Fed to hike rates December 14; non-OPEC to cut production; Trump and oil supporting equities

Key Market Indicators

Stock markets	Index	Change (%)	
		weekly	YTD
Regional			
Abu Dhabi SM	4,517	4.84	4.87
Bahrain ASI	1,192	1.21	-1.97
Dubai FM	3,559	5.88	12.94
Egypt EGX 30	11,298	-2.29	61.26
KSA Tadawul	7,118	0.24	2.98
Kuwait SE	5,599	0.54	-0.28
Muscat SM 30	5,671	1.45	4.90
Qatar Exchange	10,054	1.41	-3.60
MSCI GCC	709	1.01	56.97
International			
DAX	11,204	6.57	4.29
DJIA	19,757	3.06	13.38
FTSE 100	6,954	3.32	11.40
Nikkei	18,996	3.10	-0.20
S&P 500	2,260	3.08	10.55

Commodities	$/bbl	Change (%)	
		weekly	YTD
Brent crude ($/bbl)	54.3	-0.24	45.73
KEC ($/bbl)	49.5	1.08	74.62
WTI ($/bbl)	51.5	-0.35	39.04
Gold ($/t oz.)	1158.4	-1.47	9.25

Exchange rates	Rate	Change (%)	
		weekly	YTD
KWD per USD	0.305	0.18	0.63
KWD per EUR	0.327	0.28	-0.94
USD per EUR	1.056	-1.04	-2.81
JPY per USD	115.36	1.60	-4.10

Interbank rates	%	Change (bps)	
		weekly	YTD
Kibor – 3 month	1.38	0	-31
Qibor – 3 month	1.70	0	39
Libor – 3 month	0.96	1	34

Fixed income	%	Change (bps)	
		weekly	YTD
Regional			
Abu Dhabi 2021	2.50	-3	N/A
Dubai 2021	3.31	-6	-33
Qatar 2021	2.77	0	N/A
Saudi Arabia 2021	2.91	-5	N/A
International			
UST 10 year	2.47	7	20
Bunds 10 year	0.37	9	-27
Gilts 10 year	1.46	8	-50
JGB 10 year	0.06	1	-20

Source: Thomson Reuters Datastream

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Summary

Equities advanced further this week in the region and internationally, as oil prices held firm above $50 /bbl (Brent), and as US president-elect Trump shored up his image as a doer. He first convinced (or pressured) AC maker, Carrier, to keep in the US a plant that employs 1100 people. A few days later, he announced that Japanese telecom giant Softbank had committed to invest USD50 billion in the US while creating 50K jobs. These individual deals, by themselves, will not be enough to fix the US economy, but nonetheless, provide further cause for optimism (US equities) as investors eye the new presidency (and Congress). The University of Michigan consumer survey confirmed that jump in sentiment, with the metric surging from 93.8 to 98.0 in December, its highest level in over 10 years.

These visible success stories are feeding into the narrative of an incoming hands-on president who will not take "no" for answer, at a time when many sectors are positive in anticipation of lower taxes, reduced regulation, and new infrastructure spending.

As US data remain healthy (e.g. PMIs), the Fed will finally hike rates on December 14, by 25 bps to a new federal funds rate target of 50-75 bps. (Chart 1.) The fixed-income markets are already priced for such a move, and the primary GCC central banks (KSA, UAE, Kuwait) are expected to follow suit, just as they did in December 2015.

At its December 8 meeting, the ECB decided to extend its current QE program by 9 months until the end of 2017, while reducing the amount it will purchase monthly, from EUR 80 billion to EUR 60 billion (as of 4/17).

