Trump, president; Hard turn for Brexit; ECB stands pat; Kuwait equities up on volume

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,705	0.50	3.48
Bahrain ASI	1,240	2.31	1.58
Dubai FM	3,690	-0.81	4.52
Egypt EGX 30	12,807	-3.15	3.74
KSA Tadawul	6,876	-0.66	-4.64
Kuwait SE	6,436	5.37	11.96
Muscat SM 30	5,734	-0.49	-0.18
Qatar Exchange	10,941	2.17	4.84
MSCI GCC	473	0.55	-0.36
International			
DAX	11,630	0.01	1.30
DJIA	19,827	-0.29	0.33
FTSE 100	7,198	-1.90	0.78
Nikkei	19,138	-0.77	0.12
S&P 500	2,271	-0.15	1.45

Commodities	$/bbl	Change (%) weekly	Change (%) YTD
Brent crude ($/bbl)	55.5	0.07	-2.34
KEC ($/bbl)	52.3	2.19	0.79
WTI ($/bbl)	53.2	1.62	-0.93
Gold ($/t oz.)	1210.0	1.84	4.64

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.305	0.00	-0.03
KWD per EUR	0.365	13.21	14.74
USD per EUR	1.070	0.55	1.77
JPY per USD	114.60	0.08	-1.94

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Kibor – 3 month	1.44	0.0	0.0
Qibor – 3 month	1.82	-3.2	3.5
Libor – 3 month	1.04	2.0	4.6

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.54	0.1	-0.3
Dubai 2021	3.23	1.4	-9.8
Qatar 2021	2.83	-1.9	-12.4
Saudi Arabia 2021	3.11	12.3	5.9
International			
UST 10 year	2.47	6.9	3.5
Bunds 10 year	0.42	8.3	21.5
Gilts 10 year	1.43	7.4	18.9
JGB 10 year	0.06	1.0	1.1

Source: Thomson Reuters Datastream

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Summary

In the US, data and pronouncements continue to support a tighter Fed stance and higher interest rates ahead. December CPI rose above 2.0% y/y for the first time since 2014, in line with firmer inflation numbers worldwide. Fed Chair Yellen intimated that the US was close to full employment, and getting closer to its inflation target. These "pluses" for the USD were offset by a statement from Mr. Trump suggesting the USD may be "too strong". Markets would certainly like more clarity on this and other policy issues. The Dow is still struggling to pass 20,000.

President Donald Trump was inaugurated on 20 January, and his new cabinet should be confirmed in the next few days, so we can expect further clarity on the new administration's policies. The long-awaited inauguration speech was short on specifics. However, it did reaffirm a very strong national "America first" focus, which could shake some defense or trade policy foundations ahead.

British PM Theresa May signaled a move toward "hard" Brexit, i.e. a clean break from the EU, for the United Kingdom. The process is also one of several large political/policy question marks looming in 2017.

The ECB met and left policy rates unchanged, no surprise there.

GCC equities outperformed their peers last week, led by Kuwait. In Kuwait, the stock market had another good week with daily volumes quite impressive by recent standards: KD 60-70 million on some days for the first time since 2013. The IMF issued its Article IV report, forecasting 3.5% non-oil growth for 2017 and 2018; NBK expects 3.5% and 4.0%.

International macroeconomics

USA: The December CPI inflation was above 2.0% y/y, for the first time since 2014, though the core CPI was very steady, running at 2.2% y/y, its average for 2016. Higher energy prices were the main factor behind the rises, as they were behind higher PPI and CPI numbers around the globe. This effect should abate for now, as further rises in oil prices appear contained. US inflation should also be checked by the recent strength in the USD, and by limited wage inflation, notwithstanding Janet Yellen's statement regarding full employment and firmer inflation.

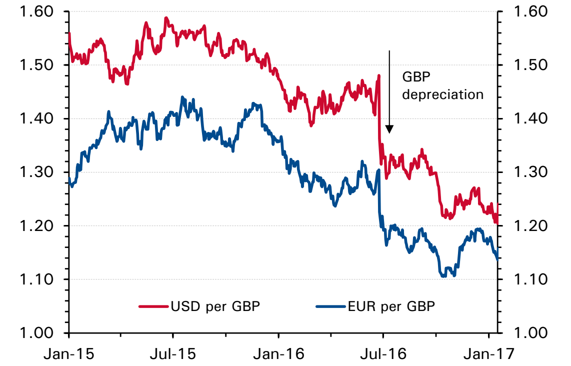
The Fed, and everyone else, will be fully focused on data, and on the new administration in the months ahead. The Philly Fed activity index rose to 19.7 for January. The improvement in recent months takes the index to its best level since 2014.

