Most GCC central banks hike interest rates following Fed move; oil prices rise to above $65

Overview

As expected, the US Federal Reserve increased interest rates by 0.25%. Markets mostly took the well-telegraphed move in stride, with the news that two FOMC members dissented against the decision being interpreted as mildly dovish. Indeed, other key central banks left policy rates on hold last week, and confidence appears to be growing that, although global monetary policy will tighten in 2018, the current broadly favorable climate for risk-based assets such as equities will persist.

The price of Brent crude surged early in the week to above $65/bbl for the first time in over two years, driven by the shutdown of the Forties pipeline system in the UK’s North Sea – key for the Brent pricing structure. The closure is likely to last a few weeks, though is not expected to have a large impact on the global demand-supply balance. Prices edged back down later in the week on a further climb in US crude production (now 9.78 mb/d) and surprisingly weak US gasoline demand.

Following the Fed’s rate decision, central banks in four of the six GCC countries announced rate hikes of their own. Of the remaining two, Oman’s policy rate has been drifting up anyway in recent months, while Kuwait’s central bank kept rates on hold “to avoid stifling non-oil growth”. The Kuwaiti dinar’s peg to a currency basket has traditionally afforded the CBK slightly more flexibility in setting interest rates than its GCC peers.

International macroeconomics

USA: The Fed increased the federal funds rate target by 25 bps to 1.25-1.50%, in a move that was largely expected. The Fed continued to expect three hikes in 2018, though its growth outlook for 2018 was upped to 2.5% from 2.1% as it factored in the impact of recent tax cuts. Its forecast for inflation remained unchanged. Market expectations of further hikes in 2018 cooled slightly, probably reflecting the increase in dissenting votes to two. The CME Group’s estimated probability for a hike in March 2018 fell to 48% from 66%.

Tax reform moved a step closer to realization after the House and Senate agreed on a merged tax reform bill. Some last minute obstacles that threatened the bill were ironed out by the end of the week. The legislation is expected to go to a vote this week and the White House to sign the bill before the end of the year. Meanwhile, Congress will be focused on a spending bill this week, as lawmakers seek to avoid a government shutdown later this month.

Core inflation disappointed in November. While headline inflation picked up thanks to an increase in gasoline prices, core inflation remained subdued at just 0.1% during the month. (Chart 1.) Annual core inflation slipped to 1.7% y/y. Producer price inflation continued to indicate rising price pressures, with the core PPI up 0.3% in November.

Retail sales were strong in November. Sales excluding autos and gasoline jumped by 0.8% m/m. Meanwhile, industrial production saw a modest 0.2% gain in November, though growth picked up to a robust 3.4% y/y.
Eurozone: The European Central Bank kept rates unchanged last week, though in a sign of increased confidence in the economy, it raised its growth forecast for 2018 to 2.4%. At the same time, while the ECB is going forward with a taper of its asset purchase program (QE) at the start of 2018, it signaled its readiness to increase those purchases once again if conditions warrant. Indeed, the ECB still sees inflation running well below its 2% target in the coming three years.

The economic data came in strong last week, as the eurozone appears to be closing an unexpectedly strong year in good form. The flash PMI for the area rose to 58, its highest level in nearly seven years. Meanwhile, industrial production for October also came in robust, gaining 0.2% during the month, with the index up 3.7% y/y.

Japan: Japan’s annualized real GDP growth eased slightly in 3Q17, but at 2.5% remained near the two-year high of 2.9% recorded in 2Q17. (Chart 2) Growth has mainly been export-led, thanks to a weak yen and a gradual improvement in global demand. Exports grew by a healthy 14% y/y in October. In contrast, retail sales contracted slightly during the same month, by -0.2% y/y. The strength in export growth has helped offset some of the ongoing weakness in the consumer sector. With consumption still relatively weak, Japan is unlikely to tighten its current monetary policy in the medium-to-long term, in a bid to help prop up growth in the sector.

UK: Fresh off securing the EU’s preliminary nod to advance Brexit negotiations, the government suffered a legislative defeat over its EU Withdrawal Bill. Eleven Conservative ‘rebels’ (out of 316 Tory members), along with the other opposition parties, voted against the bill, essentially giving parliament the last word on the terms of the Brexit agreement.

On Friday, the EU-27 acknowledged that “sufficient progress” had indeed been made on the Brexit “divorce bill” and agreed to move negotiations on to the next stage. Sterling, however, fell in response to Brussels’ publication of guidelines for phase two, which ruled out discussions on trade until at least March. The currency was down 0.8% against the US dollar on Friday to $1.332, though the FTSE-100 was up 0.5%.

Inflation reached 3.1% in November, its highest level in more than five years. Continued sterling weakness, which is pushing up the cost of imports, was a major factor in the increase. The Bank of England (BoE) agreed last Thursday to keep rates unchanged, judging that inflation is close to its peak but that “further modest increases” in interest rates would be likely (possibly two in 2018) to bring the headline rate back down to the 2% target in the medium term. Ahead of the decision, the yield on the 10-year UK gilt rose 2 bps to 1.22%; it then settled back at 1.15% by the week’s end.