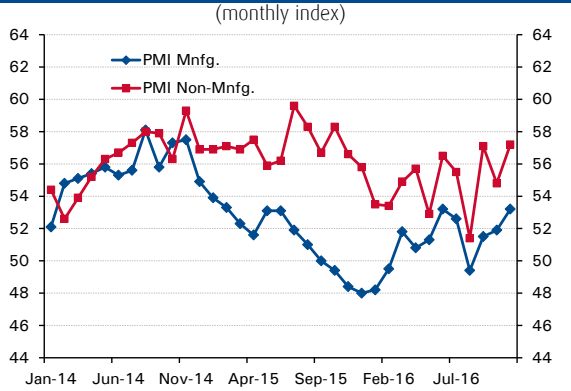
The ECB digested the results of last week's referendum, which saw PM Matteo Renzi resign after reforms he had proposed/endorsed were soundly rejected at the polls. The election was technically to reform the constitution, but turned inevitably into a plebiscite on Renzi himself. There continues to be concern about the ability of a new government to help troubled and undercapitalized Italian banks and also about the rise of anti-EU sentiment as Europe faces important elections in France, Germany and the Netherlands in 2017

Nonetheless, the EU and other markets took the Italian results in their stride, rising on the day. There continues to be a sense that central banks and governments will continue (and succeed) in doing "whatever is necessary" to keep markets and economies afloat. The markets took two weeks to adjust (or to ignore, for now) Brexit, one night to digest Mr Trump's election, and less than that to assimilate Renzi's defeat. These political "shocks" seem to have become "routine". Resilience is good, complacency not so much, and sometimes it's hard to tell one from the other.

More good news for oil markets as non-OPEC countries, led by Russia, agreed to support OPEC and cut production by 558,000 b/d. This strengthens the recent OPEC agreement.

Chart 1: US PMIs

(monthly index)



Source: Institute Of Supply Management

Local economies and markets are bound to benefit from the overall positive sentiment, and certainly from higher oil prices. Equities which had been underwater for most of the year are finally in the black or close to that (on a ytd basis).

In Kuwait, Prime Minister Sheikh Jaber al-Mubarak al-Sabah was reappointed to form the new government, following parliamentary elections that saw 60% of the National Assembly's members replaced. The move was no surprise and reflects a commitment to maintain capital spending plans while pursuing fiscal reform.

For the GCC region, growth, though softer, remains in decent shape in the non-oil economy, as attested by recent PMI activity indexes. We continue to expect moderate GDP growth for the next 2 years, close to 2% overall, and around 3% on a non-oil basis (led by Kuwait and Qatar). In light of the above, we are seeing the early stages of renewed interest in the region on the part of foreign investors, both on the fixed-income and on the equity sides.

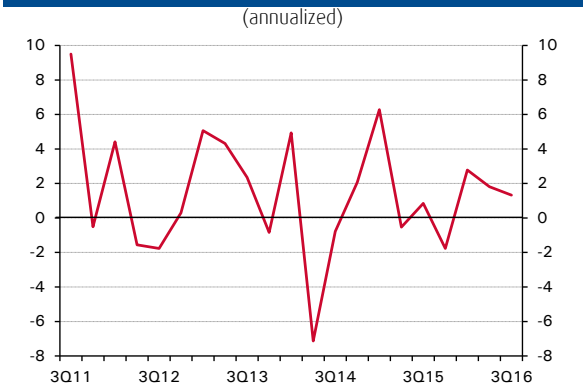
International Macroeconomics

Eurozone: Italy's referendum saw Italians reject proposed constitutional reforms that were meant to streamline the legislative process. In line with earlier poll predictions but above expectations, close to 60% rejected the proposed change. As a result, Italian Prime Minister Matteo Renzi announced his resignation. On the bright side, the market jitters that followed the result, which were fanned by rising anti-establishment fears, faded rather quickly. Italian banks, however, remain in funding limbo. Rumors abounded surrounding funding scenarios. It is believed that the government may take EUR2 billlion controlling stake in Monte dei Paschi (a likely event given the ECB's recent rejection of an extension for more time to recapitalize) and a EUR15 billion loan from the European Stability Mechanism to help re-capitalize other ailing banks.

The EZ composite PMI registered at 53.9, slightly below its flash estimate of 54.1, driven by strong expansion in Germany, Ireland, and Spain, across both manufacturing and services. The more complete reading also re-confirmed the transmission of inflationary momentum from input prices to output prices.

