of policy to begin from Q2 2015
 - > Low inflation and global growth concerns holding back the Fed from turning more hawkish
 - > There is a large gap between money market pricing of the tightening path and the Fed's forecasts, the market being more aligned with the most conservative Fed member.
 - > Market expectations are for rates to rise to 0.75% by end-2015 and 1.75% by end-2016
- ❖ Ultimately US rates should rise, but only on the back of improving signals on employment, inflation and housing
 - > US labor market trend is intact and the recovery remains on a firm footing
 - > Housing market recovery expected to gather further steam
- ❖ BOE to wait and see inflation and employment/wage trends
 - > First Rate hike probably delayed until Q1 2015
- ❖ Weaker data and a tepid market response to recent measures has raised pressure on the ECB to do more
- ❖ BOJ to remain on the expansionary path with lower rates for longer

FOMC Projections & Market Expectations



Source: Bloomberg

Fed Assets (trillion dollars)



Note: QE1 (announced 11/25/08) = Fed buys \$1.24tn in mortgage securities. QE2 (announced 11/3/10) = Fed buys \$600bn in Treasuries. QE3 (announced 9/13/12) = Fed buys \$40bn/month in mortgage securities (to infinity and beyond). QE4 (announced 12/12/12) = Fed buys \$45bn/month in Treasuries.
 * Average of daily figures for weeks ending Wednesday.
 Source: Federal Reserve Board.

Source: Yardeni Research

FFTR – Implied Probability & Fed’s Projections

Implied Probability	Target Fed Funds Rate (Current: 0.25%)				
	0.00%	0.25%	0.50%	0.75%	1.00%
FOMC Meeting	0.00%	0.25%	0.50%	0.75%	1.00%
28 January 2015	52.0%	48.0%			
18 March 2015	47.8%	48.3%	3.9%		
29 April 2015	43.0%	48.3%	8.3%	0.4%	
17 June 2015	26.7%	46.3%	23.5%	3.4%	0.1%
29 July 2015	21.4%	42.4%	28.0%	7.4%	0.8%
17 September 2015	10.7%	31.9%	35.2%	17.7%	4.1%
28 October 2015	7.7%	25.9%	34.3%	22.6%	7.9%
16 December 2015	2.8%	14.2%	28.9%	30.1%	17.3%
27 January 2016	1.9%	10.6%	24.2%	29.7%	21.4%

FOMC Projections (December 2014)	2014	2015	2016	2017
Median	0.125%	1.125%	2.5%	3.625%
High	0.125%	1.875%	4.00%	4.25%
Low	0.125%	0.125%	0.375%	2.00%
	Mashreq’s Projections			
	0.125%	1.50%	3.50%	4.50%

Swap Rates - Update

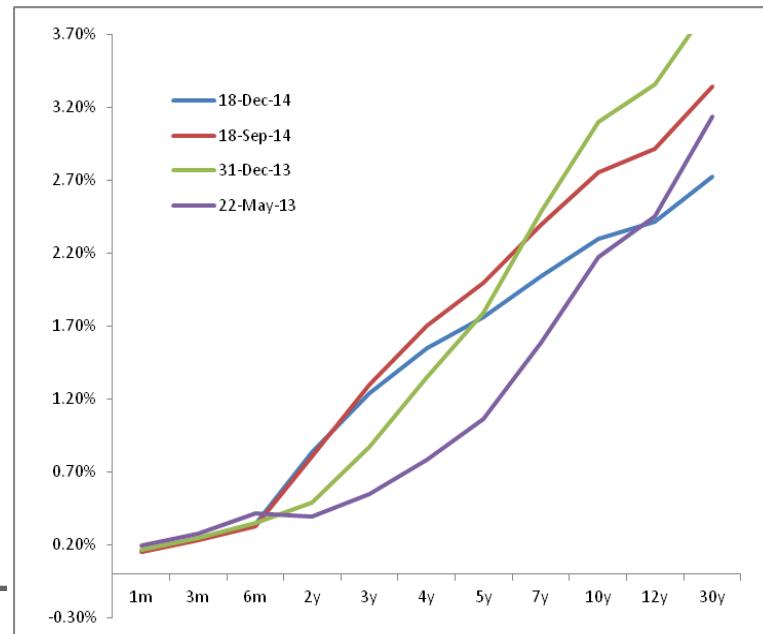
Absolute Change in USD Swap Curve

	18 Dec 14	1 M Δ	3 M Δ	6 M Δ
2 Year Swap	0.84%	12	3	23
3 Year Swap	1.24%	11	-5	20
4 Year Swap	1.55%	7	-16	11
5 Year Swap	1.76%	2	-24	0
7 Year Swap	2.04%	-6	-35	-20
10 Year Swap	2.30%	-14	-46	-38
12 Year Swap	2.41%	-18	-50	-47
30 Year Swap	2.73%	-27	-61	-64

