Weekly Economic and Markets Review

NBK Economic Research Department I 07 October 2018

International & MENA

Strong US data triggers bond market sell-off; Brent crude hits near four-year high of $86

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	5,007	1.20	13.84
Bahrain (ASI)	1,325	-1.75	-0.51
Dubai (DFMGI)	2,792	-1.20	-17.16
Egypt (EGX 30)	14,105	-3.61	-6.09
GCC (S&P GCC 40)	1,102	1.20	11.92
Kuwait (All Share Index)	5,111	-0.53	5.81
KSA (TASI)	7,998	1.25	10.67
Oman (MSM 30)	4,526	0.04	-11.25
Qatar (QE Index)	9,902	1.21	16.18
International			
CSI 300	3,439	0.00	-14.69
DAX	12,112	-1.10	-6.24
DJIA	26,447	-0.04	6.99
Euro Stoxx 50	3,346	-1.58	-4.52
FTSE 100	7,319	-2.55	-4.80
Nikkei 225	23,784	-1.39	4.48
S&P 500	2,886	-0.97	7.93
Bond yields	**%**	**Change (bps) weekly**	**YTD**
Regional			
Abu Dhabi 2022	3.61	12.6	66.6
Dubai 2022	4.08	14.5	93.9
Qatar 2022	3.63	14.1	55.9
Kuwait 2022	3.60	10.6	79.6
Saudi Arabia 2023	3.83	8.6	61.6
International			
UST 10 Year	3.23	17.1	81.6
Bunds 10 Year	0.56	9.0	14.0
Gilts 10 Year	1.73	15.2	53.8
JGB 10 Year	0.15	2.3	9.9
3m interbank rates	**%**	**Change (bps) weekly**	**YTD**
Bhibor	3.73	0.0	100.0
Kibor	2.06	6.3	18.8
Qibor	2.78	10.1	4.2
Eibor	2.70	-0.4	89.8
Saibor	2.73	2.0	83.3
Libor	2.41	1.4	71.5
Exchange rates	**Rate**	**Change (%) weekly**	**YTD**
KWD per USD	0.303	0.14	0.71
KWD per EUR	0.355	0.00	0.06
USD per EUR	1.152	-0.73	-3.94
JPY per USD	113.7	0.02	0.91
USD per GBP	1.312	0.72	-2.89
EGP per USD	17.84	0.28	0.62
Commodities	**$/unit**	**Change (%) weekly**	**YTD**
Brent crude	84.2	1.74	25.86
KEC	82.66	3.91	30.17
WTI	74.3	1.49	23.04
Gold	1201.2	0.81	-8.05

Source: Thomson Reuters Datastream; as of Friday's close 5/10/2018

Overview

Global bond markets suffered a major sell-off last week, with the yield on US 10-year treasuries surging 17 bps to 3.23% following the release of bullish US survey and labor market data and comments by Fed Chairman Jay Powell that reinforced the case for higher policy rates. The bond market repricing also hit equities, with the US S&P falling an aggregate 1.4% in the last two days of the week and also reapplied pressure on emerging markets, where stocks declined 3.7% w/w and currencies – notably in India, Turkey and South Africa – fell.

Crude oil prices continued their now four-week rally with Brent crude finishing up 1.7% w/w at $84/bbl, having hit a near four-year high of $86 mid-week. Investors are fretting over the response – or lack of – by OPEC to the impending (and potentially large) drop in Iranian supply as US energy sanctions on Iran are re-imposed from November. Saudi Arabia's energy minister announced that Saudi output had hit 10.7 million b/d in October and would rise further in November, a move that would take output to record levels amid market concerns over the true scale of the kingdom's available spare capacity.

In Egypt, after four successive bond auction cancellations the government managed to sell EGP904 million worth of three and seven-year bonds last Monday, albeit at an 18.4% rate that is 370bps above the average debt cost it had targeted in this year's budget. Egypt – set to run a 9.5% of GDP fiscal deficit this year – has suffered from a combination of rising inflation (now 14%), rising international interest rates and increased investor risk aversion amid weaker sentiment towards emerging markets generally.

