Fed confirms QE unwind, possible December rate hike; Qatari banks see inflows of government cash

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,455	-0.58	-2.01
Bahrain ASI	1,308	0.32	7.17
Dubai FM	3,633	-0.68	2.88
Egypt EGX 30	13,695	0.62	10.94
S&P GCC 40	1,040	-0.30	-9.98
Kuwait SE	6,849	-0.94	19.15
KSA Tadawul	7,326	-0.64	1.61
Muscat SM 30	5,100	1.96	-11.80
Qatar Exchange	8,361	-0.58	-19.89
International			
CSI 300	3,838	0.17	15.94
DAX	12,592	0.59	9.68
DJIA	22,350	0.36	13.09
Eurostoxx 50	3,541	0.74	7.62
FTSE 100	7,311	1.32	2.35
Nikkei 225	20,296	1.94	6.18
S&P 500	2,502	0.08	11.76

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	56.9	2.23	0.07
KEC	53.5	2.29	2.33
WTI	50.7	1.54	-5.70
Gold	1293.3	-2.05	12.46

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.301	0.06	-1.39
KWD per EUR	0.361	0.00	13.39
USD per EUR	1.195	0.09	13.69
JPY per USD	111.970	1.02	-4.19
GBP per USD	1.349	-0.74	9.36
EGP per USD	17.610	-0.16	-2.17

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor - 3 month	2.45	0.0	35.0
Kibor - 3 month	1.75	0.0	31.3
Qibor - 3 month	2.50	6.9	71.7
Eibor - 3 month	1.56	0.6	8.1
Saibor - 3 month	1.79	0.0	-24.1
Libor - 3 month	1.33	0.7	33.0

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.13	-1.8	-40.5
Dubai 2021	2.92	2.1	-37.4
Qatar 2021	2.78	6.2	-15.5
Kuwait 2022	2.47	6.2	n/a
Saudi Arabia 2021	2.95	6.2	n/a
International			
UST 10 Year	2.26	6.0	-17.0
Bunds 10 Year	0.45	1.4	24.4
Gilts 10 Year	1.36	4.6	11.5
JGB 10 Year	0.02	0.2	-2.5

Source: Thomson Reuters Datastream; as of Friday's close 22/09/2017

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Overview

The US Fed announced last week, as expected, that it would start to unwind its QE program in October and may also consider a further interest rate rise this year, amid broad optimism on the outlook for growth and a tightening labor market. The Fed's main challenges are the complexity of the unwind operation, the potential market reaction and still puzzlingly-weak inflation figures: inflation is now not expected to hit the 2% target until 2019.

Meanwhile, UK Prime Minister Theresa May's Brexit speech on Friday struck a relatively conciliatory tone. But it is unclear whether her proposal of a 2-year transition period for the UK (after 2019) and continued payments to the EU will be enough to ease gridlocked negotiations with the EU over the terms of the UK's withdrawal and subsequent trading arrangement. Just hours later, Moody's – which had held off from a downgrade after the UK's referendum result last year – lowered the UK's rating one notch to Aa2, citing both Brexit-related uncertainty facing businesses and still-weak public finances.

In another solid week for oil markets, Brent crude prices closed at $56.9, the highest since January. Despite continued resilience in US production, OPEC members appear increasingly confident that the global market is rebalancing and are prepared to postpone a decision on extending current production cuts until January – well after the group's next official meeting in November.

In the Gulf, there were further signs of the impact of the diplomatic crisis on Qatar's financial sector, with latest figures showing that the government injected an additional $8 billion in deposits into the banking system in August to offset further large non-resident outflows – and some $26 billion since the crisis began. Although the stock market (QSE) ended the week on a positive note, supported by local buying, it had earlier hit a new 5-year low and remains down some 20% so far this year.

International macroeconomics

USA: There were no major surprises at the latest FOMC meeting where the Fed announced it would begin unwinding its $4.5 trillion balance sheet in October at the pace already outlined in its June statement. Up to $10 billion in assets will be allowed to mature monthly without being replaced; the figure will increase by $10 billion quarterly until it reaches $50 billion.

