China rumor triggers bond market sell-off; continued oil price rally sends Brent crude to $70 mark

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,591	0.94	4.38
Bahrain ASI	1,317	0.35	0.83
Dubai FM	3,495	0.90	3.70
Egypt EGX 30	15,242	3.11	1.50
S&P GCC 40	1,031	0.94	4.68
Kuwait SE	6,561	1.65	2.38
KSA Tadawul	7,338	0.84	1.49
Muscat SM 30	5,087	-0.34	0.80
Qatar Exchange	9,136	5.85	7.15
International			
CSI 300	4,225	2.08	4.82
DAX	13,245	-0.56	2.53
DJIA	25,803	2.01	4.39
Euro Stoxx 50	3,613	0.14	3.10
FTSE 100	7,779	0.70	1.18
Nikkei 225	23,654	-0.26	3.90
S&P 500	2,786	1.57	4.21

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	69.9	3.33	4.49
KEC	65.93	1.81	3.83
WTI	64.3	4.65	6.42
Gold	1333.4	0.99	2.07

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.301	-0.08	-0.14
KWD per EUR	0.363	2.37	2.37
USD per EUR	1.219	1.31	1.58
JPY per USD	111.030	-1.80	-1.46
GBP per USD	1.373	1.17	1.59
EGP per USD	17.660	0.00	-0.39

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor - 3 month	2.78	5.0	5.0
Kibor - 3 month	1.88	0.0	0.0
Qibor - 3 month	2.62	-0.8	-12.4
Eibor - 3 month	1.82	5.4	2.1
Saibor - 3 month	1.89	-0.1	-0.4
Libor - 3 month	1.72	1.6	2.6

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2022	2.99	6.2	4.2
Dubai 2022	3.07	4.4	-7.0
Qatar 2022	3.20	6.2	12.2
Kuwait 2022	2.95	10.2	14.2
Saudi Arabia 2023	3.25	5.2	3.2
International			
UST 10 Year	2.55	7.6	14.1
Bunds 10 Year	0.53	8.8	10.4
Gilts 10 Year	1.34	9.1	14.9
JGB 10 Year	0.07	1.5	2.4

Source: Thomson Reuters Datastream; as of Friday's close 12/1/2018

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Overview

While equity markets enjoyed another good week, the bond market saw a significant sell-off triggered by news of a possible reduction in monetary stimulus by the Bank of Japan and then rumors – subsequently denied by the Chinese authorities – that China would slow or halt its purchases of US government debt. Feeding the mood was also the latest core US inflation figure, which came in at a higher-than-expected 1.8% in December and pointed to a further Fed rate hike in March. US 10-year Treasury yields ended the week up 8 bps at 2.55%.

Oil prices continued their now 7-month climb, with Brent finishing the week fractionally short of the $70/bbl mark but still hitting a 3-year high. Prices were helped by an unexpectedly large 5 million barrel draw in US crude inventories, the eighth successive weekly decline. Meanwhile, President Trump decided to waive sanctions on Iran that were lifted as a result of the 2015 nuclear deal for a further 120 days. But his declaration that the waiver will not be renewed next time around means Iran may be forced to make steep cutbacks in supply by the summer.

Aside from boosting sentiment in the GCC and supporting financial markets, the rise in oil prices will have a meaningful impact on the region's fiscal position: every $1 rise in prices generates around $6 billion in oil revenues per year, or 0.4% of GDP. Based upon an oil price of $55, we forecast a regional deficit of 5% of GDP in 2018; but if oil prices were to stay at current levels, the fiscal position could be close to balance.

International macroeconomics

USA: Retail sales figures were solid in December while November's data was revised noticeably upward. Growth in retail sales excluding volatile autos and gasoline stood at 6.0% y/y, after December saw a decent 0.4% m/m rise. Sales were particularly strong in 4Q17, having registered a seasonally-adjusted gain of 8.4% during the quarter.

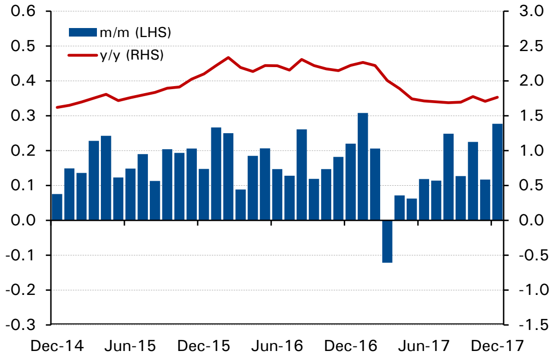
Inflation appeared somewhat stronger in December. Core consumer price inflation rose 0.3% m/m during the month, the strongest gain in nearly a year. The pace of annual inflation rose a notch to 1.8% y/y. (Chart 1.) This coincided with a healthy December increase in wage inflation, though weaker producer price growth during the month could indicate some continued softness in the coming months. The PPI rose by just 0.05% in December, with the annual pace slipping to 2.0% y/y.

