Weekly Economic and Markets Review

NBK Economic Research Department I 5 August 2018

International & MENA

Fed leaves rates on hold but seen hiking next month; crude prices ease as OPEC production rises

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,811	-0.68	9.39
Bahrain (ASI)	1,349	-1.37	1.31
Dubai (DFMGI)	2,974	0.85	-11.75
Egypt (EGX 30)	15,806	3.99	5.24
GCC (S&P GCC 40)	1,100	-0.68	11.70
Kuwait (All Share Index)	5,206	-0.38	7.77
KSA (TASI)	8,254	-1.36	14.21
Oman (MSM 30)	4,327	-0.21	-15.15
Qatar (QE Index)	9,981	3.89	17.10
International			
CSI 300	3,315	-5.85	-17.75
DAX	12,616	-1.90	-2.34
DJIA	25,463	0.05	3.01
Euro Stoxx 50	3,482	-1.27	-0.62
FTSE 100	7,659	-0.55	-0.37
Nikkei 225	22,525	-0.83	-1.05
S&P 500	2,840	0.76	6.24

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.50	-3.2	55.9
Dubai 2022	3.85	-3.8	70.8
Qatar 2022	3.64	-0.2	56.9
Kuwait 2022	3.48	3.8	67.9
Saudi Arabia 2023	3.83	2.8	61.9
International			
UST 10 Year	2.95	-1.0	54.1
Bunds 10 Year	0.41	-0.1	-1.6
Gilts 10 Year	1.33	4.9	14.1
JGB 10 Year	0.11	1.2	6.1

3m interbank rates	%	Change (bps) weekly	YTD
Bhibor	3.50	0.0	77.5
Kibor	2.06	0.0	18.8
Qibor	2.65	2.8	-9.4
Eibor	2.56	3.8	76.4
Saibor	2.61	-0.1	71.0
Libor	2.34	0.2	64.6

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.303	0.06	0.44
KWD per EUR	0.352	0.00	-0.76
USD per EUR	1.157	-0.76	-3.58
JPY per USD	111.3	0.20	-1.26
USD per GBP	1.301	-0.75	-3.75
EGP per USD	17.84	0.34	0.62

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	73.2	-1.45	9.48
KEC	71.20	-2.14	12.13
WTI	68.5	-0.29	13.36
Gold	1214.2	-0.69	-7.05

Source: Thomson Reuters Datastream; as of Friday's close 3/8/2018

Overview

Global monetary policy was back in focus last week, with central banks continuing to chart a course between higher interest rates required for policy normalization on the one hand, and a largely benign inflation outlook and downside risks to growth on the other. As expected, the US Fed left rates unchanged and delivered an upbeat assessment of the economic outlook, while the Bank of England increased rates for only the second time since the financial crisis, despite Brexit-related uncertainty. The most notable move however came from the Bank of Japan, which avoided a change in its inflation target that might have triggered tighter policy, but introduced so-called "forward guidance" and said it would tolerate yields on 10-year government bonds rising fractionally further above its 0% goal. The shift pushed JGB yields to an 18-month high of 0.12%.

This came against a backdrop of mounting tension over global trade, with the US threatening to hike tariffs on $200 billion of imports from China to 25% from the 10% announced before, and China promising retaliatory tariffs if the US follows through. The Chinese central bank did, however, take steps to curb downward pressure on the renminbi which has plunged in recent weeks against the US dollar – possibly an attempt to assuage US criticism of China's "cheap currency" policy.

The price of Brent crude fell 1.5% w/w to finish at $74.2/bbl, following a large mid-week drop on a surprise rise in US crude inventories. There are also signs that OPEC producers are ramping up output following the agreement to ease supply restrictions which took effect from July, with output in linchpin producer Saudi Arabia now close to an all-time high. This has helped offset concern of falling Iranian supply as US sanctions kick in over coming months.

In the GCC, closing accounts for FY2017/18 showed Kuwait's budget deficit narrowing to 8.9% of GDP from 13.8% a year earlier on higher oil prices and despite an unexpectedly strong increase in spending. Meanwhile, Kuwait's stock market logged its best performance in a year and a half in July, increasing by nearly 6% on growing foreign investor interest and strong demand for newly-listed Integrated Holding.