GCC & regional macroeconomics

Kuwait: Last week saw the formation of a new government, which included nine (out of 16) new members. This is the seventh cabinet to be led by Prime Minister Sheikh Jaber Al-Mubarak, who has been in that role since 2011. The most noticeable change was the appointment of Sheikh Nasser Sabah Al-Ahmad, who had been heading the Amiri Diwan, to the senior role of First Deputy Prime Minister and Minister of Defense. In another surprise, the head of the CMA, Mr. Nayef Al-Hajraf, was tapped for Minister of Finance to replace Mr. Anas Al-Saleh, who was named minister in charge of cabinet affairs and will have a more direct impact on the government’s legislative priorities.
In response to the Fed rate hike, the CBK decided to keep the discount rate (DR) at 2.75%, making it the second time it holds off hiking its key rate during the current Fed cycle of rising rates. However, the CBK indicated it might continue to take steps to push bank deposit rates higher while keeping bank lending rates as they are. The CBK explained that, in keeping the DR unchanged, it sought to avoid stifling non-oil growth while continuing to take further action to maintain the dinar’s attractiveness.

The trade surplus was mostly steady at KD 1.4 billion in 3Q17, though there was robust growth in both imports and exports. (Chart 3) Exports grew by 9.4% y/y, thanks to a 19% y/y increase in the price of oil. Imports also saw healthy 13% y/y growth, a trend which was already evident since the start of 2017. Imports, buoyed by improving non-oil activity, were up 9.2% y/y during the first nine months of 2017 on the heels of a flat year in 2016.

After a strong performance in October, real estate sales activity cooled in November. Preliminary numbers show a decline of 30% y/y in sales activity, with the greatest drop coming from the investment and commercial sectors. Real estate prices continue to stabilize; prices of investment buildings saw the first y/y increase since March 2016.

Saudi Arabia: The kingdom unveiled on Thursday a SR 72 billion ($19.2 billion) private sector support program, part of the SR 200 billion ($53 billion) stimulus program announced last year. The package will see extra money being made available to support small businesses and to construct more houses, two key targets of the Saudi Vision 2030 strategy. At least SR 24 billion is due to be dispensed in 2018, the Commerce and Investment Minister, Majid Al-Qasabi, said.

The authorities have also announced that the second round of fuel price rises will occur in January. The price of gasoline is set to rise by 80% and the cost of jet fuel will be normalized with international prices. These price rises will occur in January. The price of gasoline is set to rise by 80% and the cost of jet fuel will be normalized with international prices. These price rises were scheduled for mid-2017 but delayed due to concerns over the breakneck pace of the kingdom’s austerity program.

Following the US Fed’s lead, SAMA raised its benchmark reverse repo rate by 25 basis points to 1.5%. This is SAMA’s third interest rate rise of the year. The repo rate was left unchanged at 2.0%.

UAE: As widely expected, the central bank of the UAE raised its repo rate (its main policy rate), by 25 bps to 1.75%, in tandem with the 25 bps rate hike in the US Federal Fund’s rate. It also raised the rate on its certificates of deposit by the same amount.

Dubai’s government approved a record $15.4 billion of budgeted spending for 2018, up 20% from last year’s budget. The increase was driven by a 49% y/y rise in projected capex spending, mainly related to Expo 2020. Total revenue is to rise 13% y/y, with tax revenues up 47% y/y due to the introduction of the VAT. The budget deficit is expected to widen from $0.7 billion in 2017 to $1.7 billion (around 1.6% of GDP) in 2018.

The Dubai economy tracker, a good gauge of economic growth, was broadly steady at 5.5% in November thanks to the ongoing resilience in domestic conditions, particularly in the wholesale & retail trade and construction sectors. (Chart 4) The wholesale & retail trade sector is expected to hold strong in December, as consumers frontload spending ahead of the introduction of the VAT at the start of next year.

As part of the authorities’ reform program, 10% of state-owned oil giant ADNOC’s distribution arm began trading on the Abu Dhabi Securities
Exchange last week. It was Abu Dhabi’s first stock listing in over six years. The stock was well-received by retail investors, jumping by 16% within the first minute of trading, before ending the day up 6%. ADNOC raised $0.8 billion in the IPO, which valued the distributor at $8.5 billion.

Qatar: The central bank hiked its repo rate by 25 bps to 2.5% following the move by the US Fed. (Chart 5.) But its other policy rates were left unchanged. This is the first hike in the repo rate in the current tightening cycle. In the present climate, higher US rates present a challenge for the Qatari authorities: leaving rates on hold would risk inviting unwelcome pressure on the currency peg that had recently seemed to ease. But higher rates threaten to tighten credit conditions at a time when the economy is in need of support.

