Weekly Economic and Markets Review
28 May 2017

OPEC announces 9-month output cut extension; equities regain footing; Moody's downgrades China and Qatar

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi (ADI)	4,496	-1.41	-1.10
Bahrain (ASI)	1,317	0.42	7.94
Dubai (DFMGI)	3,294	-1.51	-6.72
Egypt (EGX 30)	13,181	1.10	6.78
KSA (TASI)	6,803	-0.96	-5.65
Kuwait (Price Index)	6,650	-0.57	15.68
Oman (MSM 30)	5,387	-0.22	-6.23
Qatar (QE Index)	10,123	-0.42	-3.00
MSCI GCC	465	-0.56	-2.11
International			
DAX	12,602	-0.29	9.76
DJIA	21,080	1.32	6.67
FTSE 100	7,548	1.03	5.67
Nikkei	19,687	0.49	2.99
S&P 500	2,416	1.43	7.91

Commodities	$/bbl	Change (%) weekly	Change (%) YTD
Brent crude ($/bbl)	52.2	-2.72	-8.22
KEC ($/bbl)	48.4	-3.78	-6.71
WTI ($/bbl)	49.8	-1.05	-7.30
Gold ($/t oz.)	1255.8	0.33	8.60

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.303	-0.53	-0.78
KWD per EUR	0.340	2.54	6.73
USD per EUR	1.120	2.54	6.57
JPY per USD	111.26	-1.83	-4.80

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Kibor – 3 month	1.63	0.0	18.8
Qibor – 3 month	1.94	-2.9	16.0
Libor – 3 month	1.20	1.5	20.4

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.31	-1.0	-24.0
Dubai 2021	2.90	-1.1	-42.9
Qatar 2021	2.39	-4.6	-56.6
Saudi Arabia 2021	2.64	-6.2	-41.7
International			
UST 10 year	2.25	0.5	-18.2
Bunds 10 year	0.33	-4.6	12.1
Gilts 10 year	1.01	-8.7	-23.2
JGB 10 year	0.04	0.0	-1.0

Source: Thomson Reuters Datastream

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Summary

Markets returned to less volatility and more "normal" after President Trump embarked on his successful world tour (Saudi Arabia, Israel, the Vatican, Belgium and Italy). Equities advanced again and the USD continued to drift lower on the strength of the euro. Chancellor Merkel was quoted as saying that the euro was "too weak".

Oil prices dipped after OPEC and some non-OPEC producers announced a 9-month extension to their oil supply cut agreement before Brent settled at around $52/bbl. The extension should see the 1.8 mb/d of oil that has been taken off maintained through to March 2018, which should be enough to accelerate the global stock drawdown and support prices at current levels or higher. We still expect Brent to average $55/bbl this year.

Financial markets are back to expecting delivery on reform and tax cuts, even if it means occurring later this year or even in 2018. Firm US data and a weaker USD, along with steady markets, should set the stage for a Fed rate hike (25 bps in the federal funds rate) at the June FOMC meeting. The May FOMC minutes and some recent Fed speeches suggest as much. The Fed appears ready to move "soon", and is already thinking about reducing its huge balance sheet of $4.5 trillion very gradually toward year-end.

Moody's downgraded China's debt, the first such move since 1989, on concerns about slowing growth and high debt levels. Regionally, Moody's affirmed the ratings for Kuwait and the UAE, while downgrading Qatar's by one notch. All three saw their outlooks changed from 'negative' to 'stable'.

Oman and Egypt issued USD debt worth $2 billion (sukuk) and $3 billion (bonds), respectively. The issuances attracted considerable interest.

International macroeconomics

USA: 1Q17 GDP was revised from 0.7% to 1.2% (q/q ann.). We prefer to focus on the y/y rate, which barely budged from 1.9% to 2.0%; 2.0-2.5% appears to be the current underlying pace of the US economy. That pace is in line with Fed projections and consistent with a Fed hike at the next FOMC meeting on 13-14 June (even with current 2Q17 GDP expectations of 3.1% q/q ann.).