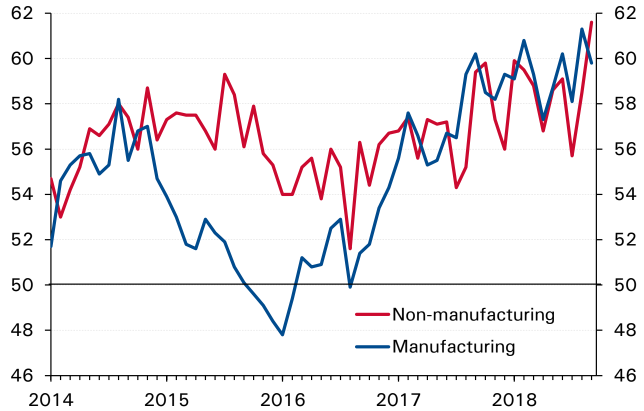
Meanwhile, after months of discussions, GCC governments have agreed to provide Bahrain with $10 billion in aid over five years as the Bahraini government pursues reforms aimed at eliminating its large budget deficit by 2022.

International macroeconomics

USA: Supporting the Fed's recent decision to raise interest rates, the latest batch of survey data suggests strong economic growth in 3Q18. The ISM activity index for manufacturing slipped slightly in September, but remained exceptionally strong at 59.8 with strong output levels offsetting concerns over tariffs and cost pressures due to capacity shortages. More eye-catching still was the surge in the equivalent non-manufacturing survey to an all-time high of 61.6, on higher readings for output and employment. (Chart 1.)

Chart 1: US ISM activity indices

(index, above 50 = expansion)



Source: Thomson Reuters Datastream

Fueling the positive mood was news on the labor market, with unemployment falling to a 49-year low of 3.7% in September from 3.9% in August. Employment rose by a below-consensus (though still positive) 134,000 m/m, but this was accompanied by a big upward revision to the previous month's gains. Wages rose 2.8% y/y, slightly softer than in August. Still, together with comments by Fed Chairman Powell that the policy rate may go beyond the "neutral rate", last week's strong data pushed the yield on the 10-year government bond to 3.23%, its highest since 2011.

Finally, the goods and services trade deficit widened to $53 billion from $50 billion in July, with the deficit with China reaching a record $39 billion as US soybean exports fell back after a previous tariff-related boost. Two months in, the data point to a lower contribution from net exports to GDP growth in the third quarter, after a large positive contribution in Q2.

Eurozone: The final September PMI (54.1) affirmed the divergence between the Eurozone's external and domestic sectors. The expansion in manufacturing PMI (53.2) was at its slowest since mid-May 2016, on weak demand for new export orders, as well as subdued business confidence. The services PMI (54.7) however edged higher in September, but remains frail. Retail sales for August witnessed a second consecutive month of decline – and although up 1.3% y/y still below the 2017 average of 2.4%.

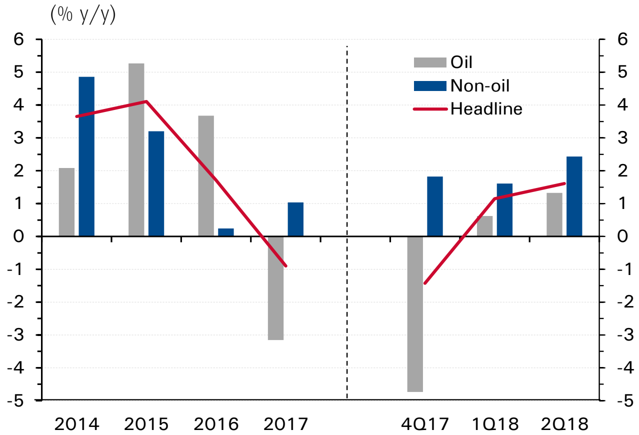
Italian assets continued to sell off as the discord between the coalition government's populist ideals and Italy's economic reality remained a concern. While the government did adjust lower its deficit estimates for 2020 and 2021 (to 2.1% and 1.8% of GDP, respectively), it still stands at odds with previous official estimates of a balanced budget by 2020 and a surplus the year after. The government also kept unchanged the deficit estimate for 2019 at 2.4%, three times larger than previous official estimates. Supporting their forecasts is a bullish outlook hinged on expenditure-led growth. The government is projecting economic growth of 1.5% in 2019, much higher than the European Commission's forecast of 1.1%.