Eurozone: The eurozone's economic environment improved some more last week, with unemployment reaching a 9-year low of 8.7% in November, and retail sales coming in surprisingly strong at 2.7%. Consumer and business optimism was also robust, with economic sentiment recording its best reading in 17 years (133 for December).

In Germany, Chancellor Merkel made significant progress toward forming a government, with the framework for a grand coalition now formalized. Some of the agreed upon policies include increased expenditures, tax cuts, and limits on immigration. The Social Democratic Party still needs to approve the framework at a party convention on 21 January.

Chart 1: US CPI inflation

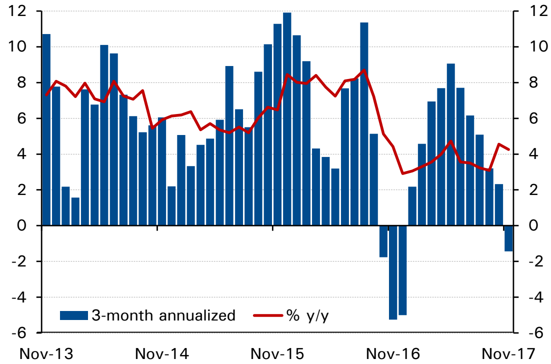
(% y/y)



Source: U.S. Bureau of Labor Statistics

Chart 2: Kuwait private credit growth

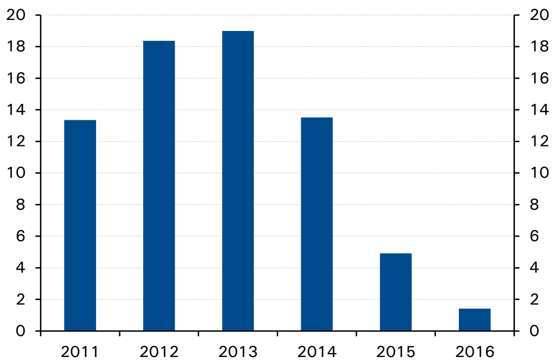
(%)



Source: Central Bank of Kuwait

Chart 3: UAE current account balance

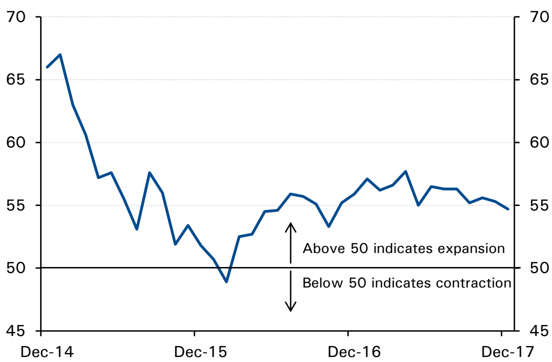
(% of GDP)



Source: Central Bank of the UAE

Chart 4: Dubai economy tracker

(index)



Source: Emirates NBD

China: Consumer price inflation rose in December to 1.8% y/y from 1.7% the month before. Average inflation cooled in 2017 to 1.6% y/y from 2016's 2.0%, falling further below the 3% government target. Higher producer prices, which rose to 6.3% y/y in 2017, may drive consumer prices higher. For now, the low-inflation environment allows room for a more active fiscal policy, while monetary policy remains broadly neutral.

GCC & regional macroeconomics

Kuwait: Credit growth slowed to 4.3% y/y in November 2017 (Chart 2) after bank credit to the private sector contracted by KD 140 million during the month. The decline is thought to be due to a large corporate repayment following the acquisition by Omantel of a KD 400 million stake in Zain. Credit was already softening before this, with growth during the three months ending in October slipping to an annualized 2.3%.

Boursa Kuwait announced a new exchange structure and rulebook, in a bid to boost liquidity and the market's attractiveness to investors. Equities will be split into three markets. The "Premier" market will have more stringent size and liquidity requirements, require companies to publish financial reports in both English and Arabic and to hold quarterly conference calls. Companies that do not meet these requirements and can maintain a certain level of liquidity will be listed on the "Main" market. All others will be listed on the "Auctions" market. The new rulebook also includes a new fee structure, and market-wide and stock-specific circuit breakers. Boursa Kuwait has not announced an implementation date, but it is likely sometime in 1Q18, with a one-year phase-in period for some listings.

