EU fires latest shot in trade war with US; oil prices rise despite deal by OPEC+ to boost output

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,535	-3.81	3.11
Bahrain (ASI)	1,309	0.16	-1.67
Dubai (DFMGI)	2,928	-3.62	-13.11
Egypt (EGX 30)	16,346	0.77	8.83
GCC (S&P GCC 40)	1,011	-3.81	2.71
Kuwait (All Share Index)	4,823	-0.41	-0.16
KSA (TASI)	8,206	-0.77	13.56
Oman (MSM 30)	4,610	0.30	-9.60
Qatar (QE Index)	8,923	-1.93	4.68
International			
CSI 300	3,609	-3.85	-10.47
DAX	12,580	-3.31	-2.62
DJIA	24,581	-2.03	-0.56
Euro Stoxx 50	3,442	-1.81	-1.78
FTSE 100	7,682	0.63	-0.07
Nikkei 225	22,517	-1.47	-1.09
S&P 500	2,755	-0.89	3.04

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.60	-2.9	65.4
Dubai 2022	3.98	0.6	84.0
Qatar 2022	3.81	-3.9	73.4
Kuwait 2022	3.54	-2.0	73.4
Saudi Arabia 2023	3.84	-2.0	62.4
International			
UST 10 Year	2.90	-2.4	48.9
Bunds 10 Year	0.33	-7.2	-9.1
Gilts 10 Year	1.32	-0.7	13.2
JGB 10 Year	0.03	-0.5	-1.8

3m interbank rates	%	Change (bps) weekly	YTD
Bhibor	3.50	0.0	77.5
Kibor	2.00	0.0	12.5
Qibor	2.61	-3.2	-13.2
Eibor	2.48	-0.7	68.1
Saibor	2.54	7.7	64.4
Libor	2.34	0.0	64.1

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.302	-0.04	0.31
KWD per EUR	0.353	-1.01	-0.68
USD per EUR	1.166	0.41	-2.84
JPY per USD	110.0	-0.63	-2.41
GBP per USD	1.327	-0.11	-1.81
EGP per USD	17.82	0.11	0.51

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	75.6	2.87	12.98
KEC	72.3	0.49	13.86
WTI	68.6	5.41	13.51
Gold	1267.4	-0.56	-2.98

Source: Thomson Reuters Datastream; as of Friday's close 22/6/2018

Overview

Following the EU's move to impose tariffs on nearly €3 billion of imports from the US – itself a response to earlier US measures on steel and aluminum – concerns over trade wars intensified with a fresh US threat to impose heavy tariffs on European cars, on top of additional tariffs on Chinese imports. Escalating trade tensions weighed on markets, with key global equity indices falling 1-2% w/w and the safe-haven US dollar hitting a 2018 high. There was positive news for Greece, with Eurozone governments agreeing to extend maturities on nearly €100 billion in Greek debt ahead of the end of the current bailout program in August, though worries about the long-term overall debt load still lingers.

Major global oil producers struck a deal to increase crude output by 1 million b/d from July, reversing more than half of the cuts they had announced in late 2016. The price of Brent crude nevertheless rallied on the announcement, finishing the week up 3% at just below $76/bbl on uncertainties over how much of the increase will materialize in practice but also the implications for dwindling spare production capacity against a backdrop of rising global demand.

In the GCC, there was good news for investors with global index provider MSCI announcing that it will upgrade Saudi Arabia to Emerging Market status while putting Kuwait on review for a possible future upgrade. Saudi's inclusion will be phased in in May and August next year and could trigger about $40 billion in inflows, compared to a current market capitalization of around $500 billion. This follows similar recent moves by FTSE Russell, which will upgrade Saudi and Kuwait to Emerging Market status from September 2018 and March 2019, respectively.

