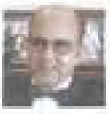
A television screen on the floor of the New York Stock Exchange shows the decision of the Federal Reserve on March 15. The Fed's key short-term rate is rising by a quarter-point to a still-low range of 0.75 percent to one percent. — *AP*

Divergence between GCC, US business cycles rising



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DATELINE DOHA

IN LINE WITH market expectation the US Federal Reserve last week raised interest rates by 25 basis points, taking the overnight fund rate to a target range of 0.75 per cent to one per cent. Yellen walked a balance between bracing the market for additional hikes but stressing that the Fed remains data-dependent and not interested in aggressive tightening.

In a move that would please global markets, the Federal Open Market Committee (FOMC) described job gains as solid and business investment appearing to firm up. The Fed had forecast inflation to reach 1.9 per cent in the fourth quarter of current year and two per cent in both 2018 and 2019. Though interest rates have been increased the Fed has not shifted its estimation of US GDP growth at 2.1 per cent in 2017 though it projected a minor increase from two per cent to 2.1 per cent in 2018 and kept 2019 estimates at the same level of 1.9 per cent. The Fed last week indicated that it still expects three moves.

Market waits to see how President Donald Trump see his Congress take the responsibility for providing economic stimulus. Expectations in the US markets are high that an aggressive fiscal policy will bring back growth. However, Fed's data does not reflect the optimism — growth has been stagnant for three years.

After the Fed action last week most of the GCC central banks have hiked rates. Rates on certificates of deposit issued by the UAE central bank will increase, and the repo rate at which financial institutions borrow short-term liquidity from the central bank will increase to 1.25 per cent.

> The Fed forecast inflation to reach
> 1.9%
> in Q4 of current year and
> 2%
> in both 2018 and 2019

Kuwait's central bank raised its discount rate to 2.75 per cent to keep the Kuwaiti dinar an attractive currency for savings. Saudi Arabia's central bank raised its reverse repo rate, the rate at which commercial banks deposit money with the central bank, to one per cent. But it kept its repo rate, which it uses to lend money to banks, unchanged at two per cent.

The central bank of Bahrain had raised its key policy interest rate on the one-week deposit facility by 25 basis points to 1.25 per cent. It also increased three other rates by 25bps: the overnight deposit rate to one per cent, the one-month deposit rate to 1.75 per cent, and the lending rate to three per cent.

Earlier after Fed hiked rates in December 2015 all GCC central Banks except Oman followed the same. Rising funding costs as a result of Fed rate hikes could eventually translate into pressure on margins for GCC banks. Cost of borrowings for the banks will go up, however given high level of current account deposits, bank's borrowing needs are less and therefore the absolute increase in their borrowing cost will be lower than the income they will generate on lending at higher rates to the customers. However those banks which have higher borrowing will face pressure from margins. Banks which are able to reprice their loans while remaining locked to the existing rates on deposits stand to gain.

The GCC economies with pegged currencies are expected to face further rise in cost of funds and impact of currency appreciation. Monetary tightening in 2017 will continue to act as a headwind to any pickup in economic activity in the GCC this year. The US rate hiking cycle will also underpin dollar strength, which will continue to erode the export competitiveness of the GCC's non-oil sector. A stronger dollar should affect Dubai's economy, as it is more dependent on real estate and tourism.

Many investors will look for dollar-based investments, especially real assets to hedge their currency exposure, and we could see activity from Chinese and from Russian investors. Strengthening currencies will reduce cost of imports, thereby improving the terms of trade. Strengthening terms of trade are generally a good thing for an economy as they imply a higher standard of living and stronger economic growth, particularly where economic inputs are largely imported. The rising divergence between the US business cycle where growth is accelerating along with inflationary pressures and the GCC cycle where it is decelerating will lead to monetary realignment in GCC.

The writer is group CEO at Doha Bank. Views expressed are his own and do not reflect the newspaper's policy.