Fed chair nominee seen as continuity candidate on monetary policy; IMF cuts GCC growth forecasts

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,465	-0.06	-1.79
Bahrain ASI	1,283	0.43	5.11
Dubai FM	3,622	-0.79	2.59
Egypt EGX 30	14,319	2.61	15.99
S&P GCC 40	1,039	-1.24	-10.05
Kuwait SE	6,548	-1.13	13.92
KSA Tadawul	6,957	0.66	-3.52
Muscat SM 30	5,040	1.65	-12.84
Qatar Exchange	8,146	0.22	-21.95
International			
CSI 300	3,993	-0.73	20.63
DAX	13,479	1.98	17.40
DJIA	23,539	0.45	19.11
Eurostoxx 50	3,690	1.03	12.14
FTSE 100	7,560	0.74	5.85
Nikkei 225	22,539	2.41	17.92
S&P 500	2,588	0.26	15.59

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	62.1	2.70	9.24
KEC	57.7	3.07	11.18
WTI	55.6	3.23	3.57
Gold	1266.5	-0.16	10.13

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.303	0.10	-0.91
KWD per EUR	0.351	-1.85	10.28
USD per EUR	1.161	-0.01	10.41
JPY per USD	114.060	0.34	-2.40
USD per GBP	1.307	-0.40	5.98
EGP per USD	17.600	-0.23	-2.22

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor - 3 month	2.50	5.0	40.0
Kibor - 3 month	1.81	0.0	37.5
Qibor - 3 month	2.46	-3.5	68.1
Eibor - 3 month	1.57	0.2	9.7
Saibor - 3 month	1.79	-0.2	-24.4
Libor - 3 month	1.39	1.3	39.4

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.37	-4.0	-15.8
Dubai 2021	2.97	-2.7	-33.1
Qatar 2021	2.99	-4.0	6.2
Kuwait 2022	2.52	-3.0	n/a
Saudi Arabia 2022	2.85	-4.0	n/a
International			
UST 10 Year	2.34	-8.5	-8.9
Bunds 10 Year	0.37	-2.0	15.9
Gilts 10 Year	1.27	-8.3	2.7
JGB 10 Year	0.06	-1.5	0.7

Source: Thomson Reuters Datastream; as of Friday's close 3/11/2017

> Economic Research Department
+965 2259 5500
econ@nbk.com

Overview

The US Federal Reserve chose to keep interest rates on hold at 1-1.25% last week, but the decision was overshadowed by the announcement that President Trump had nominated Fed Governor Jerome Powell to replace Janet Yellen as Fed chair when her term expires in February. The move is seen as an attempt by Trump to put his own stamp on the central bank, but the consensus view is that it is unlikely to yield a major shift in the pace of policy tightening.

The Bank of England hiked rates 25 bps as expected – the first rise in a decade – in an effort to move policy back towards 'normal', with the worst fears of a Brexit-related slowdown having failed to materialize. The pound nevertheless sank as the Bank's statement dropped a previous reference to rates possibly having to rise faster than markets expect in future.

Brent crude held above $60/bbl through the week, with prices now having climbed nearly 40% off their mid-June low. Oil is currently benefitting from a combination of factors including declining crude stocks, OPEC discipline on supply cuts, expectations of the cuts being extended through 2018, geopolitical factors and a cyclical upswing in the global economy that is lifting demand. Robust performance of US oil production remains the key negative for crude: US crude exports reached their highest ever level of 2.1 mb/d in late October.

The latest round of forecasts by the IMF saw GDP growth in the Gulf revised down for 2017 and 2018 to 0.5% and 2.2%, respectively (lower by around 0.3-0.4% from May), partly the result of downgrades to oil output linked to OPEC policy. But there were downgrades to non-oil growth too, to 2.6% and 2.4% (also by 0.3-0.4%), with cuts for Qatar, Saudi Arabia and the UAE. This brings the IMF outlook closer in line with our own, which sees non-oil growth at 2.3% this year and 2.5% next.

News of a government clampdown on corruption in Saudi Arabia over the weekend came too late to have a market impact.