GCC & regional macroeconomics

Saudi Arabia: Saudi economic growth accelerated slightly in 2Q18, to 1.6% y/y. (Chart 2.) The oil and non-oil sectors posted gains of 1.3% and 2.4%, respectively. While higher oil production was a factor, higher output in both the private (1.8%) and the government sectors (4%) was of greater importance due to a boost in public spending of 34%. Non-oil growth in 2Q18 on a q/q basis, however, was negative for a second consecutive quarter (-3.8%), with private sector activity weighed down by tax rises including VAT and the expatriate levy, alongside the continued departure of expatriates. Note also that the PMI fell from 55.1 in August to 53.4 in September – the weakest expansion in four months – on slower output, new orders and employment growth.

Chart 2: Saudi real GDP growth

(% y/y)

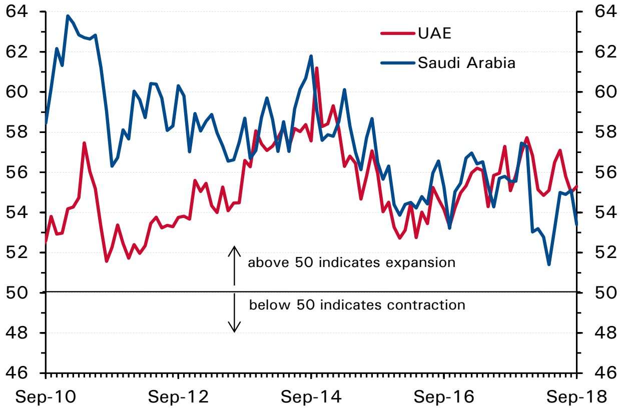


Source: GASTAT

The Saudi authorities released their 2019 pre-budget statement that aims to stimulate private sector growth. Government spending is forecast to rise a solid 7.3% in 2019 to SR1,106 trillion. The government intends to announce soon a package of private-sector boosting measures. Meanwhile, Crown Prince Mohammed Bin Salman insisted that the Saudi Aramco IPO will be going head, despite reports that it had been postponed indefinitely. The prince expects the flotation by 2021. He also stuck to his $2 trillion Aramco valuation estimate.

Chart 3: Saudi and UAE PMIs

(index)

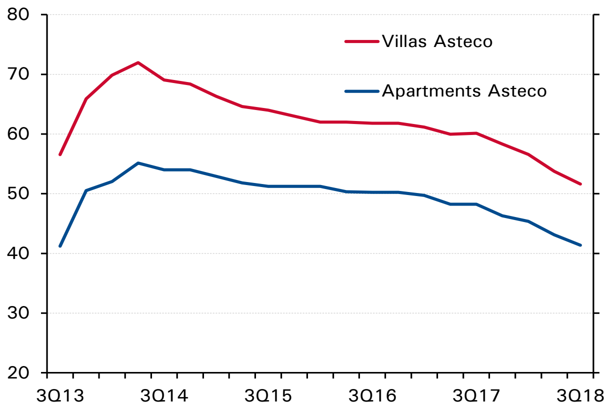


Source: Markit, Emirates NBD

UAE: Residential property prices in Dubai continued to fall in 3Q18, weighed down by higher supply and increasingly cost-conscious tenants opting for more affordable housing units. According to Asteco, the prices of both apartments and villas fell at a faster pace, by -13.6% y/y on average, in 3Q18, compared to -9.3% y/y in the previous quarter. (Chart 4.)

Chart 4: Dubai residential property sales prices

(index)



Source: Asteco

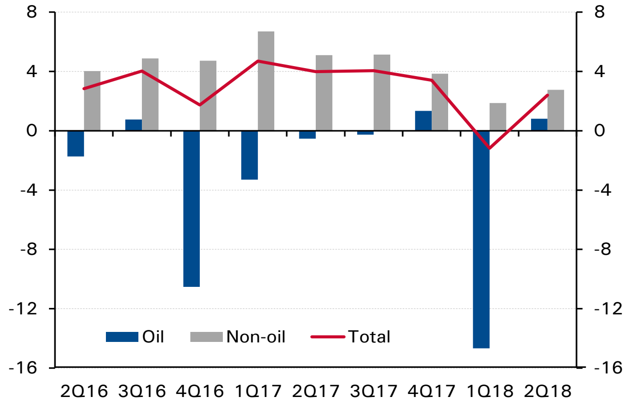
The PMI was a tick higher at 55.3 in September, as new orders, including new export orders, picked up and output held strong thanks to a steady improvement in both domestic and foreign demand. Amid cost-cutting measures, employment activity fell for the second consecutive month. Looking ahead, however, businesses remain optimistic about future growth prospects. (Chart 3.)