The Fed also kept its policy rate unchanged, though the likelihood of a hike in December jumped to 70% following the meeting. An overwhelming majority at the Fed signaled, via the dot-plots, that it expected such a December move. The Fed's dot-plots also show the FOMC members expect three further 25 bps hikes in 2018, though market expectations are not quite there yet.

The economic data remained solid. August housing starts were generally robust, coming in slightly above expectations at 1.18 million despite some negative impact from the severe hurricane season. The impact of the weather was felt in home sales which came in at the weaker end of expectations. Meanwhile, the Philadelphia Fed Business Outlook Survey ticked up for September maintaining a relatively robust level at 23.8 (or 58.7 on a PMI-comparable basis). (Chart 1.)

Eurozone: The eurozone seemed steadfast in its recovery as recent economic data pointed to robust growth. Germany's September ZEW survey revealed greater investor optimism, surprising at 17 (10.9 in August), while producers reported increased prices, up 2.6% y/y, the highest since May. Stronger momentum was also evident across the Eurozone as September's flash composite PMI came in at 56.7, up 1 point from August, pointing at solid 3Q17 prospects. Core country dynamics were also encouraging, with Germany and France both recording their highest PMI performances in six years.

France revised down its deficit outlook for 2017 and 2018 to 2.9% (3.0%) and 2.6% (2.7%) of GDP, respectively. The improvement stemmed from further cuts to spending, supported by the resurgence of economic activity.

German elections take place today, with polls still showing a comfortable lead for Angela Merkel and her Christian Democrats (37%). While this may grant her a win, she will still need to form a potential coalition for a governing majority.

China: S&P downgraded China's long-term sovereign credit rating by one notch, from AA- to A+ amid growing concerns about its rising levels of debt. This is the nation's second rating downgrade this year, after Moody's cut its rating by one notch back in May. China has become increasingly reliant on strong credit growth over the years to help prop up its economy, but this has also increased its exposure to financial risks. Whilst efforts have been made to mitigate these risks, they have not been fast enough.

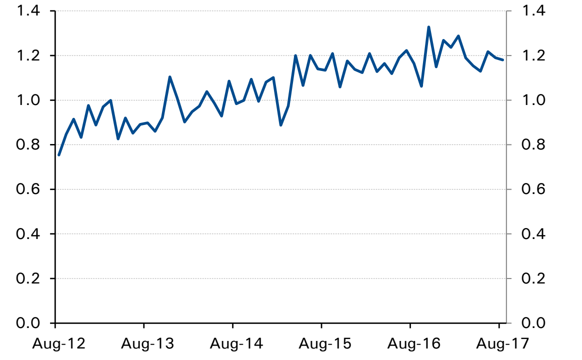
Japan: Exports continued to bounce back strongly in August, thanks to healthy global demand and some yen weakness. Growth in exports jumped to an almost four-year high of 18.1% y/y. (Chart 2.) The strength in exports should continue to support the economy. Growth in imports also remained elevated at 15.2% y/y reflecting in part higher oil prices.

UK: In a highly-anticipated speech in Florence, PM Theresa May set out her plans for a two-year transition period that would, essentially, keep Britain in the EU in all but name after 2019. During this time, the government hopes to continue to have access to the single market and to be a part of the customs union; in return the country would be prepared to continue to abide by all EU rules and regulations, including the free movement of EU workers and the payment of budgetary contributions to Brussels. However, the PM explicitly ruled out paying for single market access beyond the expiration of the transition deal, the so-called Norway model. The speech was welcomed by the UK business community, which has all along been fearful of a "cliff-edge" exit from the EU in the absence of a trade agreement. EU leaders were also more receptive to the PM's somewhat conciliatory speech, although they cautioned that there is still much work to be done and too little time.

Moody's downgraded the UK's credit rating by a notch to Aa2 (with a stable outlook), citing weakening public finances and the potential negative impact of Brexit. Moody's was not confident that the government would be able to secure a free trade agreement with the EU before it formally leaves the union in 2019. The UK's rating is now two notches below the triple A rating the country had enjoyed for 35 years until 2013. Sterling reacted to the news by weakening, falling below $1.35.