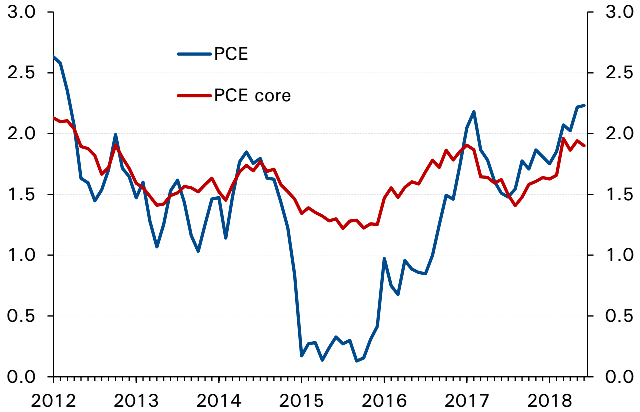
International macroeconomics

USA: As expected, the Federal Reserve kept monetary policy on hold in August, leaving the range for the Fed Funds rate at 1.75-2.00% while continuing its unwind of quantitative easing. It also delivered an upbeat assessment of the economy, citing the "sustained expansion of economic activity, strong labor market conditions and inflation near the ... symmetric 2% objective over the medium term," while avoiding warnings over downside risks from escalating trade wars. The comments confirmed the likelihood of a rate increase in September, with markets now assigning a 90% probability of a 25 bps hike followed by a 60%+ chance of another in December.

The Fed will be mildly encouraged by news that the core personal consumer expenditure price gauge – its preferred inflation measure – was unchanged at 1.9% y/y in June but below expectations, easing concerns of overheating. (Chart 1.)

Chart 1: US inflation

(% y/y, personal consumer expenditure measure)



Source: Thomson Reuters Datastream

Last week's economic data generally confirmed buoyant activity conditions. Consumer spending rose a very solid 0.4% m/m in June and 5.1% y/y, with May numbers revised higher. The Conference Board's consumer confidence measure also beat the consensus in July and stayed close to recent 17-year highs. Non-farm payroll gains for July came in lower than expected at 157,000, perhaps reflecting capacity issues and following significant upward revisions to previous months. ISM and PMI surveys showed activity in manufacturing and services sectors easing slightly in July but still at very strong levels.

Eurozone: The Eurozone expanded by a smaller-than-expected 0.3% q/q in 2Q18, compared to 0.4% in 1Q18. The softer performance was in line with a slew of indicators hinting at still weak growth during the second quarter. However, domestic demand remains strong, labor markets are tightening, and sentiment remains above average, possibly helping support future growth despite the dip in business confidence due to trade uncertainties.

Meanwhile, Eurozone inflation trended higher on rising energy and core prices. Headline inflation hit 2.1% in July, while core inflation surprised at 1.1%, up from 0.9% in June. Stronger fundamentals and high oil prices could see this trend carry through the rest of 2018.

China: The official purchasing managers Index (PMI) showed manufacturing activity weakened slightly in July, slipping to 51.2 from 51.5 in June and its lowest reading since February on the back of a brewing trade war with the US, bad weather and weaker domestic demand. The official services PMI figure (more closely watched by Chinese policymakers) also fell for the first time in five months, to 54.0 from 55.0 in June, amid a slowdown in spending. The services sector currently makes up more than half of China's economy and policy makers are increasingly looking to growth in services and consumption to help veer the economy away from an export and investment-led growth model.

Japan: The Bank of Japan held monetary policy steady, maintaining its target for the 10-year government bond yield at or around 0% and the short-term interest rate target at -0.1%. However, it added that it will adopt a more flexible approach for its long-term yield target, allowing for greater movement in 10-year yields. The announcement comes after reports that the bank was mulling ways to improve policy sustainability, which lifted government bond yields. It also acknowledged that more time was needed to achieve its 2% inflation target.