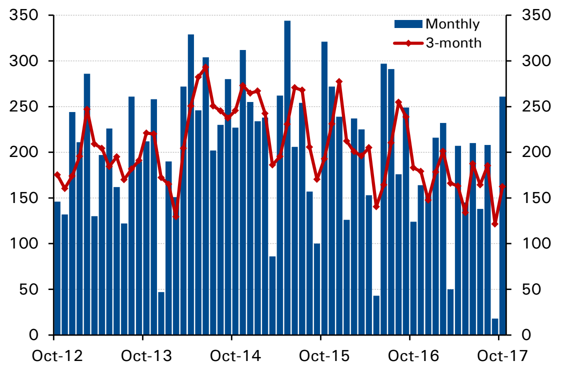
International macroeconomics

USA: Employment was strong in October, with the economy adding 261,000 jobs during the month. September's figure was also revised upward to a gain of 18,000. (Chart 1.) The unemployment rate fell to 4.1%. Other recent economic data continued to confirm strength in the economy. The personal income and spending data for September revealed decent growth. Though October's ISM manufacturing index cooled slightly, it remained at an elevated level at 58.7. The strong data has seen the Atlanta Fed's GDPNow forecast for 4Q17 upped to 4.5%.

Meanwhile, inflationary pressures remained soft. Growth of non-supervisory employee wages slipped to 2.3% y/y in October after two months of stronger figures (Chart 2). The PCE index also showed subdued inflationary trends in September. While no one was surprised when the Fed kept rates unchanged at last week's FOMC meeting, the soft inflation data has not derailed expectations of a December hike; indeed, expectations of that stood at 98% thanks to the solid economic data.

Chart 1: US new jobs (nonfarm payrolls)

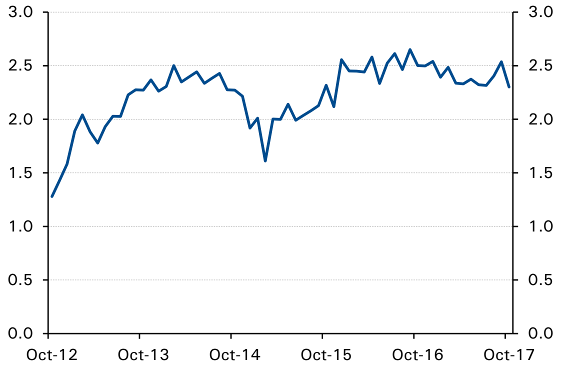
(thousand)



Source: U.S. Bureau of Labor Statistics

Chart 2: US wage growth

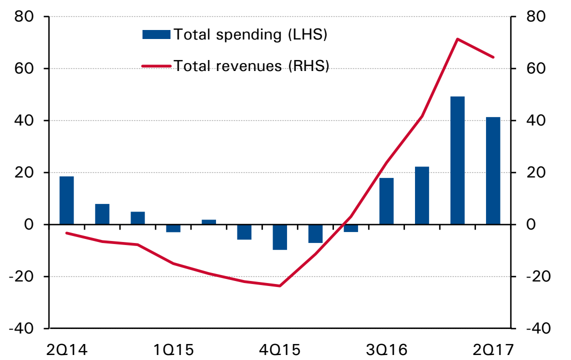
(% y/y, non-supervisory employees)



Source: U.S. Bureau of Labor Statistics

Chart 3: UAE public finances

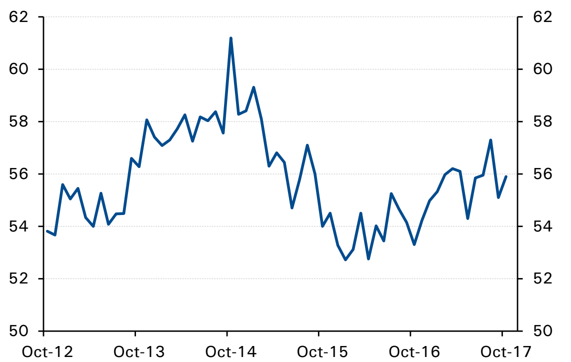
(% y/y, 9-mma)



Source: UAE Ministry of Finance

Chart 4: UAE Purchasing Managers' Index

(index)



Source: Markit

The Trump administration announced it will name Jerome Powell to replace Janet Yellen as Fed chair after her term ends in February 2018. Powell is expected to continue Yellen's more dovish approach to monetary policy, though he is seen as more open to Trump's financial sector deregulation agenda.