Saudi Arabia: The authorities dispensed their second installment of welfare benefits for low and middle-income families under the Citizens Account social security program. It was reported that SR 2.1 billion ($560 million) had been deposited into eligible accounts. Welfare payments under the housing allowance program are expected to reach SR 35-45 billion this year (4.6% of the budget) and SR 60-75 billion by 2020.

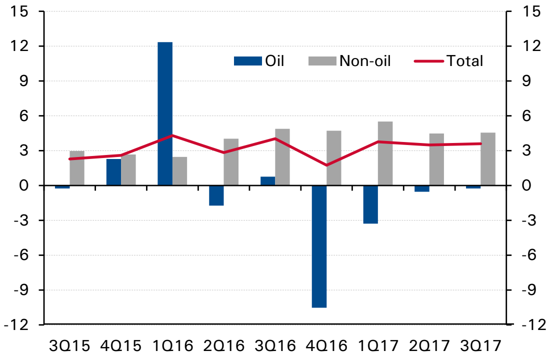
The government is reportedly in talks to increase the size of a $10 billion syndicated loan that it secured in 2016 from a consortium of HSBC, JPMorgan Chase and Bank of Tokyo Mitsubishi. An additional $5 billion could be sought to add to the $31 billion (SR 116 billion) the kingdom is expected to borrow this year as it attempts to bridge an expected budget deficit of $53 billion (SR 198 billion).

The Saudi bourse is adjusting its rules to make it easier for foreign investors to trade in the kingdom by changing the independent custody system (to allow investors to use a global custodian bank rather than a local broker) and portfolio order aggregation limits (which would allow fund managers to aggregate their orders and obtain better prices). Both changes will take effect from 21 January. The kingdom is seeking inclusion in the MSCI and FTSE emerging market indices this year.

UAE: Recently revised balance of payments data showed that the surplus on the current account fell from 4.9% of GDP in 2015 to a mere 1.4% of GDP in 2016, lower than the initial estimate of 3.2%. The lower surplus came on the back of a bigger than expected rebound in import growth (2.9% y/y versus the previously estimated 1.2% y/y), and a larger than previously forecast decline in oil export revenues (-24% y/y versus the initial estimate of -17% y/y). (Chart 3.) We expect the current account surplus to expand marginally in 2018 and 2019 against a backdrop of more stable oil exports and improving external demand.

Chart 5: Bahrain real GDP growth

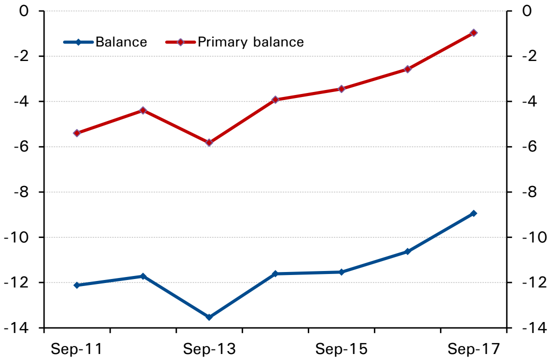
(% y/y)



Source: Information & e-Government Authority

Chart 6: Egypt fiscal balance

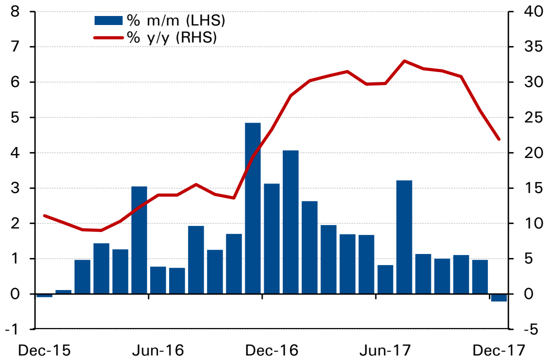
(% of GDP)



Source: Ministry of Finance, NBK estimates

Chart 7: Egypt inflation

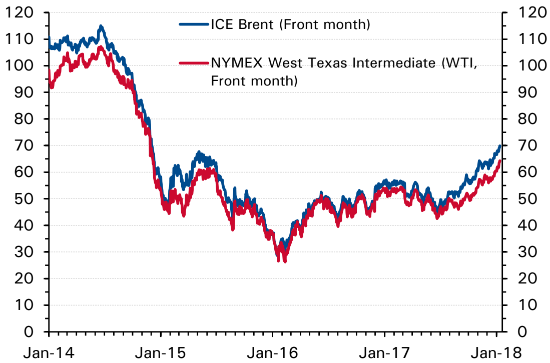
(%)



Source: Central Bank of Egypt

Chart 8: Benchmark crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

The Dubai economy tracker, a good gauge of economic growth, edged down from 55.3 in November to 54.7 in December. (Chart 4.) Nonetheless, it still logged a solid annual average of 56.0 in 2017, higher than the 53.8 average recorded in 2016, thanks to a recovery in domestic conditions, particularly in the wholesale & retail trade and constructions sectors.

