International scene

Alan Greenspan worries, the markets not so much

> Elias Bikhazi
Group Chief Economist
+965 2259 5364, eliasb@nbk.com

World growth is on track. The Fed is proceeding with tightening or "normalizing", if one prefers. Other central banks are getting ready to follow suit, but in a long while. OPEC is attempting to balance oil markets. The Trump administration appears, or is, in disarray. How are markets reacting to all this? Fairly well, thank you very much. Equities, the only asset market performing in line with consensus expectations from earlier in the year, advanced further in July. The equity markets in the US are in fact making new historic highs (Dow Industrials 22,000). This US performance is predicated on strong US earnings, steady growth, a Fed tightening very gradually, deregulation, and potential tax reform ahead.

All these equity "positives" spilled over into other equity markets (Europe, EMs). The US, of course, remains a crucial factor in the world economy, and a crucial member of the synchronized growth club: the notion that, currently, all major economies are growing at a moderate or good sustained clip, very much at the same time. The Eurozone economy edged the US last year, for the first time since 2011 (GDP 1.7% to 1.5%). And in 1H17 the two economies were running neck-in-neck at 2.0% growth.

In fact, the IMF just released its July update of the World Economic Outlook (WEO), which kept world growth at 3.5% and 3.6% for 2017 and 2018, while tweaking its US numbers lower (2.1%, 2.1%), and its EU (1.9%, 1.7%) and China (6.7%, 6.4%) forecasts higher.

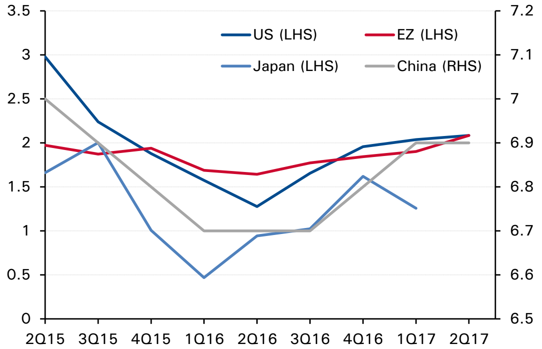
Stocks were expected to do well this year, and have delivered, so far, beyond expectations in many cases. US stocks are up over 10% ytd (S&P 500), and European stocks are up 5% in local currency (Euro Stoxx, much more in USD terms). Emerging markets are up 23% ytd (MSCI EM) while the GCC lagged in 1H17 (MSCI GCC +0.6%).

On the unexpected side, surprises were plentiful this year. Coincidentally, they all seemed to add to the bullish sentiment for stocks. One surprise, lower inflation, means the Fed does not have to be aggressive in raising rates, the ECB can dilly-dally on tapering and other "tighter" money measures, pressure on the BoE eases, and the BOJ needs to keep pumping liquidity beyond forever.

Lower interest rates and available liquidity continue to bolster stocks. In fact, by some measures financial conditions, even in the US with higher Fed policy rates, have eased. The US 10-year note yield is off 20 bps on the year (when the Fed has been raising its policy rates), and the USD is down more than 10% versus the euro, among others. This is somewhat reminiscent of Alan Greenspan's bond conundrum argument of 2005. Then, the Fed was tightening and yields on long-dated securities would decline, the USD fall, and equities rise. Part of it was, of course, one huge buyer of US Treasuries, China. During 2004-2006, the Fed raised the federal funds rate 425 bps, versus a meek 30 bps rise in the yield of 10-year note.

Chart 1: GDP growth

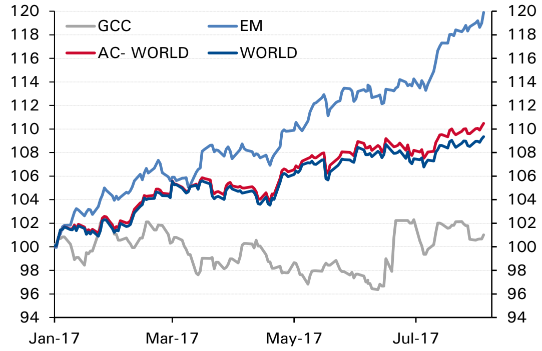
(quarterly, % y/y)