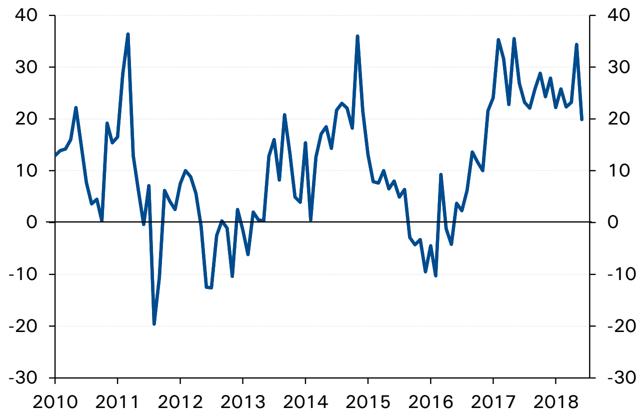
International macroeconomics

USA: Last week's economic data saw few major surprises, generally reinforcing the narrative of robust economic growth that had compelled the Federal Reserve to hike interest rates a week earlier. The Philadelphia Fed's Business Outlook survey (of manufacturers) fell sharply in June but remains at very strong levels and will ease recent fears of overheating. (Chart 1.) The composite PMI edged up to 56.0 in June from 55.7 in May on account of a rise in the services index, though higher costs point to a possible impact from steel tariffs on manufacturing. One softer spot was the 3% y/y fall in existing home sales in May, perhaps affected by higher prices and in contrast to new home sales which remain strong.

The current account deficit widened to $124 billion (2.5% of GDP) in 1Q18, from a revised $116 billion (2.4% of GDP) in 4Q18. The increase was due to a larger trade deficit of $221 billion. Although not large by historic standards, the path of the deficit will be watched in regards to US trade policy, with President Trump claiming that the US is being disadvantaged by unfair trade barriers in other countries. The figures also showed $305 billion in repatriated earnings from overseas US multinationals following the tax reforms of December 2017.

Chart 1: US Philadelphia Fed Business Outlook

(index)



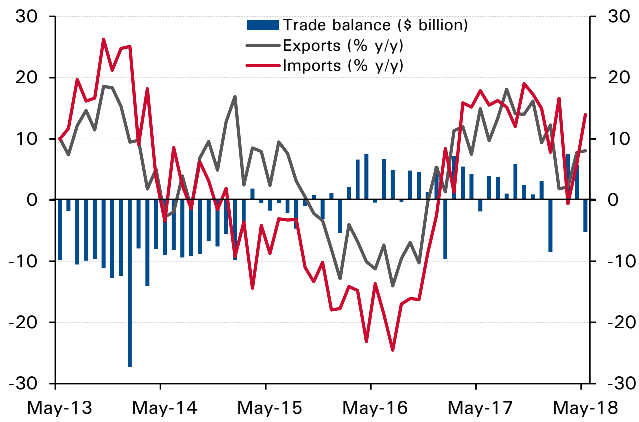
Source: Thomson Reuters Datastream

Eurozone: Eurozone finance ministers agreed to push back Greek repayments on €96 billion of debt by 10 years, with the earliest repayment in 2033. Meanwhile, comments by ECB President Draghi at a conference in Portugal had a dovish tone, acknowledging increased uncertainties arising from escalating global trade conflict and reinforcing its message of a 'patient' approach to policy tightening. The Bank announced the previous week that its QE asset purchases would wind down in October and end in December, but signaled that the first rate hike might not take place until Autumn 2019 rather than the June originally expected. The news pushed the euro to below $1.16 against the US dollar – 2% below its early June peak.

The Eurozone PMI recovered from a disappointing 54.1 May to 54.8 in June, though suggested that activity in the region has not yet passed its recent soft patch. The manufacturing component fell, influenced by a weaker figure in Germany perhaps linked to US tariffs. Eurozone consumer confidence fell unexpectedly in June to -0.5 from +0.2 in May, the lowest reading since October and perhaps influenced by rising oil prices, trade war concerns and recent regional political instability. French GDP growth was confirmed at just 0.2% q/q in 1Q18 compared to 0.7% in 4Q17.