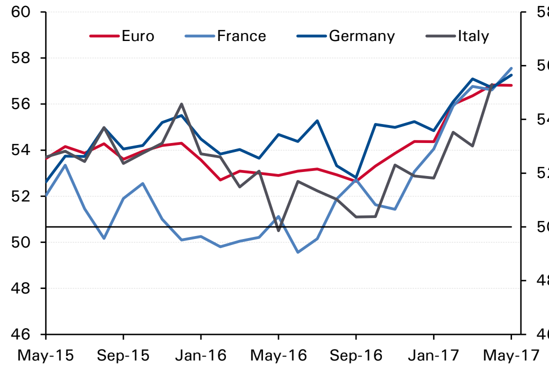
Recent data on home sales and durable orders were somewhat below expectations, but nothing to derail the outlook described above. The flash PMI for May was also steady at 53.9, up from 52.7.

Eurozone: The Eurozone's (EZ) May flash PMI was unchanged from April, at a strong 56.8, with solid optimism about the EZ's business outlook. (Chart 1.) The drive was led by manufacturing, which recorded its strongest reading in six years (58.4). Backlogs of work across the manufacturing and services sectors are on the rise, reflecting the strong pick-up in demand.

Eurozone finance ministers were unable to reach a deal on Greece's bailout, a resolution is expected in mid-June. The disagreement revolved around Greece's debt relief (to be implemented once the country's program ends in 2018), as a proposed plan was rejected by the Greek government due to a lack of clarity. The IMF, whose participation hinges on Greece obtaining debt relief, also wanted more clarity.

Chart 1: Eurozone PMIs

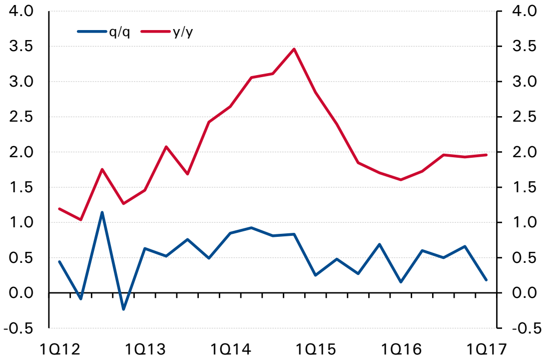
(index)



Source: HIS Markit

Chart 2: UK real GDP growth

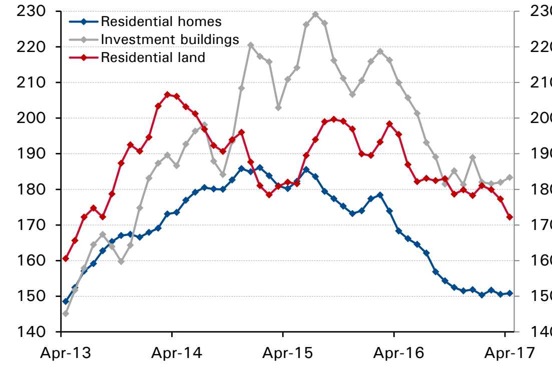
(% y/y)



Source: ONS

Chart 3: Kuwait real estate prices

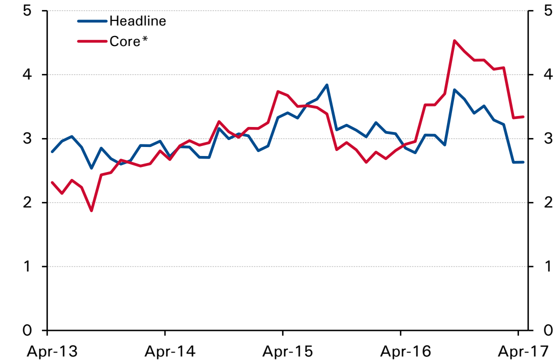
(NBK real estate price indices)



Source: Ministry of Justice, NBK

Chart 4: Kuwait inflation

(% y/y)



Source: Central Statistical Bureau, NBK estimates

China: Moody's downgraded China's long-term credit rating by one notch to A1 from Aa3, after citing concerns about the nation's mounting debt, which currently stands at around 260% of GDP. This was the nation's first downgrade by Moody's in almost three decades. The Yuan and China's stock markets retreated following the downgrade, with the Shanghai Composite index falling by 1.3%, before paring back its losses towards the end of the trading session.