Chart 2: Japan real GDP growth

(annualized)



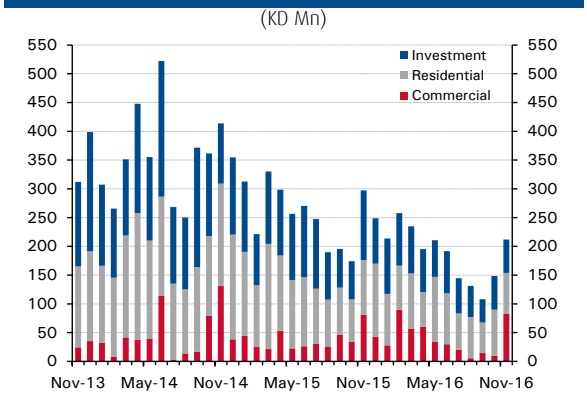
Source: Thomson Reuters Datastream

Japan: Japan revised down its third-quarter GDP growth rate from a preliminary annualized reading of 2.2% to a much lower 1.3% due to bigger-than-expected cuts in capex and inventories. (Chart 2.)

UK: The UK's trade deficit narrowed from GBP5.8bn in September to GBP2bn in October, an unexpectedly large fall which is also the largest since records began in 1998. While the data showed that exports increased and imports decreased, the ONS believes that it is too early to link it conclusively to the weaker pound

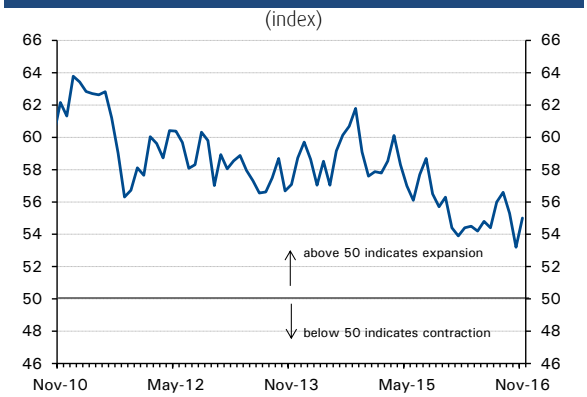
Meanwhile, the ONS also reported that construction activity unexpectedly slowed in October, with the sector contracting 0.6% m/m. The fall was due to a decrease in new construction orders for big public projects such as schools and hospitals. Industrial activity was disappointing as well, the sector, which accounts for almost 15% of the UK economy, contracted by 1.3% in October.

Chart 3: Kuwait real estate sales



Source: Kuwait Ministry of Justice

Chart 4: Saudi PMIs



Source: Emirates NBD/Markit

Chart 5: UAE PMIs

Source: Emirates NBD/Markit

GCC & Regional Macroeconomics

Kuwait: Activity in the real estate sector in Kuwait picked up slightly in November, supported by the commercial sector. (Chart 3.) Year-to-date sales were down 26% from the same period last year. The commercial sector was the exception, posting positive ytd growth of 5%. Prices remain soft, with the NBK real estate price indices down 9.5-12.6% y/y.

Production from two oil fields shared by Kuwait and Saudi Arabia could resume in 2017. Khafji and Wafra have been shuttered since October 2014 and May 2015, respectively, reportedly for technical reasons. Resumption to full production, which could take some time, would bring back around 0.5 mb/d in output, half of it for Kuwait. Kuwait is likely to offset the rise by reducing output elsewhere, keeping overall production steady at just under 3 mb/d on average in 2017. The CEO of Kuwait Oil Company (KOC), Jamal Jaafar, reiterated recently that Kuwait's crude oil production capacity will be raised to 4 mb/d by 2020, up from around 3.1 mb/d now.

The Ministry of Electricity and Water (MEW) announced plans to move ahead with a power and water generation project in Nuweiseeb. The project is a major co-generation plant, with a power generation of 3GW and a water desalination capacity of 75 million imperial gallons a day. This project is only the first phase of the 6GW planned for the Nuwaiseeb site. This major utility project is tendered as an EPC contract and is part of the MEW's plan to install an additional 17.5GW of electricity generation capacity by 2030.