Japan: Export growth rose from 7.8% y/y in April to 8.1% y/y in May, amid a pickup in demand for manufacturing equipment, cars and car parts, while import growth accelerated from 5.9% y/y to 14.0% y/y on imports of aircraft and higher oil prices. Meanwhile, Japan's trade surplus with the US fell to its lowest level since 2013 due to US aircraft and coal imports. Japan, like China and the EU albeit to a lesser extent, has come under pressure from the US about unfair trade policies. (Chart 2.) Inflation in May came in at 0.7% y/y, suggesting no tightening of monetary policy will take place soon.

Chart 2: Japan trade



Source: Thomson Reuters Datastream

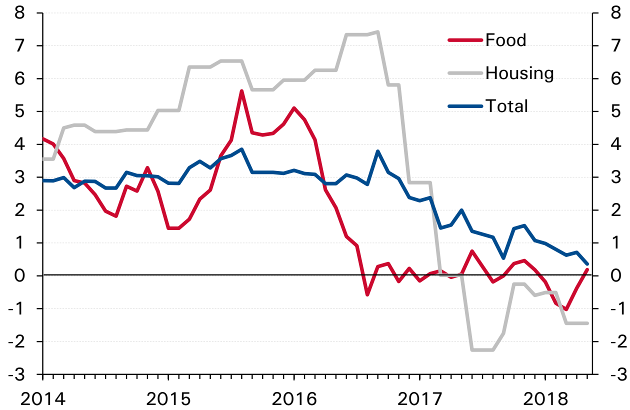
GCC & regional macroeconomics

Kuwait: Consumer price inflation eased again in May, reaching 0.4% y/y from 0.7% in April and hitting a 14-year low. (Chart 3.) Inflation has been trending down for nearly two years, thanks mainly to weakness in the food and housing sub-components, which account for around half of the index. But food price inflation rose in May and housing was steady; softness was instead the result of a fall in 'core' inflation to just 1.7% from 2.6% in April. This mostly reflects a base effect as hefty rises a year ago fell out of the annual comparison. We maintain our inflation forecast at 1% for 2018, which seems to be on the high side now but will monitor the inflation rates in the next few months and adjust our estimate accordingly.

Saudi Arabia: The Saudi stock market received a boost last week with the decision by the MSCI to include Saudi equities in its emerging market index from May 2019. The move could result in the market receiving as much as $10 billion in passive inflows, some of which may have already occurred. The inflow of active investment is estimated at some $30 billion but this will depend on developments between now and the actual inclusion in the index in 2019.

Chart 3: Kuwait consumer price inflation

(% y/y)

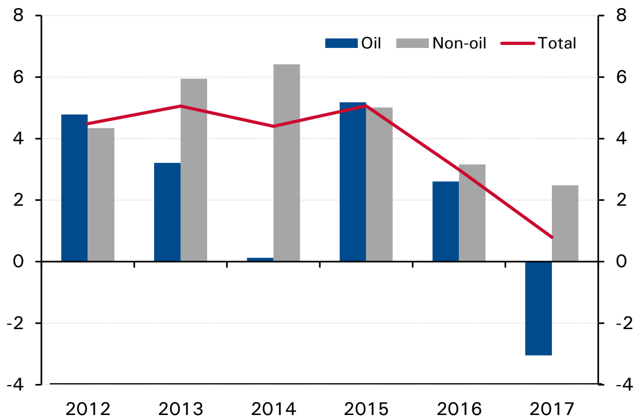


Source: Thomson Reuters Datastream

UAE: GDP growth moderated for a second straight year in 2017, from 3.0% y/y in 2016 to 0.8% y/y, as the oil sector witnessed a 3.0% decline and non-oil growth slowed slightly to 2.5%. (Chart 4.) Looking ahead, growth is set to accelerate in 2018 and 2019 to around 2.5% and 3.3%, respectively, as infrastructure investment picks up and as oil output rises, as per the latest OPEC agreement and as the fiscal stimulus package takes hold.