Bahrain: Real GDP growth in Bahrain came in at a steady 3.6% y/y in 3Q17, thanks to ongoing resilience in the non-oil sector. Growth in the non-oil economy logged in a robust 4.6% y/y versus a 0.3% y/y decline in the oil sector. Non-oil growth remains supported by elevated levels of infrastructure spending, as well as gains in financial services, transportation & communications and social & personal services sectors. (Chart 5.)

Egypt: Inflation cooled in December to 22% y/y. The month actually saw a decline in the level of consumer prices, with the CPI falling 0.2% m/m. (Chart 6.) We expect inflation to cool further to around 13% by mid-2018, though given the soft December data, more rapid disinflation is possible.

Reforms continued to make progress, with the fiscal deficit narrowing to 8.9% of GDP during the first three months of FY17/18 (through September 2017) from 10.6% a year before. The primary deficit (excluding interest payments) shrank to 1% of GDP from 2.6%. (Chart 7.) Improvements have come from a more contained wage bill, and a jump in tax revenues as a result of the VAT introduction.

Egypt will be holding its third presidential election since the "Arab Spring" on 26-28 March. Registration should be completed in January and a second runoff round could be held by the end of April. Most expect President Abdel Fattah al-Sisi to win a second four-year term.

Markets – oil

Brent crude topped $70 in mid-day trading last Thursday as oil markets extended their bullish streak into a seventh consecutive month. Brent, which settled on Friday just shy of $70 at $69.9/bbl, and WTI, which ended the week at $64.3/bbl, closed out five consecutive days of gains to reach levels last seen in December 2014. (Chart 8.) Prices are already up this year by 5.5% on average, boosted by stronger winter crude demand, tighter supplies and dwindling stockpiles (-5 million barrels w/w in the US) – the latter two a direct result of the OPEC/non-OPEC production cuts.

Geopolitical risk has also lent oil prices a helping hand, with a string of actual or potential supply outages in oil-producing countries combining with US president Trump's threat to re-impose sanctions on Iran as the deadline to extend the 2015 Iran deal's sanctions waivers approached last Friday. As it happened, the president did extend them once again but, in move that is bound to dismay the JCPOA signatories, put the deal on final notice: without a tougher agreement to limit Iran's weapons development in the next four months, the US would withdraw from the agreement entirely and re-impose sanctions.

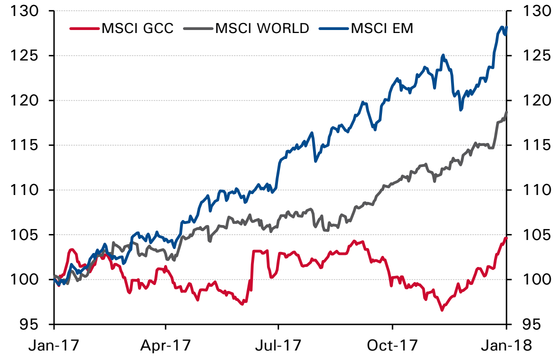
Markets – equities

Most international markets finished the week higher, buoyed by positive data, oil prices, and investors preparing for 4Q17 results. The MSCI's world index was up 1.3% on the week.

US equities continued to register new highs. The S&P 500 closed at 2786, and was up 1.6% on the week, while the DJI increased by 2.0%, to finish at 25803. Meanwhile, although strong eurozone consumer and business sentiment initially saw investors move into European equities, momentum

Chart 9: Total equity return indices

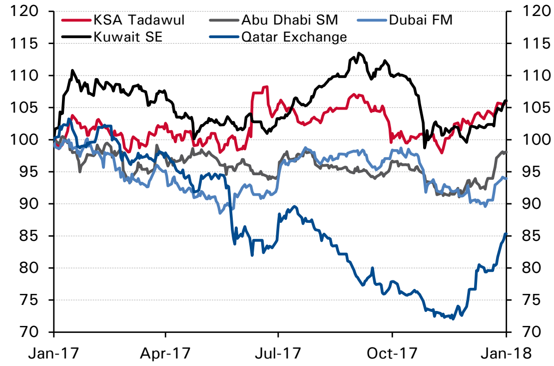
(rebased, 12 January 2017=100)