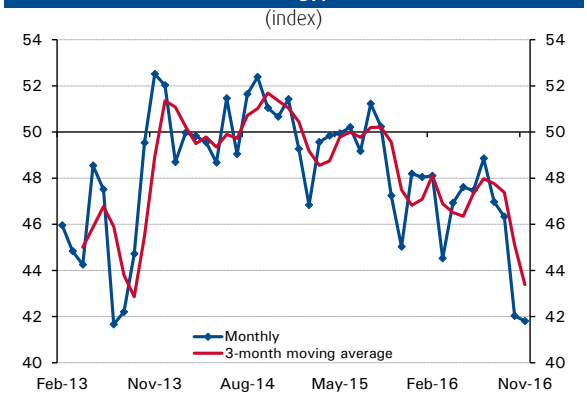
Saudi Arabia: In a sign of improving business sentiment in Saudi Arabia, the headline Saudi PMI index reversed course in November after two consecutive months of declines, rising to 55.0 from 53.2 in October. (Chart 4.) In marked contrast to October's PMI, there were gains across the board, especially in output, new orders, purchasing activity and input stocks; these all increased at a faster rate according to survey respondents. New orders accelerated to a 3-month high in November, with many respondents citing improved marketing and an uptick in demand from overseas buyers as the main reasons for the index's gains.

UAE: The headline PMI rose from 53.3 in October to 54.2 in November as an increase in new orders and purchases and strong output helped offset some of the weakness in new export orders. (Chart 5.) Thanks to relatively stable domestic economic conditions, new orders accelerated from 53.2 in October to 56.4 in November and the quantity of purchases edged up from 54.9 to 56.8 during the same period. Output held strong at 59.8. Employment also gathered some momentum in November, rising to a four-month high of 51.8 amid an improvement in business conditions.

As expected, the shareholders of both the National Bank of Abu Dhabi (NBAD) and First Gulf Bank (FGB) approved the proposed anticipated merger between the two banks. At a combined value of USD178 billion, the merger will create the Middle East's biggest bank in asset terms and has potential synergies. Whilst NBAD is known its high credit rating, FGB is renowned for its strong consumer-banking segment. The merger is scheduled for the first quarter of 2017.

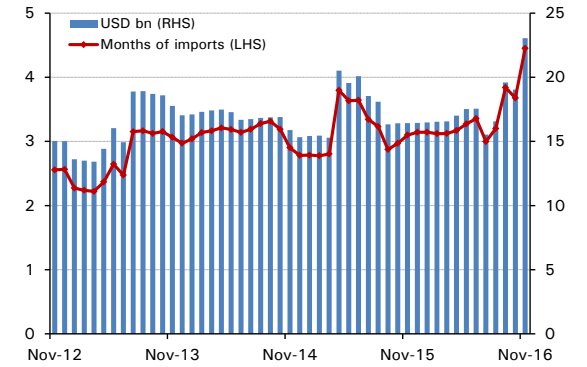
Oman: News reports hinted at a 5% cut in spending but no increase in revenue for the 2017 budget. This comes at odds with previous reports

Chart 6: Egypt PMIs



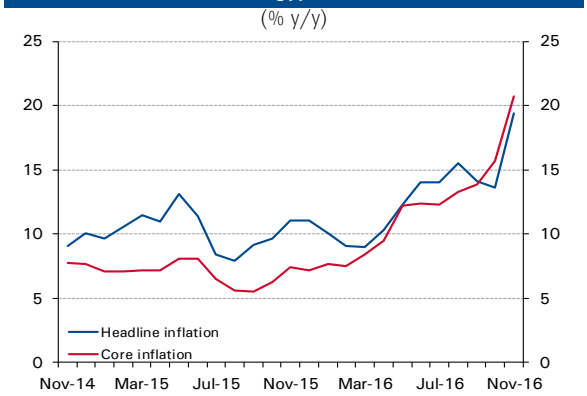
Source: Markit

Chart 7: Egypt official reserves



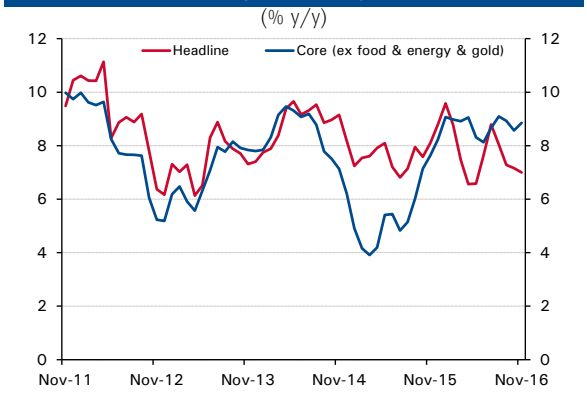
Source: CBE, Thomson Reuters Datastream, NBK estimates