UK: UK GDP growth in 1Q17 was revised down slightly, from 0.3% q/q to 0.2% q/q. Annual growth was also trimmed, to 2.0% from 2.1%. (Chart 2.)

Lower estimates of economic growth plus polling data suggesting that the Labor Party might fare better in the upcoming election than previously thought pushed Sterling back below the 1.30 level against the dollar. The Pound dropped 1.2% on Friday to a 1-month low of 1.2783 to the dollar.

GCC & regional macroeconomics

Kuwait: Moody's affirmed Kuwait's Aa2 sovereign credit rating on Friday with a stable outlook. After a year on a negative outlook, Moody's felt that Kuwait showed "sufficient signs" it can move ahead on reforms to support its rating in the medium term. According to Moody's, despite "slower" progress on reforms, the country continues to enjoy an "extraordinarily strong" balance sheet.

The real estate market softened in April following surprisingly strong activity in March. Sales were down 30% y/y as growth in the commercial and investment sectors was anemic. (Chart 3.) The residential sector was more buoyant, rising 36% y/y, supported by an increased appetite for residential homes. Real estate prices across most sectors continued to hold, though residential land prices showed some weakness.

Inflation held steady at 2.6% y/y in April. (Chart 4.) Softer housing inflation has been a key contributor to lower inflation recently, as has food inflation. Local food prices have been falling amid decline in global food prices. (Chart 4.)

The Ministry of Electricity & Water began applying new utility tariffs in the commercial sector. Tariffs rose to 5 fils/kWh from 2 fils and to KD 2 per 1,000 imperial gallon of water from KD 0.8. The new rates can increase government revenues by KD 40-50 million in FY17/18.

UAE: Moody's affirmed Abu Dhabi's long-term credit rating at Aa2 with a stable outlook, citing an effective public policy response to the lower oil price environment and improved economic growth prospects. Moody's also affirmed the rating of the UAE federal government at Aa2 given that Abu Dhabi, the largest emirate, stands fully behind the federal government.

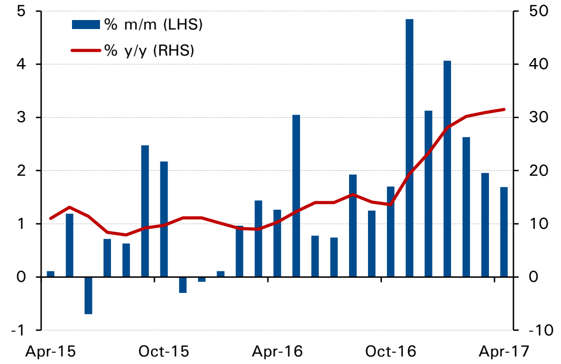
Qatar: Moody's downgraded Qatar's rating to Aa3 with a stable outlook, citing concerns over the country's weakening external position. Qatar's external debt rose sharply in 2016 to around 150% of GDP from 111% of GDP in 2015, Moody's estimated. This was due to a continued increase in commercial banks' liabilities and sovereign external debt issuance.

Egypt: In a surprise move, the central bank hiked key policy rates by 200 bps as authorities sought to combat high inflation. The vast majority of analysts polled expected rates to remain unchanged at the 21 May meeting despite calls by the IMF for a hike. Inflation, which ran at over 31% y/y in April, has been cooling. (Chart 5.) However, the CBE felt that, with "data pointing to strengthening demand-side pressures", risks to the inflation outlook "tilted more strongly to the upside".