Source: Thomson Reuters Datastream

Chart 2: Equity markets

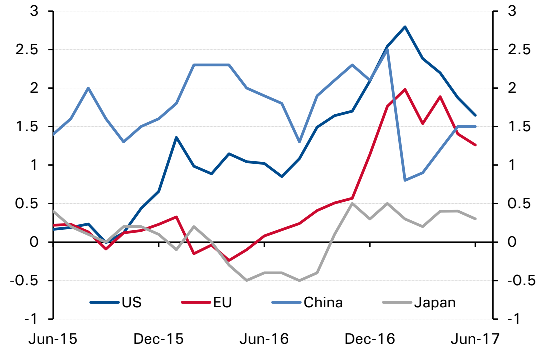
(MSCI, rebased, 30/12/2016 = 100)



Source: MSCI, Thomson Reuters Datastream

Chart 3: Inflation

(% y/y)



Source: Thomson Reuters Datastream

In fact ex-Fed Chairman Alan Greenspan was back in the news recently, warning of a bond bubble, as opposed to market talk of an equity bubble. Greenspan worried that rapidly rising rates (or the end of the bond bubble) could occur and would, then, impact equity markets. Greenspan did not put a time frame on his warning. He did mention though that things could unfold quickly once the process got underway, which is not atypical of markets or bubbles.

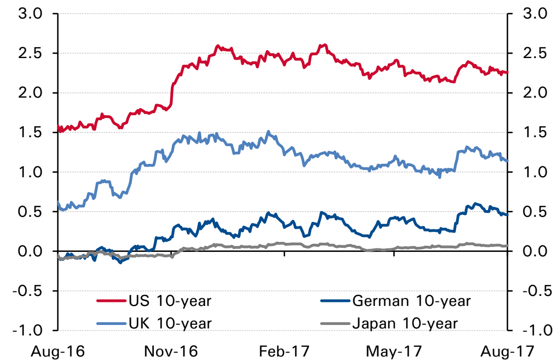
Nonetheless, the markets have heard these types of warnings several times since 2008, regarding both bonds and equities, and continue on their merry way. While it is certainly true that interest rates are at record lows, barring an unforeseen jump in inflation it is difficult to see Greenspan's warning materializing in the medium term.

The major central banks are today's large buyers of bonds who have supported the bond markets worldwide and kept interest rates very low. Sure, the Fed is getting ready to shed some of its assets, presumably this September, but that will happen at a snail's pace initially. Furthermore, the ECB and the BoJ are still on their buying spree. Before all major central banks start "selling" at the same time (and in serious numbers), Alan Greenspan's warning seems somewhat premature. Also, bear in mind that the central banks have been and are (since 2008) exceedingly cautious. Whenever they mention "higher rates" or "buying fewer assets", they always quickly add the proviso: we will stop and reverse course if something goes "wrong".

Other surprises this year came from the USD and from oil prices, and both ended up being further "pluses" for equities. Both the USD and the price of oil fell, against strong and widespread consensus, and by doing so added to the positive overall market sentiment. The weaker USD was seen as a boon to US exports and to US companies, many of which have significant business overseas. The weaker dollar was also seen as removing the threat of outflows from emerging markets (EMs). As to the weaker price of oil in 1H17, it was further supportive of low inflation (low interest rates) and positive, at least for oil importers.

So far, the expected and unexpected factors are unfolding in favor of equities at large, and are keeping interest rates in check, at least in the longer maturities. The Fed has signaled recently that it is about to start unwinding its massive balance sheet in September, starting with a measly \$10 billion per month. This amount will rise by \$10 billion per quarter. Thus, the current \$4.3 trillion Fed balance sheet, will take three years to go down to \$2.9 trillion, which would still leave it three times larger than its size prior to the 2008 financial crisis. And, for now, the ECB is still buying and hinting it may slow its purchases next year (currently euro 60 billion per month). The Bank of Japan is showing no sign of ending its purchases of government bonds. So yes, Mr. Greenspan's warning will come due at some point. However, the financial markets are likely to fret more about Alan Greenspan once inflationary pressures shows up in the data or once central banks, in concert, start shedding assets in significant amounts.

Chart 4: Benchmark yields



Source: Thomson Reuters Datastream

Chart 5: US dollar index

(index)

Source: Thomson Reuters Datastream

Chart 6: Brent oil price

(US dollars per barrel)

Source: Thomson Reuters Datastream

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Representative Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353