Eurozone: The European Commission asked Italy to cut its budget deficit by 0.2% of GDP. Italy had been expecting to get approval to overshoot its EU-mandated target. The move appeared to put into doubt the recently agreed €20 billion bailout being considered to shore up Italian banks.

China: China's fourth quarter GDP beat expectations and grew 6.8% y/y, and the growth for 2016 as a whole was 6.7%; the pace was within the government's target of 6.5-7.0% y/y. Though slower than 2015's GDP growth of 6.9%, the steady decline signals that the economy is on the

Chart 1: UK pound exchange rates

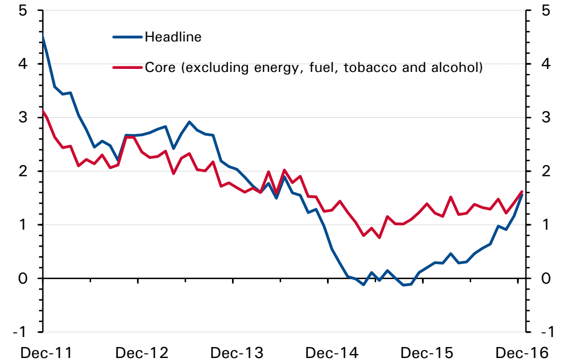
(foreign currency per pound)



Source: Thomson Reuters Datastream

Chart 2: UK inflation

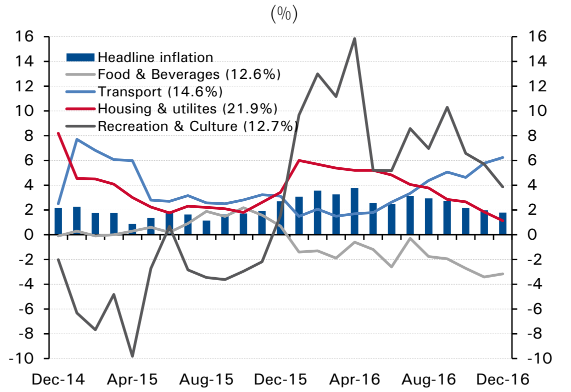
(% y/y)



Source: ONS, Thomson Reuters Datastream

Chart 3: Qatar inflation

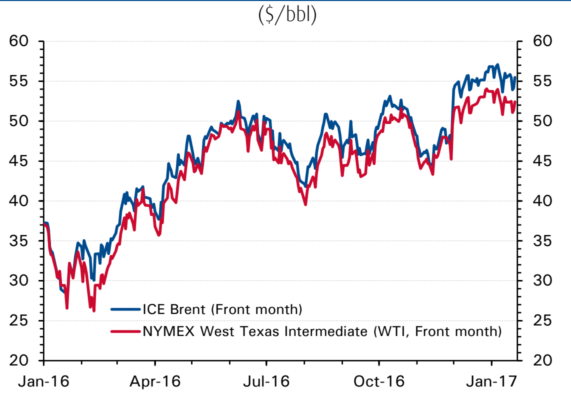
(%)



Source: Thomson Reuters Datastream

Chart 4: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

path of a soft landing. Given the possible move towards more protectionist trade measures in the US, China needs to solidify its reliance on domestic drivers, and to wean itself off debt-driven investment growth.

UK: PM Theresa May's speech and Brexit took center stage last week. The PM finally confirmed her intent to exit the EU entirely rather than retain "bits of membership", the so-called "hard" Brexit. She envisaged the UK striking a "bold and ambitious" free-trade agreement with the EU and becoming an associate member of the EU's customs union by opting out of the common external tariffs requirement that would preclude the UK from signing free trade agreements with the rest of the world. The PM also confirmed that both houses of parliament would have a say in triggering Article 50 and in the substance of the final deal with the EU.

Her comments brought some relief to the pound, with the GBP rising almost 3.0% against the USD last Tuesday—its best daily performance since 2008. (Chart 1.) By the end of the week, the pound had pared back some of its earlier gains after December's retail sales figures were published, which showed a fall of 2% m/m—the worst monthly decline in more than five years. Sterling closed Friday at 1.24 against the dollar.