The government’s budget for 2018 signals a modest 2% rise in spending, including a focus on food security projects in light of the trade embargo and a rising wage bill to reflect the launch of new schools and hospitals. As usual, capital spending will account for nearly half of all outlays, with some QAR 11 billion allocated to sports projects – primarily stadia for the 2022 World Cup. Revenues are projected to rise 3% with forecasts based upon a conservative oil price assumption of $45/bbl, leaving the budget deficit almost unchanged from 2017 at QAR 28 billion.

We think spending will overshoot the government’s projections, as it has in the previous two years. However, the revenue estimates are also too pessimistic: we see a higher oil price of $55 next year. The result is that our projection is for a narrower deficit of QAR 19 billion, or 3% of GDP.

Oman: Fitch downgraded the government’s long-term credit rating one notch to BBB- from BBB, with a negative outlook – the lowest possible investment grade rating and only just above Bahrain. It cited the government’s still very large budget deficit (projected at 13% of GDP this year) and the absence of aggressive spending cuts as the government looks to safeguard social stability. It also cited uncertainty over the eventual successor to Sultan Qaboos. Fitch’s rating remains above Standard & Poor’s, which cut Oman further into sub-investment grade territory in November.

Bahrain: The central bank raised the rate on its one-week deposit facility (its key policy rate), as expected, by 25 bps to 1.75%. It also raised its overnight deposit rate from 1.25% to 1.50%, the one-month deposit rate from 2.15% to 2.40% and the lending rate from 3.25% to 3.50%.

Egypt: The current account deficit shrank to $1.6 billion or 2.5% of GDP in 3Q17, its lowest level in three years and down from its 8.1% peak in 4Q16. (Chart 6.) The quarter also saw the third consecutive quarter of strong financial flows, with net portfolio investments in Egypt topping $7.5 billion. Strong growth in tourism receipts, remittances and exports were the main drivers of the improvement. All three have benefited significantly from the drop in the pound and from external account liberalization.

Inflation eased to 26% y/y in November, mostly on base effects, as the jump in inflationary pressures that began a year ago started to fade. (Chart 7.) Price growth during the month was relatively modest at 1% m/m, a pace which has been maintained over the last four months.

Turkey: Economic growth jumped from 5.1% y/y in 2Q17 to a whopping six-year high of 11.1% y/y in 3Q17, thanks to strong gains in consumption, investment and exports. (Chart 8.) Exports witnessed double-digit growth for the third consecutive quarter in Q3, mainly on the back of ongoing...
currency weakness. The lira is currently down 8% ytd against the US dollar.

In a bid to maintain growth momentum, the central bank abstained from raising its key policy rate. It instead raised the rate on its late liquidity window by a less-than-expected 50 bps to 12.75%, in an effort to prop up the lira and rein in inflation. Inflation hit a 14-year high of 13.0% in November, as a weak lira continued to push up imported inflation.

**Markets – oil**

A relatively calm week for the oil markets saw Brent and WTI close on Friday unchanged week-on-week, at $63/bbl and $57/bbl, respectively. However, the closure of the Forties pipeline earlier in the week due to a hairline crack did push the price of Brent briefly to a two-year high of $65 last Monday. The pipeline, which transports one quarter of the UK’s 2 mb/d of crude production from the North Sea and a third of its offshore gas output, will be closed for several weeks for repairs. (Chart 9.)

In the US, crude production continued its seemingly inexorable rise, hitting another shale-era high of 9.78 mb/d last week. That is an unbroken run of eight consecutive weeks. Commercial crude inventories, meanwhile, fell for the fourth straight week to 442 million barrels, equivalent to 26 days’ worth of supply.

**Markets – equities**

International markets continued to advance for the fourth consecutive week, with the MSCI World All Country index closing up 0.5%. The Fed’s interest rate hike came as no surprise for the markets. US equities had already priced in the rate rise, with positive economic data released over the past two weeks solidifying expectations. The tax reform bill continues to pave its way to the White House with minimal expectations of hurdles. The S&P 500 and DJIA ended the week up 0.9% and 1.3%, respectively.

European markets retreated following the Fed rate hike and possible hikes in 2018, with the Euro Stoxx 50 index down 0.9% for the week. Italian equities fared the worst following the announcement of an election date. Emerging markets were up 0.4% for the week. (Chart 10.)

GCC markets were mostly up, with the MSCI GCC index closing up 0.8% on the week. The Saudi market didn’t react much to the SAR 19 billion stimulus package to fund housing and small businesses, ending the week down 0.1%. Qatar’s market soared, rising 5.6% on foreign institutional investor inflows. The Kuwait Boursa (weighted) index was up 1.5% for the week as a new government was formed and the central bank kept interest rates unchanged. (Chart 11.)

**Markets – fixed income**

Yields were off slightly last week, as inflationary pressures continued to appear weak. The Fed decision to hike was mostly priced in and most of the economic data came in as expected. Still, yields in the US slipped slightly as inflation for November continued to disappoint, and as the number of dissenting votes at the FOMC meeting increased to two. The 10-year Treasury yield slipped 3 bps to 2.36%. Yields in Germany and Japan did much the same (Chart 12). Regionally, benchmark yields were little changed, though markets continued to benefit from firmer oil prices (Chart 13).
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