Chart 8: Egypt inflation



Source: Central Bank of Egypt, Thomson Reuters Datastream

Chart 9: Turkey consumer price inflation



Source: Thomson Reuters Datastream

that had indicated that there would be no cuts to wages and benefits and an increase in non-oil revenue. We expect Oman's deficit to reach -20% of GDP in 2016 and -15% of GDP in 2017.

Following their meeting in Oman, non-OPEC members agreed to cut their oil output in support of the broader OPEC agreement. Oman has pledged to cut its oil production by 45,000 b/d. This has led us to revise our 2017 real oil GDP growth forecast downwards to -3.3%, causing overall real GDP to be mostly flat in 2017.

Egypt: The PMI remained under pressure in November, slipping to 41.8 despite a notable improvement in export orders (Chart 6). The figure revealed the difficult economic challenges facing Egypt, especially following the recent decision to float the country's currency. The latest PMI reading suggests that real GDP could grow by less than 1%, though growth could average around 3.5% for the fiscal year 2016/17. Price pressures remained elevated and rising across the board.

Official reserves saw a sharp rise in November, as expected, adding a net of USD4 billion to reach USD23.1 billion (4.5 months of imports). (Chart 7). During the month, reserves benefited from the first tranche (USD2.75 billion) of the USD12 billion IMF loan; another USD2 billion came from a financing deal that the central bank had arranged with global banks. The move to float the Egyptian pound on 3 November should relieve much of the pressure on reserves in the months ahead. The Central Bank of Egypt announced USD1 billion of inflows received in November, exceeding expectations.

Inflation jumped to 19.4% y/y in November, pushed up by Egypt's recent decision to float its currency and the subsequent 50% decline in the value of the pound. (Chart 8.) Inflation is expected to remain high in the coming months before it eases. While inflationary pressures are expected to continue to be stoked by further hikes in subsidized prices in 2017, they should be partly offset by tighter monetary policy.

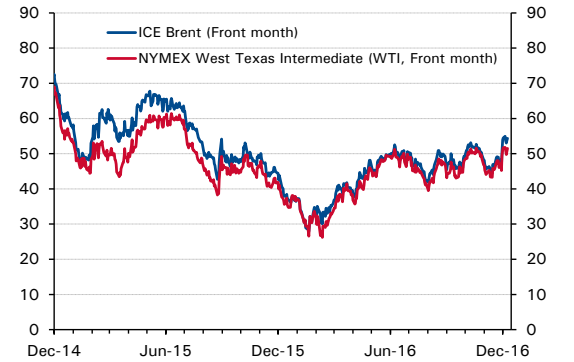
Turkey: Turkey's central bank got a bit of a reprieve after CPI inflation slowed to a six-month low in November. (Chart 9.) CPI inflation eased for the fourth consecutive month in November to 7.0% y/y, from 7.2% y/y in October. However, the recent sharp drop in the lira, which hit new lows in early December, is likely to push inflation higher in the near-to-medium term, particularly in the transport component (15% of the CPI basket). Turkey is a net importer of oil, and the recent recovery in oil prices and the lira's ongoing depreciation against the USD, have pushed inflation in the transport segment higher. In November it hit a more-than-two-year high of 9.6% y/y.

Markets - Oil

Oil prices posted two consecutive days of gains after Saudi Arabia informed its non-Asian customers that crude shipments in January will be curtailed, and after it became apparent that a non-OPEC production cut would likely be sealed later in the week. Brent had climbed 2.5% over Thursday and Friday by the time it closed at $54.33/bbl. WTI closed on Friday at $51.5/bbl, a rise of 3.5% since last Wednesday. (Chart 10.) Prices have surged more than 17% since the eve of OPEC's announcement on 30 November that it would cut its production by 1.2 mb/d as of January 2017.