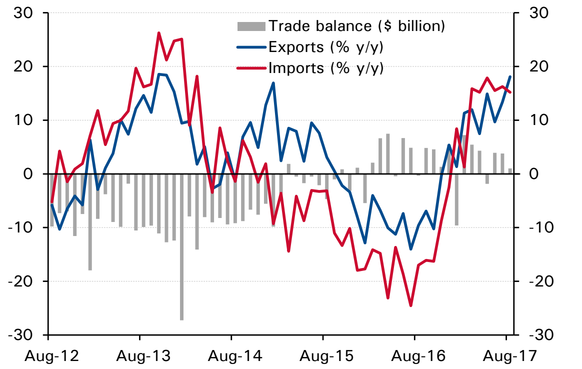
Chart 1: US housing starts

(million)



Source: U.S. Bureau of Labor Statistics

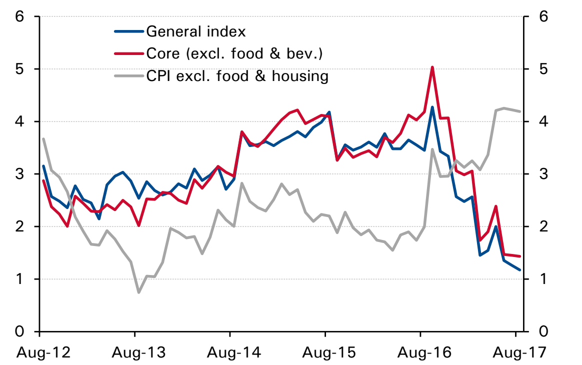
Chart 2: Japan trade



Source: Thomson Reuters Datastream

Chart 3: Kuwait consumer price inflation

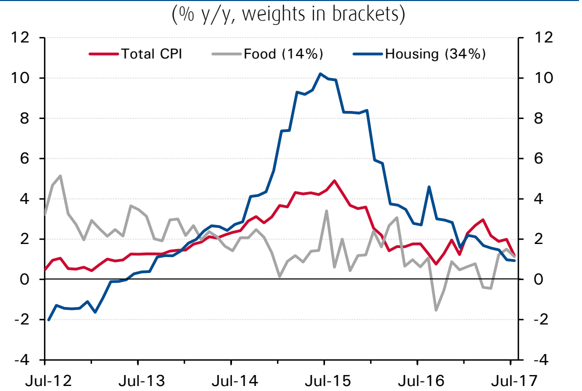
(% y/y)



Source: Central Statistical Bureau

Chart 4: UAE consumer price inflation by sector

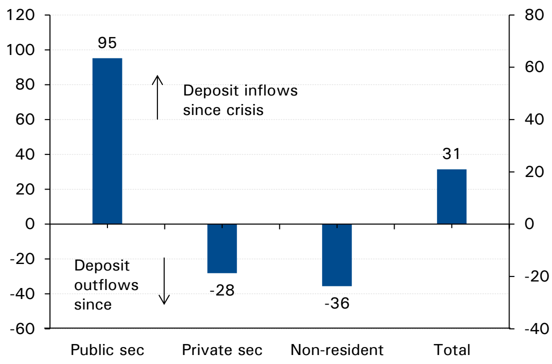
(% y/y, weights in brackets)



Source: Thomson Reuters Datastream

Chart 5: Qatar commercial bank deposits

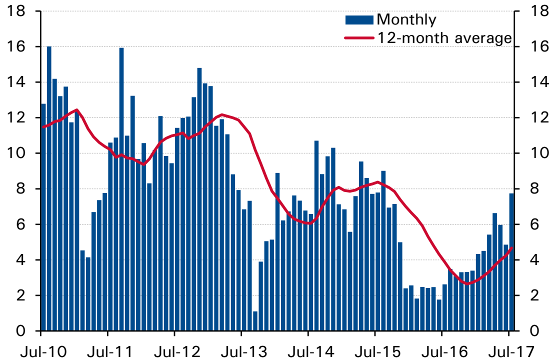
(Change between May and August, QAR billion)



Source: Thomson Reuters Datastream, QCB, NBK

Chart 6: Egypt tourism

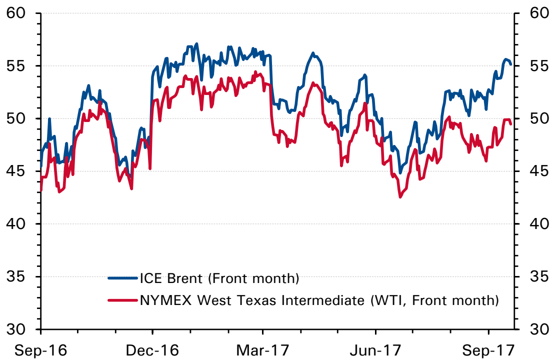
(number of hotel nights, million)