Egypt raised $3 billion in USD denominated bonds with 5, 10 and 30-year

Chart 5: Egypt inflation

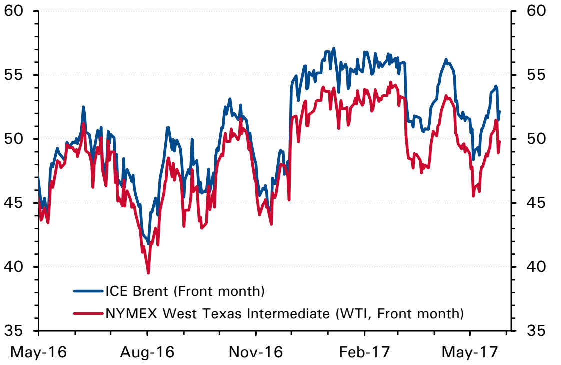
(% y/y)



Source: Central Bank of Egypt

Chart 6: Crude oil prices

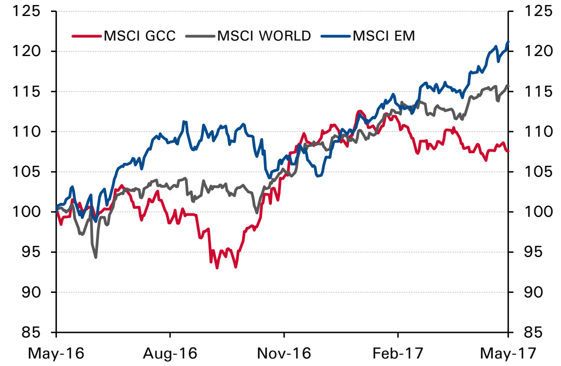
($/bbl)



Source: Thomson Reuters Datastream

Chart 7: Total return indices

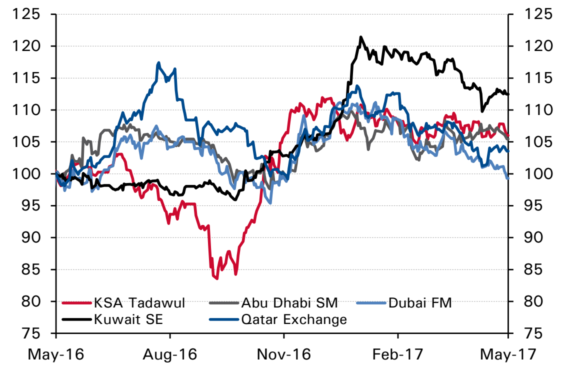
(rebased, 26 May, 2016=100)



Source: Thomson Reuters Datastream

Chart 8: GCC Markets

(rebased, 26 May, 2016=100)



Source: Thomson Reuters Datastream

maturities. The issuance, which was priced below rates of the January issuance, was double what the government was targeting.

Markets – oil

As expected, OPEC agreed to extend its 1.8 mb/d production cut agreement with Russia and 10 other non-OPEC oil producers for another 9 months. (Chart 6.) The markets, perhaps expecting deeper cuts to accompany the extension, did not seem overly impressed, however; both Brent and WTI fell by more than 4.5% on the day of the announcement, before gaining a little to close at $52.15/bbl and $49.80/bbl, respectively, on Friday.

Nevertheless, the global crude stock drawdown is firmly underway, after a first quarter that saw levels increase rather than decrease. In the US, stocks fell for the seventh consecutive week through 19 May, by 4.4 million barrels, amid higher refinery runs and lower imports into the US. With the peak summer crude demand season shortly upon us, there is a good chance that markets will see a more substantial decline in inventories over the next few months.

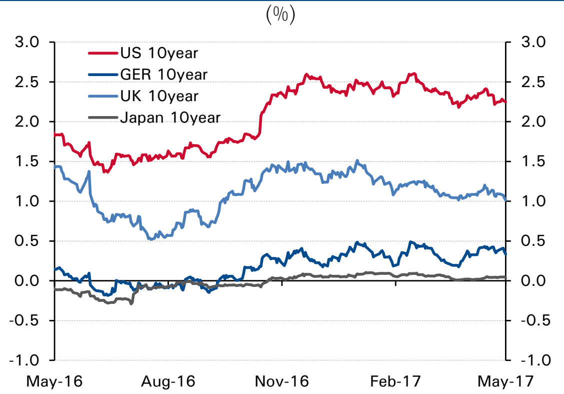
The Saudis have also indicated that they intend to push things along in the US by restricting shipments to their US refinery over the next few months. The kingdom wants to reduce its exports to the US from this year's average of 1.2 mb/d to below 1 mb/d. It has not been lost on the Saudis that oil developments in the US have tended to have an outsized impact on the oil markets.