Chart 10: Benchmark crude oil prices

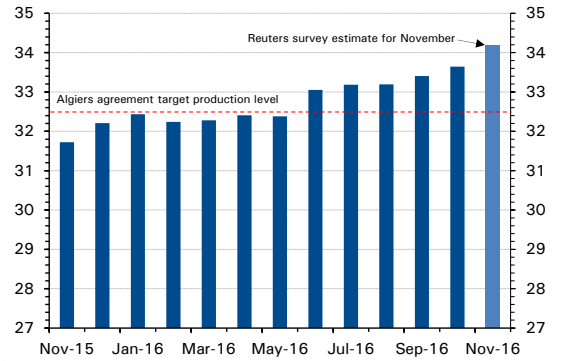
($ per barrel, $/bbl)



Source: Thomson Reuters Datastream

Chart 11: OPEC crude oil production

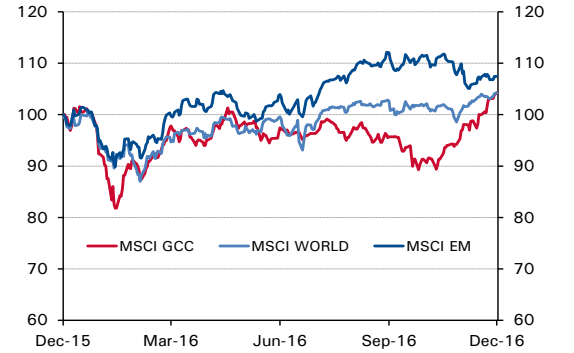
(million barrels per day, mb/d)



Source: OPEC secondary sources, Reuters survey

Chart 12: Total return indices

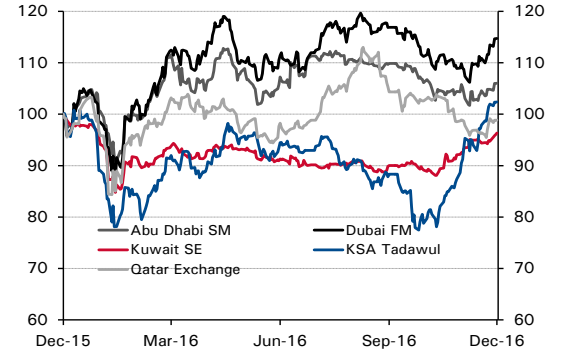
(rebased, 8 Dec 2015=100)



Source: Thomson Reuters Datastream

Chart 13: GCC Markets

(rebased, 8 Dec 2015=100)



Source: Thomson Reuters Datastream

Yesterday's non-OPEC meeting certainly delivered, with Russia and 9 other non-OPEC members including Mexico, Kazahkstan, Oman and Malaysia formally pledging to join with OPEC and bring oil production down, by a combined 558,000 b/d. The accord represents the first joint OPEC and non-OPEC collaboration to manage supply since 2001.

Moreover, soon after the non-OPEC meeting, Khaled Al-Falih, the Saudi oil minister, went on record to say that Saudi Arabia, depending on market conditions, would rein in output to even below 10 mb/d, a psychologically important production 'floor' that the kingdom has not breached in almost 2 years. Saudi Arabia and its fellow producers may indeed need to consider more sweeping cuts if November's preliminary production estimates are higher than the current target. (Chart 11.)

Markets - Equities

Most global equities continued their upward trend, with the MSCI World Total Return Index up 3.3% on the week. (Chart 12.) Markets were supported by a flow of positive data from the US and Europe. Even the mild upset on the Italian referendum was pretty much short-lived. In fact, European equities outperformed last week, with the Euro Stoxx 50 up 6.1% as expectations of a QE extension by the ECB materialized. The S&P 500 Total Return Index was up 3.1% while EM market equities underperformed, advancing 2.2%.