UK inflation accelerated in December to 1.6% y/y, the fastest rate in over two years. (Chart 2.) Higher fuel and food costs were the main contributors as well as the weaker GBP.

GCC & regional macroeconomics

Kuwait: The IMF Article IV report, which follows an October 2016 visit, had few surprises. The Fund's outlook is only slightly weaker than our own, with nonoil growth steady at 3.5% in 2017 and 2018 (versus our 3.5% and 4%) driven by government capital spending. The IMF sees inflation rising to 4.5% in 2017 based on the upcoming utility price hikes, before easing to 3.6% in 2018.

Saudi Arabia: The IMF revised its growth forecast for Saudi real GDP for 2017, lowering it from 2.0% to 0.4% on the expectation that oil GDP would contract on the back of the oil production cuts (>486,000 b/d). Growth will rebound in 2018 to 2.3%, the IMF stated. The revised outlook for 2017 is considerably below the Saudi Ministry of Finance's forecast of 2.0% and our forecast of 0.8% this year. Like NBK, the IMF expects non-oil growth to recover this year as oil prices firm, government spending increases (including payments to contractors) and confidence returns to the private sector, but by 2.0% compared to our projection of 1.0%.

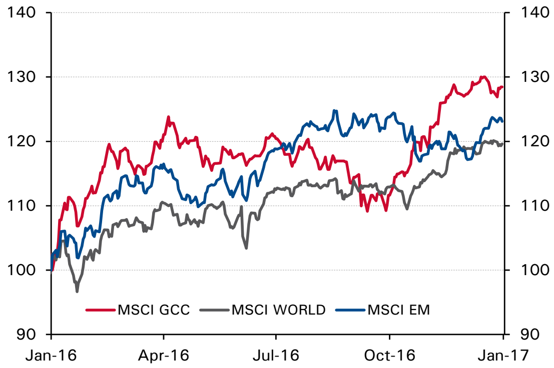
Qatar: Inflation in December 2016 came in at 1.8% y/y; this brings the average inflation for the year to 2.8% y/y, compared to 2015's average of 1.7% y/y. The IMF is forecasting 2.6% y/y for 2017

Egypt: The IMF published details of the reform program that was the basis of a $12 billion loan approved in November 2016. The program includes steps already taken like the VAT and floating the currency, as well as measures to further reduce energy subsidies and improve the business environment. Tighter monetary and fiscal policy is a key element of the program, which will coincide with deep structural reforms to boost job creation, foreign investment and exports.

A roadshow kicked off to issue $2-2.5 billion in government USD bonds. The issuance will consist of 5 and 10-year paper, with a possible smaller 30-year tranche. Egypt hopes to raise $5-6 billion internationally in 2017. The sovereign is rated B-/stable or equivalent by S&P and Moody's; Fitch's rating is a notch higher. All three agencies upgraded Egypt once since Mr. Sisi assumed power, but they remain 4-5 notches below pre-2011 ratings.

Chart 5: Global stock markets

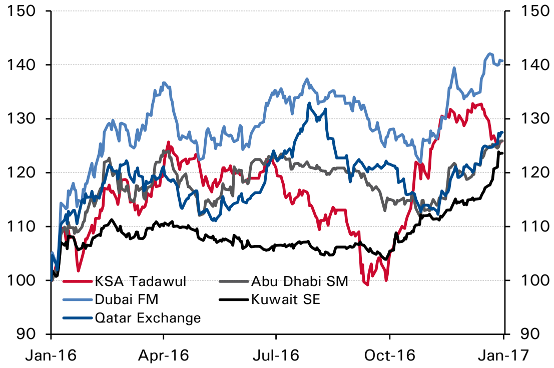
(rebased, 21 Jan 2016=100, total return)



Source: Thomson Reuters Datastream

Chart 6: GCC stock markets

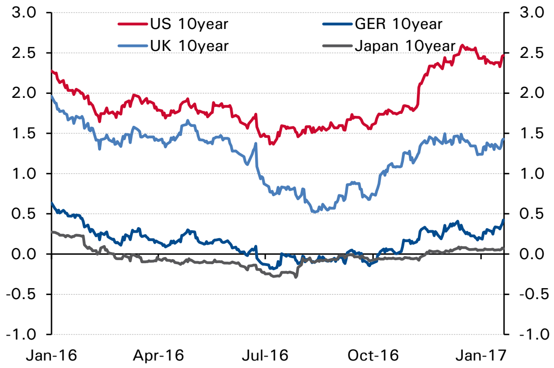
(rebased, 21 Jan 2016=100))