GCC & regional macroeconomics

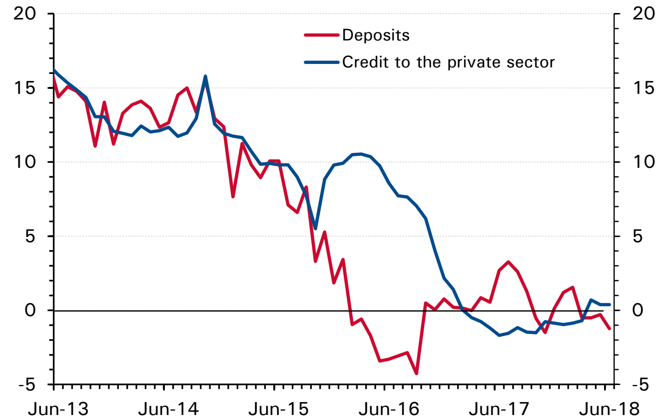
Kuwait: Credit rose by a whopping KD 712 million, its strongest monthly increase in two years, on strong borrowing by businesses and usual end-of-quarter increases related to lending for the purchase of securities. As a result, credit growth accelerated for the first time in eight months, jumping to 1.7% y/y from 0.8% in May. Year-to-date, however, lending is still lagging, with only KD 0.8 billion borrowed in the first half of the year compared to an average of KD 1.1 billion during similar periods in the last five years. We expect total credit to end 2018 up 4% y/y.

Saudi Arabia: Bank credit growth to the private sector increased slightly by 0.4% y/y in June, while total deposits in commercial banks dropped 1.2% to SAR1.61 trillion, as the government continued to withdraw emergency funds injected when oil prices slumped. (Chart 2.) If sustained, credit growth combined with shrinking deposits could lead to funding pressures in the banking sector.

Meanwhile, the central bank's total reserve assets rose by 0.9% y/y in June to $507 billion, attributed mainly to a 13.4% increase in foreign currency and deposits abroad. Remittance outflows by expatriates in the kingdom increased by 2% y/y to SAR10.6 billion, but fell 16.9% from May.

Chart 2: Saudi Bank credit and deposits

(% y/y)



Source: SAMA, Thomson Reuters Datastream

Markets – oil

Crude oil prices had an up and down week, with Brent crude dropping 2.5% on Wednesday on an unexpected rise in US crude inventories in w/e July 27th, before a partial recovery the following day left it down 1.5% w/w at $73.2/bbl. (See chart 3.) US benchmark WTI dropped a smaller 0.2% w/w. Continued global trade tensions are also weighing on crude prices, and particularly the threat of slowing growth in Asia.

Chart 3: Brent crude oil price

($/bbl)

Source: Thomson Reuters Datastream

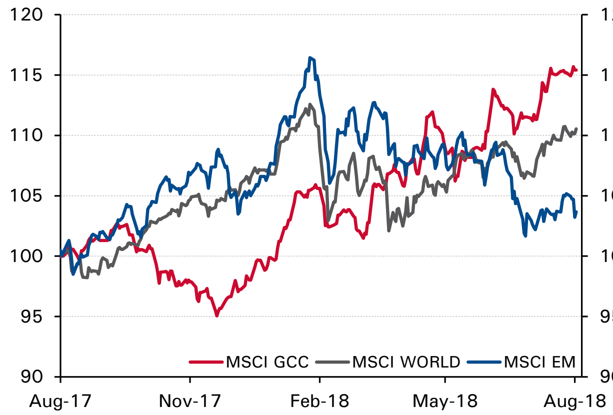
For July overall, Brent crude fell 7%, its largest monthly decline in two years despite the looming prospect of the withdrawal of Iranian supplies from the market as US sanctions are re-imposed from November. There are signs of rising output in other OPEC countries following the agreement to ease previous supply cuts by up to 1 million b/d which took effect from July. According to survey estimates, Saudi production for example may have risen 230,000 b/d in July to a near all-time high of 10.65 million b/d, with compliance among the OPEC-12 countries subject to the quota deal at an improved 105% from 131% in June. Although the latest rise in output threatens to push the market into a position of oversupply in the near term, some see it as a move by producers to temporarily build stocks in advance of an Iran-related market tightening in the autumn.

Markets – equities

Most international markets were down, affected by the ramp up in US-China trade tensions. The MSCI AC world index was down 0.1% w/w. Despite the increase in tariffs on Chinese imports and a relatively soft jobs report, US stocks held firm, with the S&P 500 up by 0.8% w/w, while the DJI ended the week flat. Weaker data out of Europe pushed the Euro Stoxx 50 lower by 1.3%, while the MSCI EM declined by 1.4% on growing trade uncertainties. (Chart 4.)