Source: Central Agency for Public Mobilization and Statistics

Chart 7: Benchmark crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

Chart 8: Total return indices

(rebased, 22 September 2016=100)

Source: Thomson Reuters Datastream

GCC & regional macroeconomics

Kuwait: Inflation in consumer prices eased slightly to 1.2% y/y in August (Chart 3.) Weak housing rent and food inflation continued to offset higher growth in transportation costs. We still expect inflation to average around 2% in 2017, down from 3.5% in 2016, but are likely to see inflation move higher in 2018 as global food inflation picks up and the housing market begins to improve once again.

Saudi Arabia: Saudi Arabia is reportedly planning to raise gasoline and jet fuel prices by the end of November, having earlier indicated that the second round of subsidy cuts would be pushed back into next year. The gasoline price rise would put it at parity with international prices. However, it was reported that the authorities might put a cap on diesel and heavy fuel oil prices in 2018, in view of their importance to the economy as inputs for power generation and industrial production.

The kingdom sold its third riyal-denominated sukuk last week, raising another SR 7 billion ($1.9 billion) in a heavily oversubscribed issuance. So far this year, the authorities have sold almost SR 71 billion ($18.9 billion) in domestic and international Islamic bonds, helping the country bridge about 34% of an expected budget shortfall of SR 207 billion ($55.2 billion), or 8% of GDP, this year.

UAE: Consumer price inflation maintained its downward trend in July, dropping to just 1.2% y/y from 2.0% y/y in June, amid softer food and housing inflation. (Chart 4.) The drop inflation in July was also led by a decline in costs in the transportation and clothing segments. We expect inflation to edge higher in the near-to-medium term and average close to 2.5% for the year, as higher oil prices push inflation in the transport segment up, housing inflation gathers some momentum and October's planned excise tax drives up the cost of selected goods. The tax, which will be levied at 100% on tobacco and energy drinks and 50% on fizzy drinks, is projected to add around 0.5% to inflation for one year.

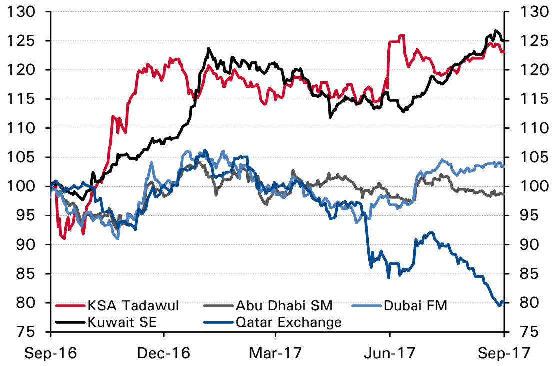
Qatar: Latest central bank figures show how the diplomatic crisis continues to affect the funding climate for banks, with the government injecting another large amount of cash into the system in August. Public sector deposits surged QAR29 billion ($8 billion) from July, leaving them up 70% y/y, and more than offsetting another heavy month of non-resident outflows of QAR8 billion. The government has now injected some QAR95 billion in deposits since the crisis began, lifting its share of total bank deposits to 37% from 26%. (Chart 5.)

The net effect of these huge injections has been a leap in overall deposit growth to 20% y/y in August from 12% in May. Moreover, the pace of non-government deposit withdrawals has slowed from the earlier months of the crisis, so the financial situation may be stabilizing somewhat: domestic private sector deposits actually saw a small m/m rise in August. Note, however, that there continues to be a delay in releasing the more comprehensive monetary data set that would reveal, among other things, the impact on central bank foreign reserves.

Egypt: Tourism continued to recover strongly, with July's number of nights spent at hotels by tourists rising to 7.7 million, the highest figure in nearly two years. (Chart 6.) The sector has been bouncing back, with tourism receipts more than tripling during 2Q17 compared to a year ago, thanks to a cheaper currency. Improving security conditions are also contributing to the recovering economy.