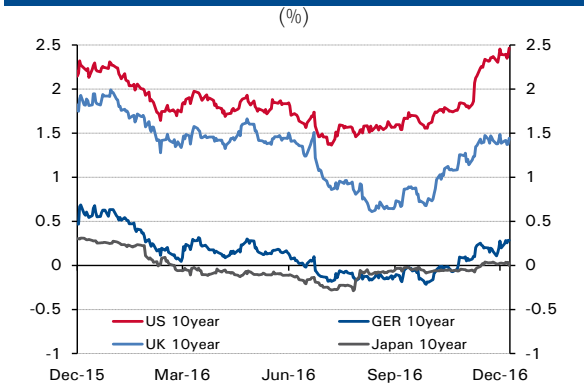
GCC markets underperformed last week, with the MSCI Total Return Index closing the week up by 1%. (Chart 13.) Emirati markets saw by far the best performance with the Dubai Financial Market and the Abu Dhabi Securities Exchange's indices up 5.9% and 4.8%, respectively, on the week. With the largest foreign investor base among their peers, Emirati equities stand to benefit most if international investors increase their allocation to the oil-rich gulf, following OPEC's recent decision to cut output. The rallies in Dubai and Abu Dhabi were also driven by company-specific factors including shareholders' approval for the merger of Abu Dhabi National Bank and First Gulf Bank. Meanwhile, the rally in KSA's Tadawul lost some steam with the index advancing a mere 0.3% last week. Still sentiment in Saudi remained quite positive, getting a further boost by the King's decision to allocate an additional USD26.7 billion to the Kingdom's Public Investment Fund. These additional funds are to be invested in both domestic and international markets.

Markets - Fixed income

Benchmark yields edged higher following the negative outcome of Italy's referendum only to come back down, once investors realized that the political fallout would be limited. (Chart 14.) Rates then steadied as investors held out for the ECB decision, which, despite its surprise "tapering" on Thursday, caused less volatility than expected. Yields have edged upwards for most benchmarks following the ECB announcement, closing the week higher by up to 9bps, with the bunds curve steepening.

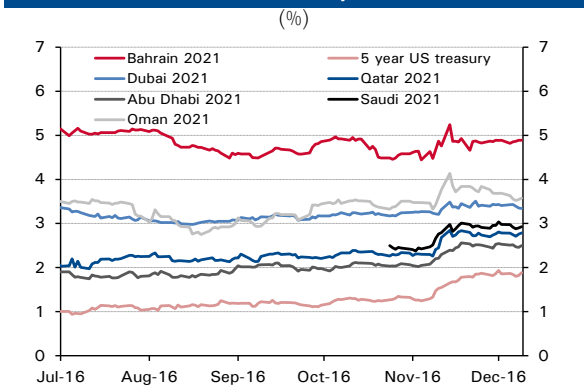
ECB governor Mario Draghi announced on Thursday the extension of the QE program by a further 9 rather than the expected 6 months. The amount purchased monthly would be reduced from EUR80 billion to EUR60 billion, although Draghi maintained his prerogative to extend or re-increase the purchases as necessary. In his words, "tapering has not been discussed" at the announcement, which is technically correct since the announced program will buy EUR540 billion worth of assets over 9 months versus EUR480 billion over 6 months had the program adhered to expectations. Markets, however, are not subscribing to that reasoning, with investors reacting as if the program were "tapering". Other

Chart 14: Global benchmark yields



Source: Thomson Reuters Datastream

Chart 15: GCC yields



Source: Thomson Reuters Datastream

announcements that day saw the inclusion of 1-year paper and assets that yield lower than the deposit rate to the basket of eligible purchases, addressing scarcity concerns. Key ECB rates were left unchanged.

Markets have priced in a Fed rate hike, which is expected at the 14 December meeting, with close to 100% certainty. Future rate hike expectations were also tempered by Fed officials before entering the FOMC blackout period, with Fed officials indirectly asking for coordinated fiscal and monetary policies. Fed officials expect 2 rate hikes in 2017, but uncertainty is high and more clarity is needed on Mr. Trump's new policies.

GCC yields were mostly lower-to-flat following the OPEC announcement. Abu Dhabi, Saudi Arabia, and Oman benchmarks were down between 3 bps and 12 bps on the week, as higher oil prices signaled improved fiscal positions. Dubai, Qatari, and Bahraini yields were little changed. (Chart 15.)

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