Fed rate hike is followed by most in GCC; Kuwait holds rates steady; Qatar crisis remains unresolved

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,502	0.56	-0.98
Bahrain ASI	1,327	0.27	8.73
Dubai FM	3,459	1.75	-2.02
Egypt EGX 30	13,479	-1.50	9.18
S&P GCC 40	1,066	-0.43	-7.76
Kuwait SE	6,811	0.40	18.49
KSA Tadawul	6,821	-0.65	-5.40
Muscat SM 30	5,248	-1.99	-9.24
Qatar Exchange	9,258	0.22	-11.30
International			
CSI 300	3,519	-1.61	6.31
DAX	12,753	-0.49	11.08
DJIA	21,384	0.53	8.21
Eurostoxx 50	3,544	-1.18	7.70
FTSE 100	7,464	-0.85	4.49
Nikkei 225	19,943	-0.35	4.34
S&P 500	2,433	0.06	8.68

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	47.4	-1.62	-16.63
KEC	44.6	-2.08	-14.65
WTI	44.7	-2.38	-16.72
Gold	1254.0	-1.14	9.04

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.303	0.03	-0.75
KWD per EUR	0.338	-1.08	6.19
USD per EUR	1.120	0.04	6.51
JPY per USD	110.840	0.46	-5.16
GBP per USD	1.277	0.27	3.55
EGP per USD	18.130	0.11	0.72

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor - 3 month	2.43	22.5	32.5
Kibor - 3 month	1.63	0.0	18.8
Qibor - 3 month	2.32	15.3	53.5
Eibor - 3 month	1.50	1.2	2.5
Saibor - 3 month	1.77	3.5	-26.6
Libor - 3 month	1.27	3.9	27.0

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.22	-15.3	-30.8
Dubai 2021	2.90	-3.6	-39.6
Qatar 2021	2.71	-31.3	-21.8
Kuwait 2022	2.51	-2.3	n/a
Saudi Arabia 2022	2.79	-12.3	n/a
International			
UST 10 Year	2.16	-4.2	-27.5
Bunds 10 Year	0.28	1.6	7.1
Gilts 10 Year	1.02	1.1	-22.3
JGB 10 Year	0.06	0.0	0.7

Source: Thomson Reuters Datastream; as of Friday close

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Summary

The US Fed went ahead with a widely expected rate hike last week, reflecting solid or as-expected economic data in the US, and progress in achieving the inflation target. The FOMC raised the target federal funds rate by 25 bps to 1.0-1.25%. Conditions elsewhere were also benign, including further evidence of solid growth in the eurozone. There was little direct reaction in most markets as the move by the Fed was telegraphed in advance.

A strong showing in the first round of the French legislative elections by Macron's party also should pave the way for his reformist and pro-growth agenda.

Regionally, the Qatar crisis remained unresolved despite efforts by Kuwait and the international community to mediate. While sanctions on Qatar weighed on its outlook, most analysts believe that the country has ample resources to withstand the pressure for the time being.

Most regional central banks followed the US Fed hike by raising policy rates, though Kuwait was a notable exception. Saudi Arabia, UAE, Qatar, and Bahrain hiked rates as they sought to support their currency pegs. In Kuwait, ample liquidity saw the central bank keep rates unchanged in order to avoid impacting moderate domestic growth.

Oil prices fell to 7-month lows last week after US gasoline stocks appeared to rise ahead of the summer driving season.

International macroeconomics

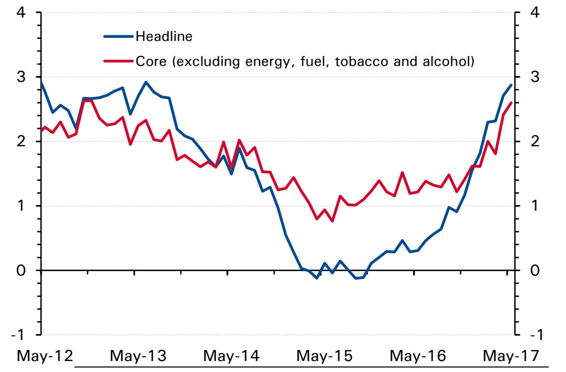
US: As expected, the Fed hiked its federal funds target rate by 25 bps on 14 June to 1.-1.25%. The move reflected the view that economic data has been quite solid, with labor conditions improving, and that inflation is nearing its 2% target. The Fed (in its dot-plots) is still signaling one more hike this year, though markets are pricing in less than a 50% likelihood. Also, most FOMC members expect 3 further hikes in 2018, which at this point appears to us as excessive, especially with inflation well-contained and oil prices wobbling.