The IMF revised the UAE's 2018 and 2019 growth forecasts higher on expectations that oil production and government spending would gain traction and boost the overall economy. (In fact, the UAE cabinet just approved a balanced budget of Dhs 60.3 billion for the 2019 fiscal year, which is 17.3% higher than this year's expected outlay and the nation's highest on record.) GDP is now forecast to grow by 2.9% in 2018 and 3.7% in 2019, versus initial estimates of 2.0% and 3.0%, respectively.

Bahrain: GDP growth grew more than expected in 2Q18, coming in at a healthier 2.4% y/y compared to -1.2% in the previous quarter, on the back of a rebound in oil sector activity and a jump in non-oil sector output. This was driven mainly by gains in the construction and manufacturing sectors. (Chart 5.)

Chart 5: Bahrain real GDP

(% y/y)



Source: Information & eGovernment Authority

Late last week, Gulf countries including Saudi Arabia, the UAE and Kuwait unveiled a $10 billion aid package for Bahrain aimed at providing help with financing its large budget deficit and debt repayments as well as boosting confidence. The aid package will be delivered in stages over five years as an interest-free loan. The announcement was followed by Bahrain delivering a reform plan – perhaps linked to the aid deal – to lower its debt and eliminate the budget deficit by 2022. Bahrain is reportedly planning to finally approve a 5% VAT as well as pension reform laws during an 'extraordinary' session in October and prior to parliamentary elections in November.

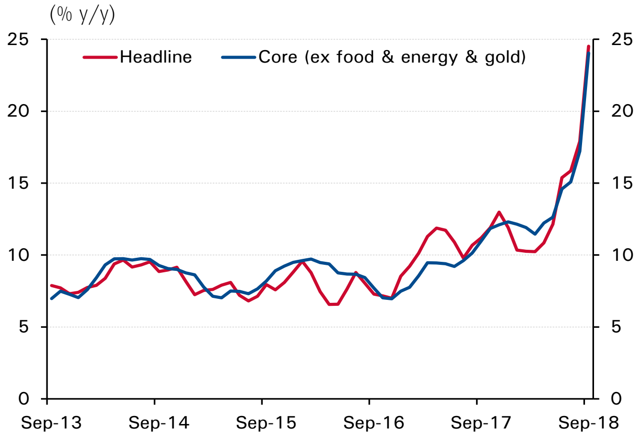
Qatar: Looking to retain its position as the world's largest liquefied natural gas (LNG) exporter amid competition from Australia and the US, Qatar intends to add a fourth LNG train to the three announced last year and boost total LNG capacity by 43% to 110 million tonnes per annum. State hydrocarbon producer, Qatar Petroleum, is looking to take advantage of current and higher projected LNG prices – the operator is predicting a shortage of LNG from around 2021 – and the lowest break-even costs in the business to maintain its competitiveness and market share, especially in Asian markets. The additional capacity should be on line by 2024.

Moody's upgraded the outlook for the Qatari banking sector to stable from negative. The rating agency noted that Qatar appears to have weathered the regional dispute and rebalanced its economy by rerouting disrupted supply chains and plugging withdrawn GCC funds through timely government injections of liquidity. Moody's expects GDP growth to accelerate from 1.6% in 2017 to an average of 2.8% during 2018-2022.

Egypt: After cancelling sales for four successive weeks, Egypt sold EGP904 million ($50.6 million) worth of three and seven-year treasury bonds on Monday. The three-year bonds carried an average yield of 18.432%, while the seven-year bonds carried an average yield of 18.431%. Meanwhile, Egypt's current account deficit was $642 million for the fourth quarter of 2017/18, a decrease of 73% y/y. The current account deficit for the whole fiscal year 2017-18 narrowed by 59% to $6 billion, thanks mainly to lower imports following depreciation of the pound . Concerning economic growth, the PMI fell back into contractionary territory to 48.7 in September after two consecutive months above 50 in July and August, indicating some weakness in the recovery of the non-oil private sector. The pressure on prices continues to ease after peaking in July 2018 when subsidies were cut. In fact, output prices stood at 52.2 in August compared to 55 the previous month, while input prices reached 64.3 from 67.7 in August and 81 in July.