Chart 9: GCC markets

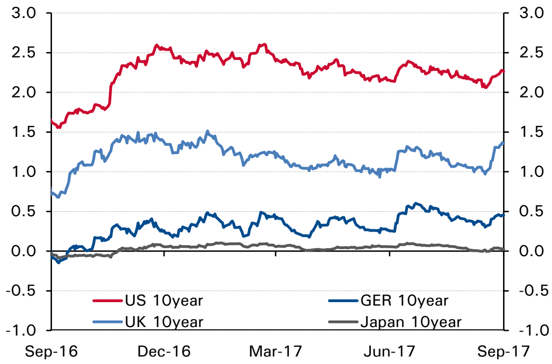
(rebased, 22 September 2016=100)



Source: Thomson Reuters Datastream

Chart 10: Global benchmark yields

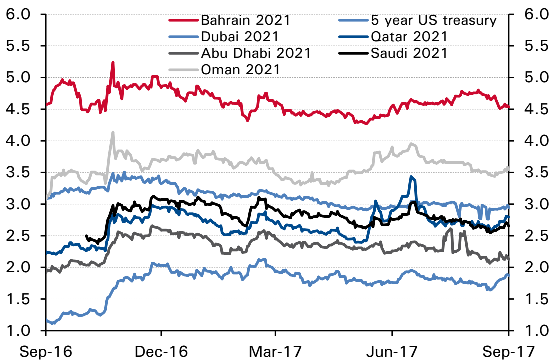
(%)



Source: Thomson Reuters Datastream

Chart 11: GCC yields

(%)



Source: Thomson Reuters Datastream

Markets – oil

It was another relatively positive week for oil prices, with Brent crude closing at its highest level, $56.9 (+2.3% w/w), since January, and WTI topping $50 (+1.5% w/w) for the first time since May. (Chart 7.) Both markers are up by between 7-9% in September, with Brent also up into unchanged territory on a year-to-date basis.

Oil's gains last week came despite the Joint Ministerial Monitoring Committee (JMMC) meeting in Vienna wrapping up without any decision on extending or deepening the OPEC/non-OPEC production cuts. In the run-up to the meeting there had been increasing chatter coming out of the OPEC camp about the possibility of rolling over the group's production cuts beyond March 2018, possibly by a further 3-6 months. Iraq even suggested that the cuts should perhaps go deeper, by an additional 1%. (Iraq has yet to comply fully with the current agreement, which targets cuts of 4-5.0%).

Markets – equities

Markets were back in 'risk on' mode as geopolitical tensions and hurricane fears took a backseat, but North Korea worries re-emerged later in the week, trimming equity gains. Nevertheless, most equity markets still managed to close the week in the green with the MSCI World All Country index up 0.5%. US equities continued to make new highs but retreated slightly towards the end of the week. The S&P 500 and DJIA closed up 0.1% and 0.4%, respectively. European equites outperformed with the Euro Stoxx 50 up 0.7%. Emerging market equities edged up with the MSCI EM closing the week 0.2% higher. (Chart 8.)

Regional markets underperformed again last week with the MSCI GCC down 0.7%. The heavily-weighted Saudi market saw some profit-taking with the Tadawul general index off 0.6%. Meanwhile, Qatari equities continued to slide with the market's general index down 0.6% on the week and 16% since the onset of the crisis that has plagued its relationship with other GCC/Arab states. (Chart 9.)

Markets – fixed income

Benchmark yields extended their climb on a more hawkish Fed, but were capped late in the week by a pick-up in tensions over North Korea. 10-year US treasuries were up 6 bps on the week to settle at 2.26%, while 10-year Bunds were little changed at 0.45%. (Chart 10.)

In a mild surprise, 12 of 16 FOMC members still expect a higher federal funds rate this year.. This saw the market probability of a rate hike for Dec-17 jump to 70%, from about 30% a few days earlier. Also the FOMC consensus appears to be around 3 further hikes in 2018.

GCC sovereign yields tracked US treasuries higher. Yields for Qatar 2021 and Kuwait and Saudi 2022 were each up 6 bps. Meanwhile, Abu Dhabi 2021 and Dubai 2021 were mixed, with the former down 2 bps, while the latter was up 2 bps. (Chart 11.)

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