Chart 4: UAE real GDP

(% y/y)



Source: UAE Federal Competitiveness & Statistics Authority

Meanwhile, the authorities unveiled a raft of economic reforms over the past two weeks, aimed at improving the business operating environment and stimulating growth. Dubai launched a package that will help businesses clear fines and renew licenses. The UAE central bank has reportedly set limits on some fees and commissions on consumer-related banking services. Furthermore, the UAE cabinet announced that it will replace a mandatory bank guarantee for labor recruitment with a less costly insurance system. In a bid to boost tourism, it will also exempt transit passengers from entry fees for the first 48 hours of their stay.

Bahrain: Bahrain's credit default swaps (CDS), bellwethers of a sovereign's level of risk, spiked last week on fresh concerns about the country's ability to tap international markets to finance its high fiscal deficits. The CDS on five-year government debt climbed to 460 basis points last Tuesday, the highest level in almost 10 years. (Chart 5.)

Chart 5: Bahrain 5-year credit default swap

(basis points)

Source: Thomson Reuters Datastream

Turkey: The economy grew at a slightly faster pace of 7.4% in 1Q18, as household consumption and investment held strong. The economy may see some moderation in the near-to-medium term on the back of the two recent rate hikes and higher oil prices. The weaker Lira may improve Turkey's export competitiveness although it could dampen consumer spending. Turkey held its and parliamentary elections this week. If President Erdogan is re-elected he may maintain an expansionary fiscal policy. But his scope to do so may be constrained by high inflation (12.1% in May) and the weak lira, currently down 25% year-to-date.

Markets – oil

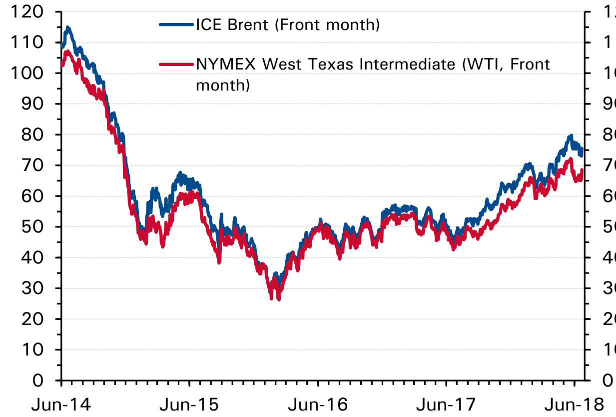
OPEC and its partners led by Russia agreed to effectively boost crude output by up to one million barrels a day by bringing collective compliance with the November 2016 production cut agreement down to 100% from May's 147% The official OPEC communique was deliberately vague about which producers would make up the shortfall and by how much. However, in real terms, the increase would likely be of the order of 700,000 b/d over the next six months, since only a handful of OPEC+ countries – Saudi Arabia, Kuwait, the UAE and Russia – have the capacity to boost output. Venezuela, Iraq and Iran initially opposed the output increase, given their limited spare capacity to raise production.

The size of the output increase disappointed slightly and crude oil prices surged after the meeting, with Brent rising 3.4% to \$75.6/bbl on Friday and WTI rising 4.6% to close the week at

$68.6/bbl. (Chart 6.) Both markers are up around 13% in 2018.

Chart 6: Crude oil prices

($/bbl)