The Fed also announced it will start gradually and slowly reducing the size of its balance sheet ($4.3 trillion) later this year. Once it starts, the Fed will begin by allowing $10 billion in assets (both Treasuries and Agencies) to mature every month; this will be increased gradually to $50 billion over a period of 12 months. This is indeed very slow and cautious, as it would take 2 years to bring down the current $4.3 trillion portfolio to $3.4 trillion. Recall that the Fed's portfolio was under $1 trillion before the 2008 crisis.

Inflation was milder than expectations in May, which contributed further to views that another Fed hike in 2017 is less likely. The overall CPI was up 1.9% y/y, with the index actually slipping 0.1% during the month. Retail sales data was also softer than expected in May, falling 0.3% m/m.

Chart 1: UK inflation

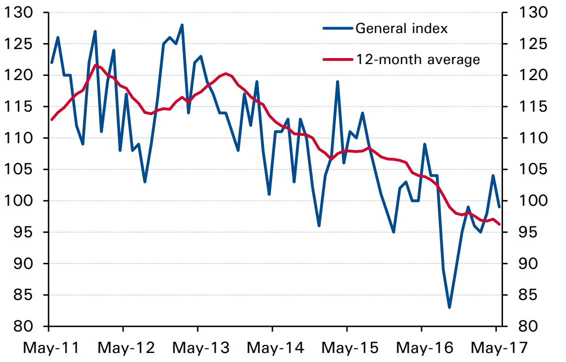
(% y/y)



Source: ONS, Thomson Reuters Datastream

Chart 2: Kuwait consumer confidence

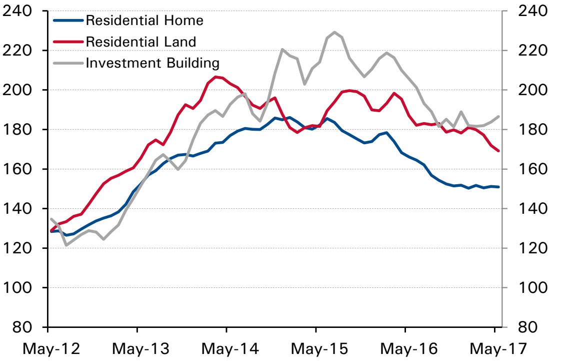
(index)



Source: ARA Research & Consultancy

Chart 3: Kuwait real estate prices

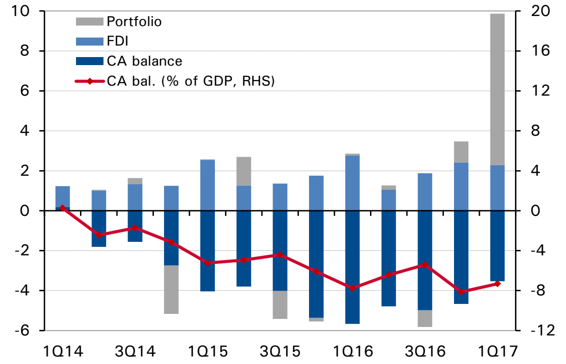
(NBK real estate indices, 2010=100)



Source: NBK

Chart4: Egypt balance of payments

(CBE foreign reserves)



Source: Central Bank of Egypt

Eurozone: French President Macron's party, "La République en Marche" (REM or LRM), is expected to win an unprecedented majority in the national assembly. REM (or LRM) garnered 32% of the votes in the first round of voting, with polls estimating that this would translate to 390-430 seats (out of a total of 577). The biggest losers will be the Socialists, who are expected to lose 90% of their seats.