Source: Thomson Reuters Datastream

Chart 7: Global bond yields

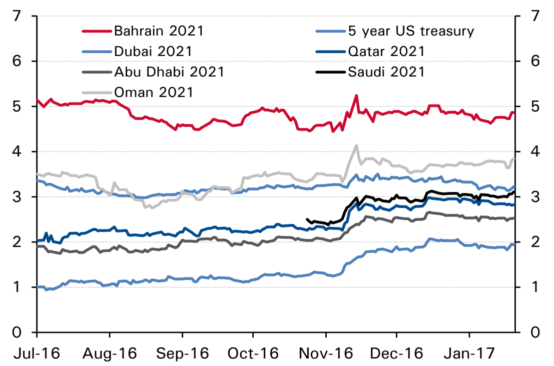
(%)



Source: Thomson Reuters Datastream

Chart 8: GCC bond yields

(%)



Source: Thomson Reuters Datastream

Markets – oil

Oil prices were little changed; markets focused on rising US shale supplies against the backdrop of higher oil prices. (Chart 4.) The IEA said that higher oil prices are likely to trigger a "significant" boost in US shale output. Oil remained steady at $55.5/bbl (Brent) and $52.4/bbl (WTI) on Friday, despite an industry report that showed that US crude stocks had fallen by 5.04 million barrels in the previous week and despite comments from Saudi Arabia that deeper-than-planned production cuts and robust demand were helping the market to rebalance.

Markets – equities

Equities had another unimpressive week with most markets registering setbacks. Capital markets seem to be on standby ahead of earnings announcements and further clarity from Trump's transition. The S&P 500 and DJIA were off 0.1% and 0.2%, respectively. European equities underperformed, with the FTSE 100 and Euro Stoxx 50 closing the week down 1.9% and 0.7%, respectively. Fears of a "hard" Brexit following Theresa May's speech weighed on European markets. Italian bank stocks took another hit after the EU asked Italy to make additional budget cuts, raising doubts about the expected bailout. Emerging markets (EM) gave up some gains following weeks of outperformance, with the MSCI EM retreating 0.4% on the week. (Chart 5.)

GCC markets outperformed last week, led by a strong performance in Kuwait. The MSCI GCC advanced 0.5%. (Chart 5.) Kuwait continued to outperform with its value-weighted index up 4.1% on the week and 7.4% year-to-date (ytd). Volumes saw a further pick-up to levels not seen in years. It's still unclear what's behind this strong rally. Technically, Kuwait has lagged the region for years, and the acquisition of Americana and the upcoming minority share buyout may have been enough to trigger a long overdue rally. Another factor is the upcoming change in the composition of frontier market (FM) indices and expectations that Kuwait's weight will increase. Otherwise, it's been all about earnings announcements lately, particularly in Saudi Arabia and Dubai, with mixed results so far. (Chart 6.)

Markets – fixed income

Benchmark bonds sold-off on the week on hawkish Fed talk, Brexit, and the inauguration of President Trump. Hawkish remarks by Fed members over the week culminated with a speech by Fed Chair Janet Yellen. In her view, the US economy seems to have amassed adequate momentum that may warrant gradual rate hikes. This, and stronger US inflation data, sent US Treasury yields higher.

The ECB meeting on Thursday was a non-event, with little news announced and the MPC keeping its rates and asset purchase program unchanged. Despite the observed pick-up in inflation, Mario Draghi voiced some skepticism over its long-term sustainability. This saw benchmark yields remain relatively steady.

President Trump's speech seemed to prioritize economic growth. This drew little attention from US 10-year Treasuries, which saw yields edge up to 2.47%. Bunds, however, rose 5 bps following the remarks, and finished the week at 0.42%, their highest in a month. (Chart 7.)

Saudi Arabia's, Oman's and Bahrain's 5-year yields rose on the week, while the rest of the GCC was flat. Saudi Arabia was up the highest on the week. It saw the yield on its 2021 paper increase by 12 bps. (Chart 8.)

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