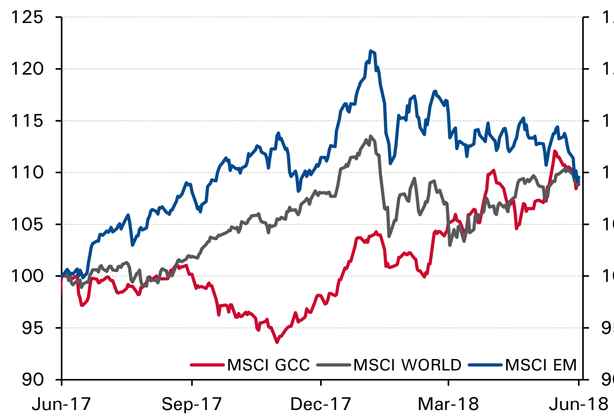
Source: Thomson Reuters Datastream

Markets – equities

International equity markets retreated as investors flocked to safer assets due to escalating trade tensions. The MSCI AC world index was down 1.1% w/w. (Chart 7.) In the US, the DJI, which consists mostly of trade-dependent businesses, was down 2.0% w/w, while the S&P 500 lost 0.9%. The prospect of tariffs on European carmakers caused the Euro stoxx 50 to finish the week 1.8% lower. But investor nervousness was highest toward emerging markets, where expectations of a Chinese slowdown, compounded by the imposed US tariffs, helped push the MSCI EM index down 2.2% w/w.

Chart 7: Total equity return indices

(rebased, 22 June 2017=100)

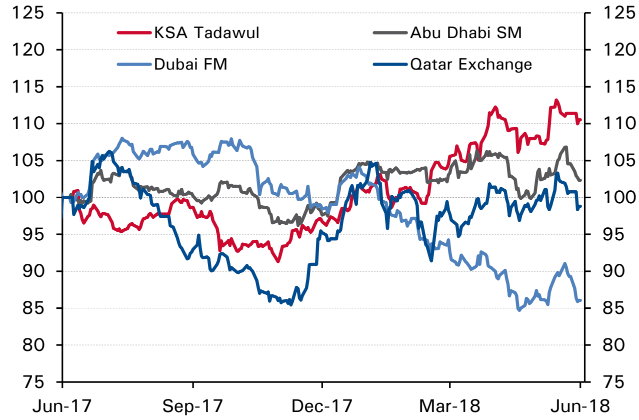


Source: Thomson Reuters Datastream

Regional bourses emerged from the Eid holiday tracking international markets lower, but were also pulled down by some profit taking. The MSCI GCC index was down 1.5% w/w, driven primarily by weakness in Dubai (-3.6% w/w) and Abu Dhabi (-3.8% w/w), with Abraaj Capital's liquidation adding to investor concerns. (Chart 8.) Saudi was down 0.8% on the week on possible profit taking following its MSCI upgrade. Saudi will be included in the MSCI EM standard index in two steps – May 2019 and August 2019 – with around $10 billion in expected passive inflows. MSCI also added Kuwait to its 2019 watch list for a potential upgrade to emerging market, with the decision to be announced next June. However, Kuwait's All Share index retreated 0.4% w/w.

Chart 8: GCC equity markets

(rebased, 22 June 2017=100)



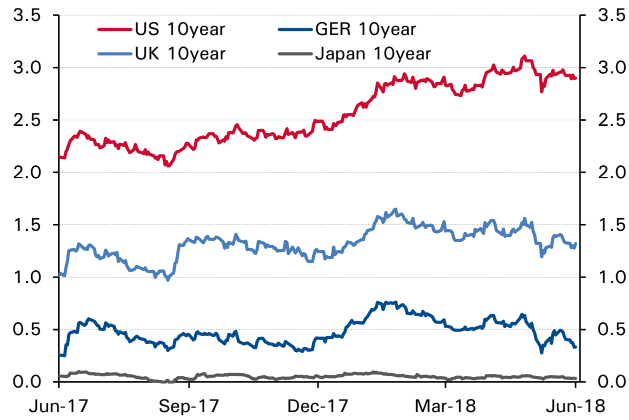
Source: Thomson Reuters Datastream

Markets – fixed income

Global yields were lower on the week on escalating trade tensions and dovish central bank speak. US 10-year yields shaved 2 bps to settle at 2.90%, while German 10-year bunds tightened by a larger 7 bps, to reach 0.33%. (Chart 9.) In the GCC, most yields followed their US counterparts, however, Bahrain is seeing investors demand rates as high as 8.4%, amid concerns over its ability to access credit markets.

Chart 9: Global bond yields

(%)



Source: Thomson Reuters Datastream

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