Markets – equities

Equity markets bounced back this week as President Trump's international tour shifted focus away from his troubles back in Washington, at least for the time being. The MSCI World index advanced 1.1% on the week. (Chart 7.) US stocks outperformed, with the S&P 500 and DJIA closing up 1.4% and 1.3%, respectively. European equities didn't fare as well, with Merkel's comment on the weakness of the euro weighing on European markets. The Euro Stoxx 50 retreated 0.2%, despite strong GDP figures out of Germany. Meanwhile, emerging markets advanced, with the MSCI EM up 1.6% on the week. Chinese equities gained this week despite Moody's downgrade of China's debt rating, spurring talk of state support for the market.

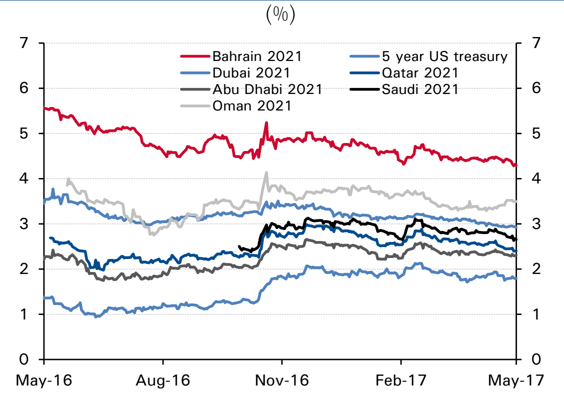
Regional markets underperformed, with the MSCI GCC index off 0.6% and most markets ending the week in the red. (Chart 8.) The boost to regional markets from President Trump's widely publicized trip to Saudi Arabia was short-lived. Markets are now heading toward the typically low volume and shorter trading hours of Ramadan, which could see investors trim their exposure to the region.

Chart 9: Global bond yields



Source: Thomson Reuters Datastream

Chart 10: GCC bond yields



Source: Thomson Reuters Datastream

Markets – fixed income

Global yields were tepid this week as the continued flow of strong economic figures (EZ PMIs, US GDP revision) was offset by still bearish central banks that remain prudent about phasing out loose monetary policies (Fed minutes, Draghi speech). Some month-end portfolio rebalancing and the advent of a long weekend also pressured yields lower. Yields on the 10-year US Treasury ended the week little changed at 2.25%, and remained within a tight 7 bps range all week; 10-year Bund yields edged lower by 5 bps to settle at 0.33%. (Chart 9.) Meanwhile, the spread on 10-year Greek debt yields to 10-year Bund yields rose as Eurozone finance ministers failed to agree on debt relief. Gilt yields, on the other hand, tightened following some concern over PM May and her conservative party.All GCC sovereign yields on bonds maturing in 2021 fell this week, possibly benefitting from the recently announced extension of OPEC/non-OPEC oil cuts. Yields on most regional debt have dropped somewhere between 1- 14 bps. (Chart 10.) Meanwhile, Kuwait's 2022 bond saw its yield almost unchanged, ending the week at 2.56%.

Oman's 7-year sukuk was priced at mid-swaps +235 bps (4.397%), as a more-than-three-times oversubscribed order book allowed the sovereign to tighten pricing. Oman sold $2 billion sukuk to help finance its deficit this year.

Egypt issued a $3 billion triple-tranche bond which was 3.7 times oversubscribed. The issuance comprised of $750 million notes due in 2022 at 5.45%, $1 billion at 6.65% and $1.25 billion at 7.95%.

A Moody's downgrade of Chinese debt (Aa3 to A1, but with a stable outlook) had minimal effect on government bond yields. China's bond market is dominated by domestic investors. Moody's also downgraded Qatar, and re-affirmed Kuwait and the UAE.

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