In Italian local elections the anti-establishment and anti-EU Five Star Movement faired poorly. This may be reflecting the waning support for such movements in the wake of an improving economic environment. Indeed, the Italian central bank has revised its growth outlook higher. It now expects Italy to grow by 1.3% in 2017, up from 1%, following a stronger-than-expected 1Q17. Markets were pleased, as the likelihood of a more establishment-friendly win in next year's elections has increased.

Greece was able to secure EUR 8.5 billion from its creditors, helping it avoid default on EUR 7 billion of its debt due in July. This disbursement will be part of the third tranche of its current bailout, and was allowed following Greece's adherence to preset austerity reforms. Although discussed, no firm commitment was made on debt relief, with creditors looking to further delve into the topic well after German elections this year. The IMF still hasn't removed itself from the negotiations. It is prepared to offer Greece a less than EUR 2 billion stand-by agreement once debt relief measures are concretized.

Eurozone (EZ) indicators continue to paint a reassuring picture. EZ industrial production came in above expectations and continued to improve, registering at 1.4% y/y. Germany's ZEW economic sentiment survey, however, eased unexpectedly to 18.6 from 20.6 in May, yet global growth is still expected to underpin German economic activity.

UK: Inflation reached a 4-year high of 2.9% y/y in May (0.3% m/m). (Chart 1.) This was above analysts' forecasts, which were for May's rate to hold steady with April's at 2.7%. The figures confirm that UK retailers have begun to pass on to consumers the higher costs associated with a depreciating pound.

GCC & regional macroeconomics

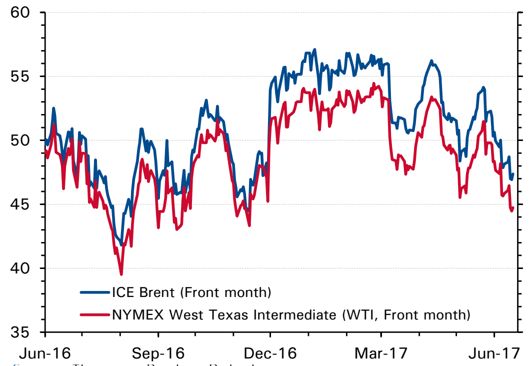
Kuwait: The central bank decided to keep the discount rate unchanged at 2.75% late on Wednesday, choosing not to follow the US Fed's 25 bps hike as it had done the previous three times. The decision is likely a reflection of the comfortable liquidity situation domestically. The CBK may also believe that growth, while decent, is too fragile to justify a third rate hike in the span of just six months.

Consumer confidence weakened in May, as the Ara index retreated back to 99, failing to stay above 100 for more than a month. The index, on a downward trend for four years, fell more rapidly in 2016 after the government hiked fuel prices. It has since recovered somewhat, though the general index's 3-month average in May was still down 2.5% y/y. The durable goods component has remained particularly unimpressive, with the 3-month average down 9% y/y. (Chart 2.)

The real estate market picked up momentum in May. Sales rose by 37% y/y to KD 289 million, their highest level in 18 months. The residential and investment sectors provided significant support to the real estate market, with sales increasing by 23% and 38% y/y, respectively. Real estate prices across most sectors continued to hold steady, although they are still off by 9-10% y/y. (Chart 3)

Chart 5: Crude oil prices

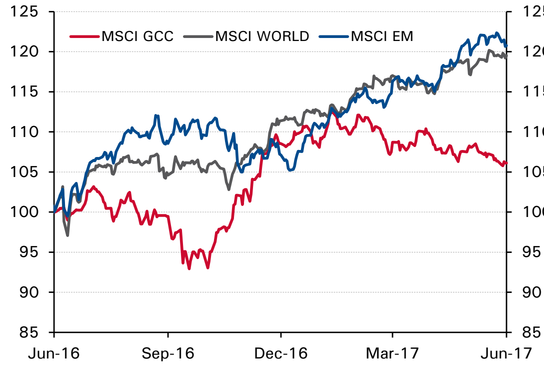
($/bbl)