Chart 4: International equity indices

(rebased, 3 August 2017=100)

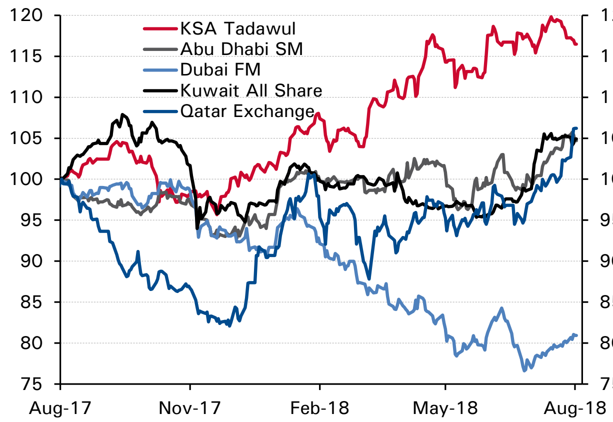


Source: Thomson Reuters Datastream

Strong bank and property earnings supported Qatar and Dubai stocks, while the rest of the region was down, with the MSCI GCC index up 0.2% w/w. Saudi was the worst performer, down 1.4% w/w on high valuation concerns and a lagging, albeit positive, performance by its banking sector. (Chart 5.)

Chart 5: GCC equity markets

(rebased, 3 August 2017=100)



Source: Thomson Reuters Datastream

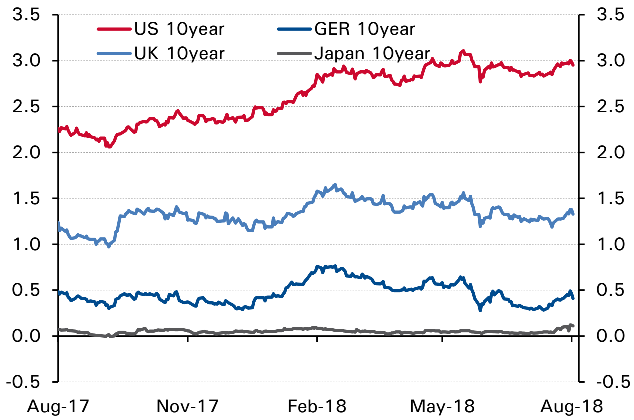
The Qatari market continued its recovery, now up 17% year-to-date and returning to levels seen before the start of the dispute with its GCC neighbors last summer, boosted by higher oil and gas prices and an increase in foreign ownership limits.

Markets – fixed income

Anticipation ahead of key central bank meetings as well as trade tensions had yields on edge. Speculation over a change in Japanese monetary policy, a sure rise in the BOE rate, and an announcement of higher US borrowing helped push up international yields for most of the week. Rates then fell, however, following growing tension in US-China trade. US 10-year yields were down 1 basis point to 2.95%, while 10-year bunds were unchanged at 0.41%. (Chart 6.) Meanwhile, GCC yields were mixed, as investors weighed the impact of rising trade tensions against higher oil prices. (Chart 7.)

Chart 6: Global bond yields

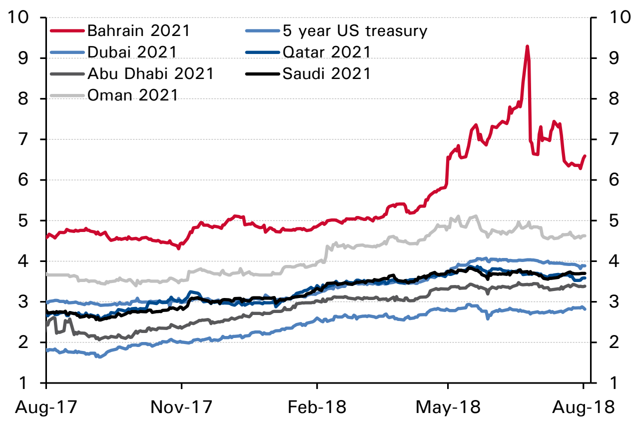
(%)



Source: Thomson Reuters Datastream

Chart 7: GCC bond yields

(%)



Source: Thomson Reuters Datastream

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