International scene

Fed will likely pass this year, market volatility off but sources remain

> Elias Bikhazi
Group Chief Economist
+965 2259 5364, eliasb@nbk.com

2015 market volatility, expected by many for this year, did not disappoint but was certainly much more vicious in the third quarter, spurred by expected sources: China's economy and Fed monetary policy. The third quarter ended with stocks significantly lower in most markets, on a year-to-date basis with US markets down some 7% for the Dow Industrials, 5% for the S&P 500. The markets have recovered some ground early in Q4 however. The US dollar was up against most currencies, up 8% ytd against the euro. And ironically US interest rates were little changed or down slightly, on the year, though the Fed keeps getting closer to raising rates for the first time in nine years, or so it seems. The weaker US September employment report, a gain of 142K new jobs, should put to rest any notion of a Fed hike this year.

The recent volatility and equity losses were driven largely by developments in the US and China, the world's two largest economies. In China, economic growth disappointed, equities weakened in response, and the government attempted to prop up both the financial markets and economic growth; with little success, at least in regards to the equity markets. A series of policy moves were undertaken: looser lending regulations, official purchases of equities, a ban on equity sales in some cases, reducing interest rates, devaluing the renminbi and freer FX trading. These measures failed to convince investors and stem the decline in China's equities. The lack of results also changed unrealistic perceptions: China's government is not all-knowing, all-competent and omnipotent all the time. A side-effect was also to revive dormant doubts about the reliability of economic and business data in the Chinese economy.

In a nutshell, and suddenly, both weaker data and eroded confidence hit Chinese equities in the midst of a massive bull run that had seen stocks double in price in less than one year. The volatility from China reverberated in all other markets, including emerging markets (FX and fixed-income) and commodity economies. Chinese equities are now 7% lower ytd (28% lower in Q3), and the economic outlook was revised down by most analysts to under 7% GDP growth, though questions still linger as to the "real/actual" pace of growth there. Recent official data showed Chinese GDP grew 6.9% y/y in Q3, the slowest pace since 2009.

For its part, the Fed was poised to "lift-off" (raise the federal funds rate 25 bps) at the recent September meeting. However the move was derailed and delayed, clearly, by financial market havoc in Q3. The Fed thus decided to buy itself some extra time and it announced (through Chair Yellen and the FOMC's dot-plots) that it still expected a rate rise before year-end. While everything was "reasonable" on the surface of the FOMC September decision, it kept two sources of uncertainty alive. One: when is lift-off (really), and what will be the reaction of the markets? Two: is the Fed really serious about "lift-off"?, in the sense that it once again delayed that crucial decision, based on international developments. The latter are not explicitly in the Fed's

mandate. China and its markets are of course very important and can, and will, affect the US economy, world inflation, FX and commodity prices etc. However the Fed's knack, more than once since 2008, in finding and adding new justifications, or targets, to delay raising rates is getting to become an issue, and has started to gnaw at the Fed's credibility. At the September FOMC meeting, four members looked for the rate rise(s) to start in 2016, versus only two at the July meeting. A vast majority was still expecting the first rate hike this year, with two FOMC meetings to go: October and December. But that was before the September jobs report.

Now, after volatility has somewhat subsided, the sources to watch remain the same. Most growth forecasts (Wall Street, IMF, World Bank etc.) have come off for this year in recent months; 3% or less for the world economy, driven by the weaker numbers for China and emerging markets. Of the large economies, Russia, Canada, and Brazil were in recession in 1H2015. Europe and the eurozone are doing "as expected" and growth is apparently supported above 1%, and the ECB stands ready to upgrade or extend its current QE program if required, as per its president Mario Draghi. Risks for all have risen on the downside thanks to the Chinese situation.

The consensus is still for no China hard-landing, for moderate worldwide growth, albeit slower than expected earlier, for most central banks to be ready to ease and help their economies, all while the Fed is forever on the verge of higher rates, which were delayed yet again by the "softish" September jobs report (142k new jobs, no wage gain).

For the GCC economies, we still expect real economic growth to hold steady, certainly in their non-oil economies (4-5%). Oil prices, which had recovered some recently, remain under pressure for the now familiar reasons: soft world demand, shale oil supply, no OPEC cuts, Iran's anticipated return... Nevertheless, GCC countries are committed to infrastructure and benefits spending that continue to support their economies, notwithstanding the need for reform and spending adjustment. The latter should occur gradually in most GCC countries. The depth of their reserves are expected to carry them over the near to medium term and, of course, they will start to borrow soon, domestically and internationally. KSA already started and announced plans to borrow more, some $28 billion this year. Kuwaiti authorities expect some issuance before year end. The major countries all benefit from high debt ratings (and low debt/GDP ratios).

Head Office

Kuwait
National Bank of Kuwait SAK
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAK
Bahrain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait
Bahrain Branch (H.O)
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAK
Head Office - Dubai
Latifa Tower, Sheikh Zayed Road
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait
Abu Dhabi - Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAK
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAK
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAK
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAK
Singapore Branch
9 Raffles Place #24-01/02
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAK
Shanghai Representative Office
Suite 1003, 10th Floor, Azia Center
133 Yin Cheng Bei Road, Lujiazui
Shanghai 200120
China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353