Source: Thomson Reuters Datastream

Chart 10: GCC equity markets

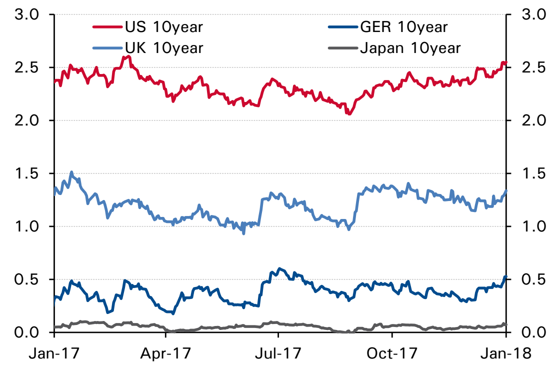
(rebased, 12 January 2017=100)



Source: Thomson Reuters Datastream

Chart 11: Global bond yields

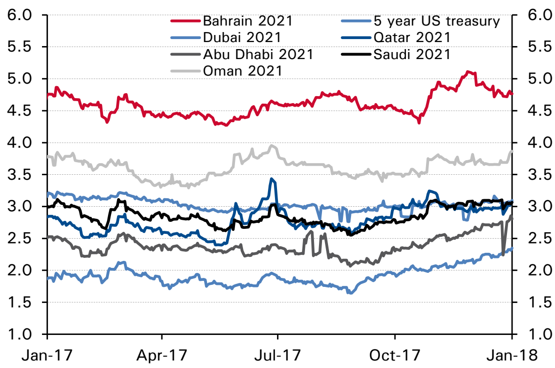
(%)



Source: Thomson Reuters Datastream

Chart 12: GCC bond yields

(%)



Source: Thomson Reuters Datastream

was muffled by a stronger euro. This left the Euro Stoxx 50 almost flat on the week. Emerging markets were up 0.7%. (Chart 9.)

In the GCC, performance was supported by oil prices and portfolio adjustments ahead of earnings, with Qatar benefitting the most. As a result, the MSCI GCC index was up 1.8% on the week. (Chart 10.)

Investors, both local and more so foreign, bought into Qatari stocks in a bid to chase dividends, helping the market outperform its peers (+5.9%). Meanwhile, Kuwait's weighted Boursa index was the second best performer, adding 1.6%, potentially supported by the upcoming overhaul of the exchange's structure. In Saudi, news of handouts to Saudi citizens initially lifted the Kingdom's stock market, but sentiment was held back following the arrest of several royals related to a major Saudi industry. As such, the TASI was up a relatively modest 0.8%. Abu Dhabi and Dubai, on the other hand, each saw a decent increase of 0.9%.

Markets – fixed income

Benchmark yields were pushed higher again this week on more speculation over the pace of global monetary tightening, news from China, and strong US inflation. (Chart 11.) A cut in the amount of long-dated debt purchased by the BOJ rattled markets early in the week, sparking fears of a sooner-than-expected wind down of the bank's QE program. The reaction came amidst strengthening Japanese data and accompanied hawkish remarks from ECB officials.

In their latest minutes, ECB board members revealed that they would actively reassess monetary policy in the face of increasingly positive data. This could see the current QE program ending sooner than expected and the focus gradually shifting to interest rate guidance. This brought forward rate hike expectations, with eurozone money markets now pricing a 70% chance of a 10 basis points hike by the end of 2018.

Meanwhile, reports of China possibly reducing or halting its purchase of US Treasuries and stronger-than-expected US inflation also pressured yields upward. As such, US 10-year Treasuries were up 8 bps to settle at 2.55%, and Bunds increased by 9 bps to reach 0.53%, their highest since July. Meanwhile, GCC benchmark yields tracked the sell-off, despite higher oil prices, increasing between 4 and 10 basis points. (Chart 12.)

Supported by the higher oil price environment, Oman issued $6.5 billion in debt over three tranches to help finance its deficit. The sovereign offered $1.25 billion in five-year dollar-denominated debt at 4.125%, $2.5 billion in 10-year debt at 5.625%, and $2.75 billion in 30-year debt at 6.75%. The issuance covers most of the expected $7.8 billion deficit, with the remaining to be borrowed from domestic markets.

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