Eurozone: Last week's eurozone data was mixed. Flash GDP for 3Q17 came in slightly higher than expected at 0.6% q/q and 2.5% y/y (its strongest pace since 1Q11). Consumer sentiment was positive as well, registering above consensus at 114. Inflation, however, missed expectations, posting its first decline since June, to land at 1.4%. Core inflation was weaker, dropping to 0.9%, its slowest pace since March. The data reaffirms the ECB's view that inflation remains weak, justifying its dovish approach to monetary tightening.

In a surprise move, Italy was upgraded to BBB from BBB- by S&P. The rating agency attributed the promotion to better economic prospects, rising investment, and progress by banks in addressing stressed balance sheets.

China: Provinces in China reported their GDP figures for the first three quarters of 2017, and 22 out of the 27 provinces showed growth figures that exceeded the national GDP 3Q17 growth of 6.9% year-on-year.

China's manufacturing sector experienced expansion at a stable pace, according to Caixin's manufacturing PMI. The index came in at 51 in October, unchanged from September; the sector has posted expansionary levels (above 50) for five consecutive months.

UK: The Bank of England (BoE) raised rates on Thursday by 0.25% to 0.5%, reversing the cut it made in the wake of the Brexit referendum in 2016. The move was widely expected and marks the first time in ten years that interest rates have increased. The Bank's decision, 7:2 in favor of a rate rise, was swayed by rising headline inflation (3.0% y/y in September) and falling unemployment (currently at a 42-year low of 4.3%).

The rate rise comes despite sub-optimal wage growth (negative real wage growth) and forecasts for relatively weak economic growth under the shadow of Brexit. Unlike most advanced economies, the UK economy did not accelerate during 1H17, and by the BoE's own estimate, UK growth is not expected to run higher than 1.7% per annum during the next three years. Last Friday's PMI survey, however, which showed the services sector improving to 55.6 in October from 53.6 in September – the highest reading in six months – would have certainly heartened the BoE's monetary policy hawks.

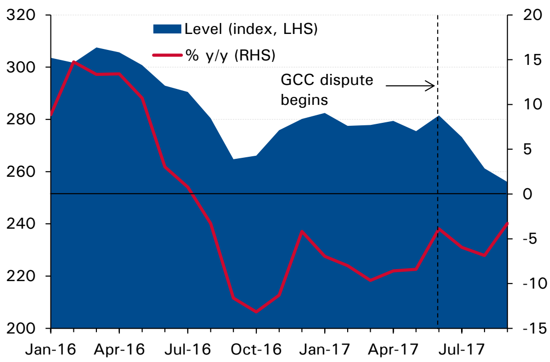
GCC & regional macroeconomics

Kuwait: The government resigned Monday, less than a week after the start of the second session of the National Assembly and just two days before a planned no-confidence vote. His Highness the Amir, Sheikh Sabah Al-Ahmad, asked outgoing PM, His Highness Sheikh Jaber Al-Mubarak, to form his seventh government since 2011. The government's resignation could delay some key legislation including pending draft laws on VAT, excise taxes, and public debt issuance.

Saudi Arabia: A newly-established anti-corruption commission, headed by Crown Prince Mohammed Bin Salman, went after several high profile individuals over the weekend. At least eleven princes, including the billionaire Prince Waleed Bin Talal and several other ministers and officials were arrested on corruption charges. The moves were welcomed by the kingdom's highest religious authority. It's not clear what evidence the

Chart 5: Qatar residential property prices

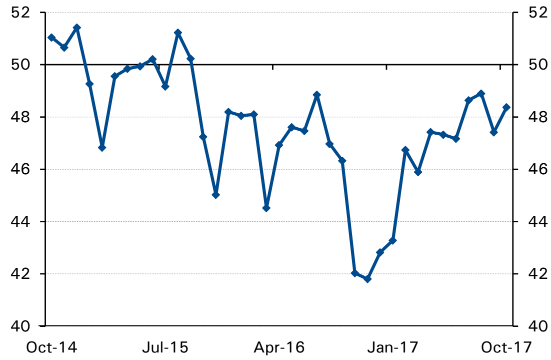
(% y/y)



Source: Qatar Central Bank

Chart 6: Egypt PMI

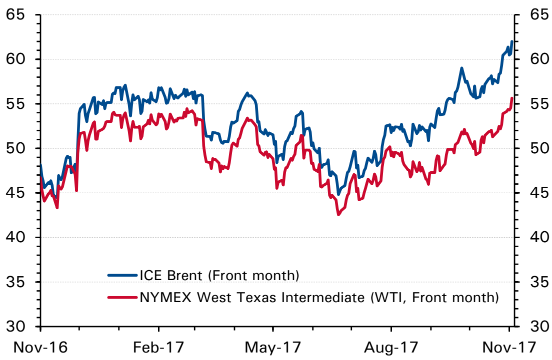
(index)