Source: Thomson Reuters Datastream

Chart 6: Total return indices

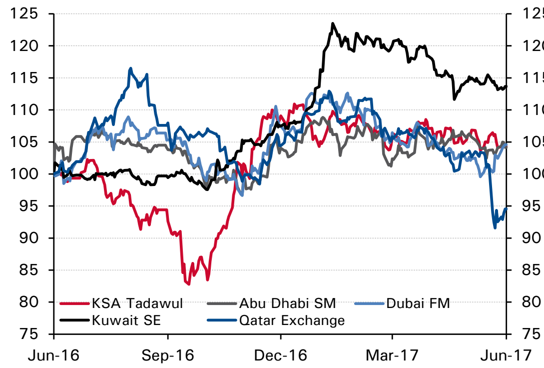
(rebased, 17 June, 2016=100)



Source: Thomson Reuters Datastream

Chart 7: GCC Markets

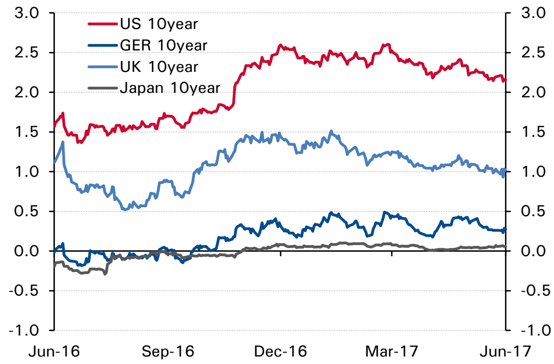
(rebased, 17 June, 2016=100)



Source: Thomson Reuters Datastream

Chart 8: Global bond yields

(%)



Source: Thomson Reuters Datastream

Saudi Arabia: Following the US Fed's move, SAMA raised its benchmark reverse repo rate by 25 bps to 1.25%. This is the second rate rise this year and the fourth since the Fed began 'normalizing' monetary policy in late 2015. The Saudi repo rate was left unchanged at 2.0%.

UAE: In a bid to safeguard its currency peg to the US dollar, the UAE Central Bank also raised its key policy rate, the repo rate, by 25 bps for the second time this year, to 1.50%.

Qatar: The Qatar Central Bank raised its QMR deposit rate (QMRD) on Thursday by 25 bps to 1.5%. The QMR lending (QMRL) and Repo rates were left unchanged.

Inflation eased further in May to 0.1% from 0.6% in April y/y. This is the lowest rate since early 2015. Prices in the housing and utilities category of the consumer basket (22% weight) fell by 2.3% y/y while costs in the food and beverages category (13% weight) dropped by 1.9% y/y. Transport costs (15% weight), however, increased by 7.9% y/y, following the rise in domestic fuel prices.

As the diplomatic dispute between Qatar and its neighbors enters its third week, the Qatari authorities revealed that since 2015 they have prosecuted five men on the US Treasury sanctions list for financing terrorism. They plan to charge two more individuals. This may not be enough to appease Qatar's neighbors, however; on Friday the Saudi foreign minister, Adel Al-Jubeir, reported that the kingdom, along with Bahrain, Egypt and the UAE, is preparing a list of "grievances" to be presented to Qatar. Al-Jubeir said that Qatar must halt its support for "extremism and terrorism", without which a rapprochement will be impossible.

Qatari banks are reported to have raised their deposit rates in order to shore up and attract foreign deposits in the wake of the diplomatic dispute. The banking system is at risk of experiencing outflows after the central banks of Saudi Arabia and the UAE instructed their banks to reduce business with Qatar. Up to $26 billion of GCC funds (8% of total banking sector liabilities) could be among the first wave of deposits to be withdrawn. Qatari banks are said to be offering a 100 bps premium over LIBOR to attract deposits.

Egypt: The current account deficit shrank to its lowest level in over two years in 1Q17, to $3.5 billion or 7.3% of GDP, and portfolio inflows skyrocketed following the pound float. (Chart 4) The current account benefited from strong export growth, which topped 30% y/y in 1Q17. The quarter also saw tourism receipts and remittances bounce back. Net investment portfolio inflows shot up to $7.6 billion during the quarter, possibly the largest such inflow ever recorded. Reserves added $4 billion in 1Q17 to $29 billion; they rose further to $31 billion by the end May.