Turkey: Inflation accelerated to a 15-year high of 24.5% in September, as a weaker lira and higher oil prices pushed costs higher across most subcomponents of the CPI basket. (Chart 6.) The lira fell almost 2% against the US dollar in response. In a bid to reassure investors, the finance minister, Berat Albayrak, said that measures to temper inflation will be announced soon.

Chart 6: Turkey consumer price inflation



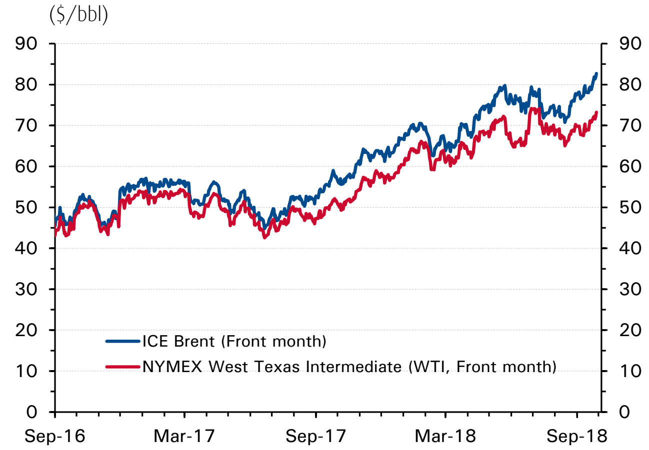
Source: Thomson Reuters Datastream

Separately, Fitch downgraded 20 Turkish banks, including major private lenders Akbank, Isbank, Garanti and Yapi Kredi and state-owned banks Vakifbank, Halkbank and Ziraat bank, citing rising risks amid a weakening currency and an expected slowdown in economic growth.

Markets – oil

Oil prices closed on Friday up for the fourth week in a row, with Brent reaching $84.2/bbl (+1.7% w/w) and WTI settling at $74.3/bbl (+1.5% w/w). (Chart 7.) Oil prices are up by as much as 26% this year, and by mid-week, Brent had reached another four-year high, of $86.3/bbl, amid persistent concerns that Saudi Arabia and Russia lack the production capacity (and perhaps the inclination) to fully offset supply losses in Iran and Venezuela . Last week's gains also came despite a bearish EIA report indicating that US crude stocks had recorded the highest weekly increase in more than eighteen months (+7.9 mb).

Chart 7: Crude oil prices



Source: Thomson Reuters Datastream

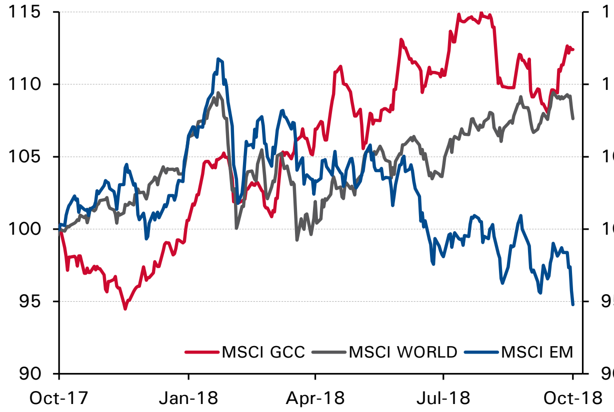
While Saudi Arabia may be hesitant to turn on the taps and risk flooding the market again, Crown Prince Mohammed Bin Salman insisted that the kingdom was fulfilling its promise to offset all Iranian barrels lost to US sanctions. He said that OPEC+ had ramped up output to 1.5 mb/d, double the 700,000 b/d lost by Iran. The Saudi energy minister, Khaled Al-Falih, also remarked that Saudi Arabia was pumping around 10.7 mb/d, close to its November 2016 record high. The Crown Prince also indicated that efforts to restart 500,000 b/d of shut-in production at the Neutral Zone, shared with Kuwait, have intensified. It is possible that 2019 could see output from Wafra and Khafji come on line after four years.

Markets – equities

A stream of robust US economic data and comments by Fed Chairman Jerome Powell prompted a sell-off that spread the world over, with investors weighing the impact of potentially tighter US monetary policy on future global economic growth and corporate earnings. The MSCI AC World index was down 1.5% w/w. The S&P 500 finished the week down 1%, while the DJI was relatively unchanged. Worries over Italy saw investors offload Italian equities, helping pull the Euro Stoxx 50 down 1.6% w/w. Meanwhile, the prospect of tighter US monetary policy renewed debt sustainability concerns in emerging markets, with the MSCI EM down 3.7% w/w, despite China being on holiday all week. (Chart 8.)