Source: Markit

Chart 7: Benchmark crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

Chart 8: Total return indices

(rebased, 3 November 2016=100)

Source: Thomson Reuters Datastream

commission has against these individuals, but some critics see the arrests as an opportunity for Mohammed Bin Salman to further consolidate his position as heir apparent. The Minister of Economy and Planning and the head of the National Guard were also replaced.

Meanwhile, the non-oil private sector activity remained firmly in expansion mode in October, according to the latest PMI. The PMI inched up slightly to 55.6 in October from 55.5 in September, buoyed by strong domestic demand; new orders reached 60.1, while operating conditions also improved, as indicated by shorter vendor delivery times.

The IMF revised down its forecast for Saudi GDP growth this year (from 0.4% to 0.1%) and in 2018 (from 1.3% to 1.1%). It cited weaker non-oil activity and reduced oil sector output, with the latter a result of the kingdom's compliance with the OPEC production cut agreement.

UAE: Growth in both public revenues and spending came off slightly in 2Q17, but remain extremely strong at 64% y/y and 41% y/y, respectively. (Chart 3.) Growth in public revenues and spending have been trending upwards since hitting a trough in late 2015, in tandem with a recovery in oil prices. Revenues have been bolstered by higher oil prices as well as an increase in tax receipts. The acceleration in public spending has been largely due to significant increases in project spending, especially as preparations for the Expo 2020 event in Dubai gathered pace. The strength of the official spending numbers are, however, slightly difficult to square with only moderate economic growth conditions.

The PMI continued to point to a steady recovery in non-oil sector activity in October. (Chart 4.) The headline PMI edged up from 55.1 in September to 55.9 in October, amid an ongoing improvement in domestic conditions and a rebound in export orders.

Qatar: The central bank's gauge of the residential property market pointed to renewed weakness in prices in Q3, suggesting that the GCC diplomatic dispute may have affected confidence and activity in the sector. Prices began falling in late 2015 (Chart 5), and although the year-on-year rate was still negative, they appeared to have levelled off in the first half of 2017. Between June and September, however, prices fell by a further 9%. Although the year-on-year rate improved slightly to 3%, we think it is likely to fall back again over the coming months.

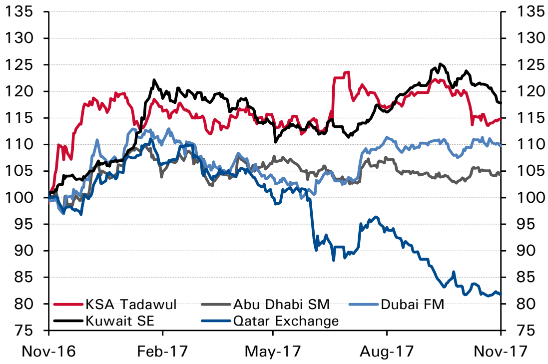
Bahrain: Bahrain has reportedly asked for financial assistance from Saudi Arabia, the UAE and Kuwait to replenish its foreign-exchange reserves – though the claim has not been confirmed by the Bahraini authorities. International reserves have decreased of late amid capital outflows, threatening to put pressure on the currency peg. Reserves stood at $1.4 billion in August or 1.2 months of imports, down from 1.9 months of imports at the end of 2016. The government has vowed to maintain the peg, being one of the key anchors of economic and financial stability.

Egypt: The PMI rose to 48.4 in October, though it continued to indicate growth well below what other data is showing (Chart 6). The index suggests growth of around 2.5%, though the most recent GDP figures have growth at 4.9% in 2Q17. Export orders improved and remained the strongest aspect of the PMI. Price pressures eased slightly during the month, but have yet to return to 'normal' levels.