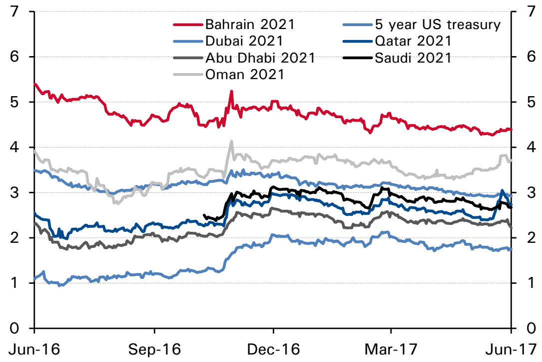
The CBE removed its $100,000 cap on foreign currency transfers abroad; with this step, the CBE did away with the last remaining limit on the movement of funds as it sought to complete the liberalization of the external account following the floatation of the currency in November.

Markets – oil

The oil market is providing little in the way of comfort for oil bulls right now. Prices fell to 7-month lows last week after US petroleum inventory data showed gasoline stocks rising for the second consecutive week, by 2 million barrels (mb), and crude stocks declining by 1.6 mb. The extent of the crude stock drawdown was less than the markets had been

Chart 9: GCC bond yields

(%)



Source: Thomson Reuters Datastream

anticipating. By Friday's close, Brent and WTI had dropped to $47.37/bbl and $44.74/bbl, respectively. The increase in stocks (distillates also increased) is running counter to historical trends, with the peak summer driving season usually associated with stock draws. To the markets, it appears that the increase in US shale supplies is offsetting the supplies withdrawn by OPEC/non-OPEC. (Chart 5.)

The IEA, in its monthly oil market report, has adjusted its projections upwards for US shale-led non-OPEC supply growth in 2018. Supplies are expected to grow by 1.5 mb/d in 2018—more than double the rate of growth expected this year—and US shale will account for 780,000 b/d of this increase (81% higher than 2017's expected growth of 430,000 b/d). Global crude demand growth has also been adjusted upwards, by 100,000 b/d to 1.4 mb/d, thanks to buoyant demand in China and India.

OPEC secondary source for May show that while overall group compliance was at 105%, higher production from Nigeria and Libya, two countries exempt from production quotas, pushed OPEC output above 32 mb/d.

Markets – equities

The performance of equity markets was mixed, with the MSCI World index closing the week down 0.2%. US stocks outperformed despite the selloff that hit technology stocks earlier in the week and which spread to tech sectors around the globe. The S&P 500 and DJIA advanced 0.1% and 0.5%, respectively. Meanwhile, European equities retreated despite a strong showing for French President Emmanuel Macron's party in legislative elections and the setback dealt to Italy's populist Five Star Movement. The Euro Stoxx 50 retreated 1.2%. Emerging markets were also down on the week, with the MSCI EM declining 1.2%. (Chart 6.)

Qatari equities took a breather from the big selloff that hit them last week following the severing of diplomatic ties by Saudi Arabia and some of its neighbors. The Qatari general index was up 0.2%. The performance among other GCC markets was mixed, but volumes continued to fall across the board. The MSCI GCC was down 0.2%. (Chart 7.)

Most GCC central banks followed the Fed's 25 bps interest rate hike last week, though the impact on GCC markets was minimal.

Markets – fixed income

Global bond markets continued to trade within a narrow band, starting the week against a backdrop of low volatility and caution ahead of policy announcements by several central banks. (Chart 8.) To begin, the Fed hiked its rate by 25 bps as was widely expected, despite disappointing retail and inflation numbers. It also struck a hawkish tone (another hike in 2017, 3 in 2018). It further indicated its resolve to carry on with unwinding its enormous balance sheet. US 10-year yields saw little movement upwards as the announcement was already fully priced in; they finished the week near 2.15%. Meanwhile, both the BOE and the BOJ held their policies steady. The former, however, came very close to hiking its rate, with 3 of its 8 members voting in favor, on the grounds of rising inflationary pressures. 10-year gilts and 10-year Bunds moved little on the week, however, while 10-year JGBs were virtually unchanged.

GCC jitters related to the Qatar crisis seem to be abating: sovereign yields on bonds maturing in 2021 for Abu Dhabi and Dubai, and 2022 for Saudi fell 4-15 bps this week, Qatar's 2021 bond dropped 31 bps. (Chart 9.) Kuwait's 2022 bond saw little movement, off 4 bps, ending at 2.51%.

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