USD Swap Curve – 10 Year High/Low and Average

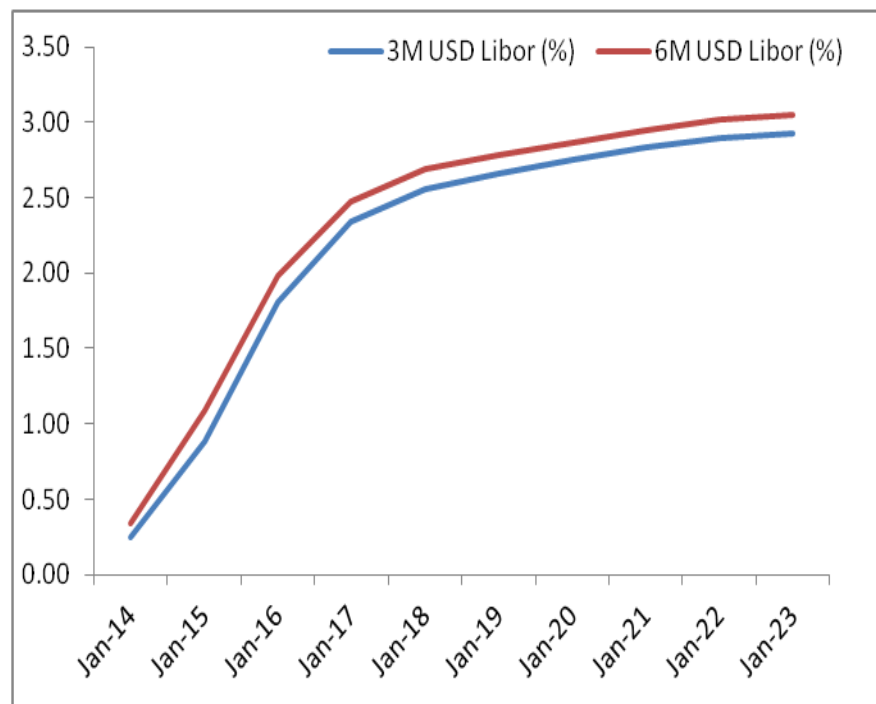
	18 Dec 14	High	Low	Average
2 Year Swap	0.84%	5.74%	0.34%	2.24%
3 Year Swap	1.24%	5.75%	0.43%	2.48%
4 Year Swap	1.55%	5.75%	0.56%	2.73%
5 Year Swap	1.76%	5.77%	0.73%	2.95%
7 Year Swap	2.04%	5.84%	1.13%	3.31%
10 Year Swap	2.30%	5.93%	1.53%	3.65%
12 Year Swap	2.41%	5.98%	1.74%	3.81%
30 Year Swap	2.73%	6.11%	2.25%	4.18%

USD Swap Curve has Flattened



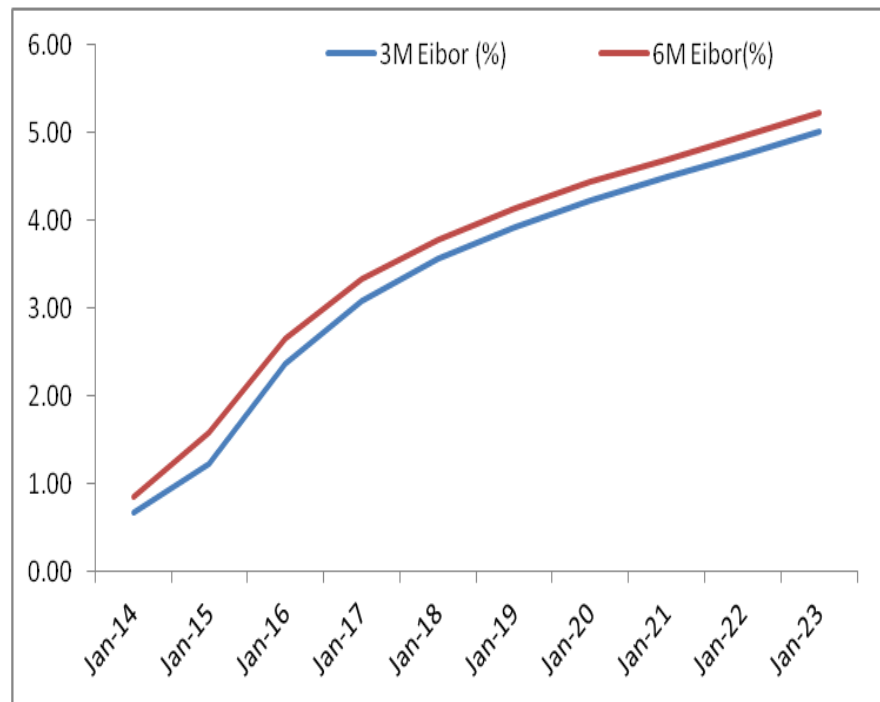
USD Libor – Implied Forwards

	3 Month (%)	6 Month (%)
Dec-14	0.25	0.34
Dec-15	0.88	1.09
Dec-16	1.81	1.98
Dec-17	2.34	2.47
Dec-18	2.56	2.69
Dec-19	2.66	2.78
Dec-20	2.75	2.87
Dec-21	2.83	2.95
Dec-22	2.90	3.02
Dec-23	2.93	3.05



AED Eibor – Implied Forwards

	3 Month (%)	6 Month (%)
Dec-14	0.68	0.85
Dec-15	1.22	1.58
Dec-16	2.37	2.66
Dec-17	3.08	3.34
Dec-18	3.56	3.78
Dec-19	3.92	4.13
Dec-20	4.23	4.44
Dec-21	4.49	4.69
Dec-22	4.74	4.95
Dec-23	5.01	5.23



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