Lebanon: In a surprise turn, PM Saad Hariri resigned in a statement that hinted at a significant deterioration in the political situation. The resignation, which was announced in Riyadh and comes a year after the

Chart 9: GCC markets

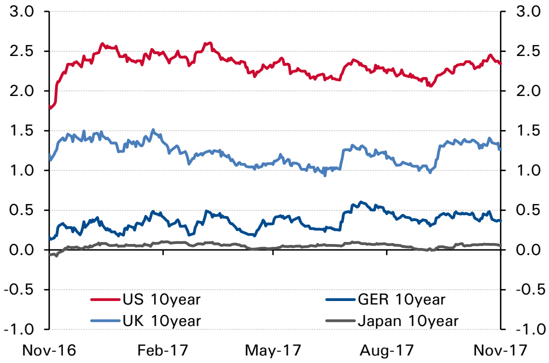
(rebased, 3 November 2016=100)



Source: Thomson Reuters Datastream

Chart 10: Global benchmark yields

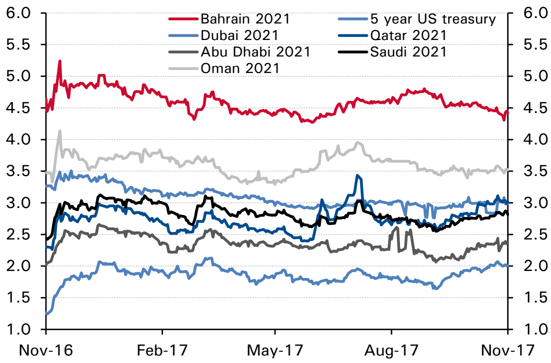
(%)



Source: Thomson Reuters Datastream

Chart 11: GCC yields

(%)



Source: Thomson Reuters Datastream

various sides in Lebanon agreed on a national unity government, took place amid deep frustration by Hariri with the status quo domestically. The move is likely to throw Lebanon back into a period of political uncertainty.

Markets – oil

Oil prices extended their gains last week, with Brent rising to $62.0/bbl and WTI increasing to $55.6/bbl before the end of trading. This is Brent's highest level in more than two-and-a-half years, bringing the crude marker's gains to more than 38% since the end of June. (Chart 7.) Driving the market are further bullish signals emanating from the OPEC camp about extending the production cut agreement to the end of 2018 and concerns that two OPEC members, Nigeria and Venezuela, are struggling to increase crude production amid sabotage by militants and impaired cash flow, respectively. Over in the US, the fact that oil rig counts declined by the most in more than a year was also taken positively by the markets, given that it could presage less dramatic shale output gains in 2018.

Markets – equities

There were no big moves in equities last week, with markets still focused on earnings. The MSCI World All Country index closed up 0.6%. US equities retreated at the beginning of the week on the Russia election probe and possible delays in the passage of the tax bill; however they later reversed the losses on the Fed's positive statement on economic activity, boosting the chances of a December rate hike. The S&P 500 and DJIA were slightly up on the week at 0.3% and 0.5%, respectively, on strong PMI and employment data. European equities bounced, pushing the Euro Stoxx 50 up 1% on the week, supported by the BOE's first rate hike in a decade. Emerging market equities picked up, with the MSCI EM improving 1.2%. (Chart 8.)

GCC markets continued to underperform, with company earnings so far coming weaker than expected. The MSCI GCC index closed the week up 0.6%. The Tadawul was up 0.7% supported by earnings. Boursa Kuwait shed 2.4% following the government's resignation. (Chart 9.)

Markets – fixed income

Benchmark yields were mixed last week. US Treasury yields edged slightly lower, while German Bund yields traded within a tight range and UK gilt yields dipped to their lowest in two months. (Chart 10.) US 10-year yields tightened to 2.34%, down 9 bps on the week, helped by the lack of wage growth in October's employment report, capping inflation expectations.

Mixed signals out of Europe left 10-year Bund yields little changed, down 2 bps on the week, to settle at 0.37%. Cooling tensions in Catalonia, an Italian sovereign rating upgrade, and a mixed batch of data (see EU section) did little to nudge them higher.

While the BoE hiked rates for the first time in ten years, it downgraded its inflation forecast, did not anticipate higher wages, and heeded caution in the face of Brexit. The latter caught markets off-guard. Investors were quick to reverse their bets, adjusting for a much milder than expected rate hike path. Yields on 10-year gilts dropped 8 bps to 1.27%.

GCC sovereign yields ended the week lower, tracking US Treasuries. Yields for most sovereigns maturing in 2021 and 2022 declined by 3 to 4 bps, with Qatar 2021 yields falling back below 3%. (Chart 11.)

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