Chart 8: International equity indices

(rebased, 5 October 2017=100)

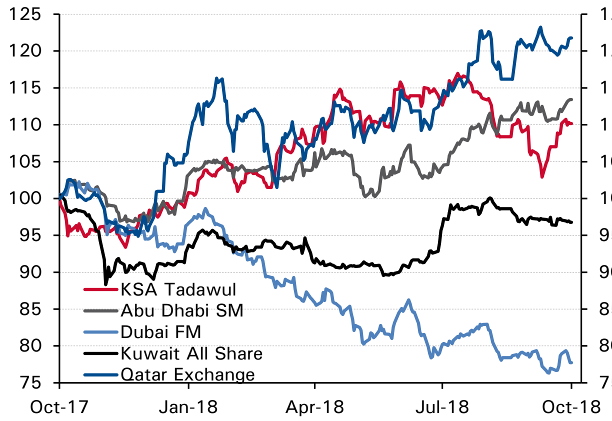


Source: Thomson Reuters Datastream

Regionally, the GCC index avoided the sell-off (MSCI GCC index +1.0% w/w), with the increase in oil prices lifting Saudi (1.3%), Abu Dhabi (+1.2%), and Qatari (+1.2%) equities. Kuwait continued to drift somewhat sideways, with its all share index down 0.5% w/w, while concerns over a still weak real estate market weighed on Dubai stocks (-1.2%). (Chart 9.)

Chart 9: GCC equity markets

(rebased, 5 October 2017=100)



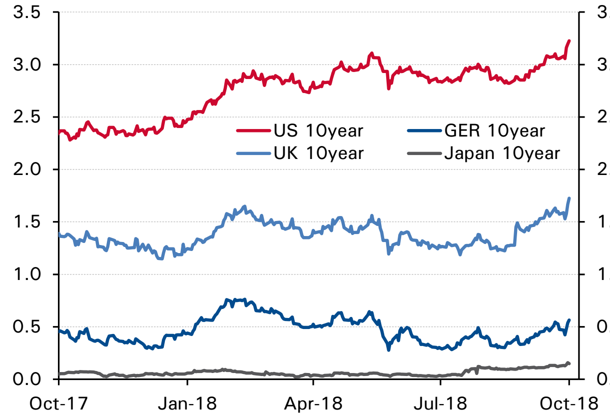
Source: Thomson Reuters Datastream

Markets – fixed income

International benchmark yields shot up last week as investors believe that US monetary tightening could happen at a faster pace. An upbeat September non-manufacturing ISM survey, a decent jobs report including a drop in US unemployment to a 49-year low is reshaping US growth expectations and Fed policy, with investors expecting a steeper path for interest rates. In consequence, 10-year US government treasury yields finished the week higher by 17 bps at 3.23%, a level not seen since 2011. (Chart 10.) The sell-off extended to other major benchmarks with 10-year Bunds, Gilts, and JGBs up 2-15 bps. Similar moves were seen regionally, with 4-5 year sovereign yields registering increases of 8-15 bps. (Chart 11.)

Chart 10: Global bond yields

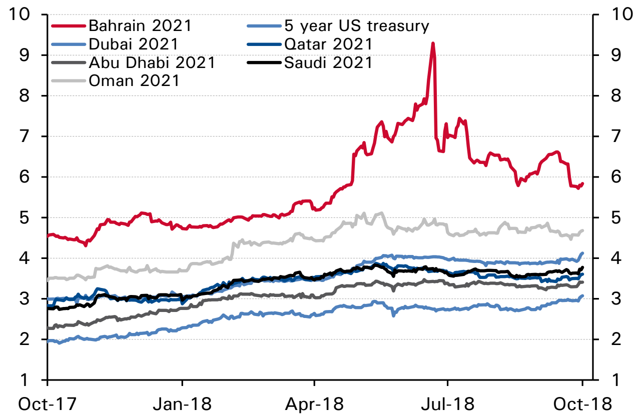
(%)



Source: Thomson Reuters Datastream

Chart 11: GCC bond yields

(%)



Source: Thomson Reuters Datastream

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