US passes landmark tax reform; OPEC agrees to extend production cuts to end-2018

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi SM	4,283	-0.09	-5.79
Bahrain ASI	1,284	0.56	5.18
Dubai FM	3,420	-1.18	-3.14
Egypt EGX 30	14,582	3.37	18.12
S&P GCC 40	964	0.07	-16.56
Kuwait SE	6,197	-0.69	7.80
KSA Tadawul	7,004	1.83	-2.86
Muscat SM 30	5,110	0.46	-11.64
Qatar Exchange	7,714	-0.36	-26.09
International			
CSI 300	3,998	-2.58	20.79
DAX	12,861	-1.52	12.02
DJIA	24,232	2.86	22.61
Eurostoxx 50	3,528	-1.50	7.20
FTSE 100	7,300	-1.47	2.21
Nikkei 225	22,819	1.19	19.38
S&P 500	2,642	1.53	18.02

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	63.7	-0.20	12.16
KEC	60.34	-0.03	16.26
WTI	58.4	-1.00	8.64
Gold	1278.8	-0.61	11.20

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.301	-0.11	-1.34
KWD per EUR	0.355	0.00	11.53
USD per EUR	1.189	-0.34	13.09
JPY per USD	112.100	0.51	-4.08
GBP per USD	1.347	1.01	9.19
EGP per USD	17.650	0.06	-1.94

Interbank rates	%	Change (bps) weekly	YTD
Bhibor - 3 month	2.55	0.0	45.0
Kibor - 3 month	1.75	-6.3	31.3
Qibor - 3 month	2.45	2.2	66.5
Eibor - 3 month	1.63	-1.1	15.8
Saibor - 3 month	1.82	0.0	-21.8
Libor - 3 month	1.49	2.5	48.9

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	2.79	3.5	25.8
Dubai 2022	2.97	-2.7	-32.5
Qatar 2022	3.10	1.5	16.8
Kuwait 2022	2.75	4.9	n/a
Saudi Arabia 2023	3.17	3.5	n/a
International			
UST 10 Year	2.36	2.3	-6.9
Bunds 10 Year	0.36	-0.6	15.7
Gilts 10 Year	1.22	-2.7	-1.6
JGB 10 Year	0.03	0.4	-1.5

Source: Thomson Reuters Datastream; as of Friday's close 1/12/2017

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

Overview

US and European stocks dropped sharply at the end of the week on news that the former US national security chief Michael Flynn lied to the FBI regarding the Russia investigation, reigniting fears about the stability and future of the Trump administration. But there was better news for the US president on Saturday when the Senate narrowly passed its own tax reform bill, bringing the prospect of final legislation being passed before year-end a step closer. The tax cuts are unlikely to boost growth by much, but they could add significantly to the federal fiscal deficit over a decade.

OPEC, Russia and other key oil producers agreed a deal to extend current production cuts by nine months to end-2018, in an attempt to support the current recovery in oil prices that saw Brent hold above $63/bbl last week, up 42% since June. The deal had been expected by the markets. The agreement also provides for a reappraisal of the cuts next June – a nod towards Russian concerns that the full extension could prove unnecessary (and counterproductive) if the market tightens earlier than expected.

Gulf markets were mixed, but received some support from the OPEC decision at the end of the week. The extended curbs on oil output are likely to see economic growth forecasts for 2018 across the Gulf edge lower (we now expect under 2%). All GCC countries are participants to the deal – though not all are OPEC members. Indeed, countries such as the UAE and Bahrain are still producing in excess of their quotas, meaning that improved compliance could have a greater negative impact on oil GDP growth there than elsewhere.

International macroeconomics

US: The Senate passed landmark tax reform last week, marking a major win for President Trump and the GOP. The much-anticipated legislation, which still needs to be reconciled with the House version, is expected to cost around $1.4 trillion over ten years. However, while most Republicans believe the cuts will generate enough growth to pay for themselves, many economists do not see them resulting in much of a fiscal stimulus, though they are expected to be a boon for corporate earnings.

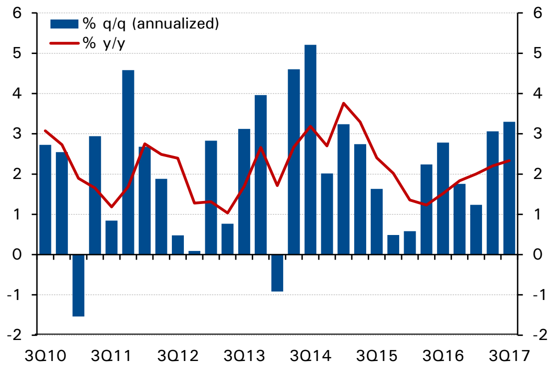
The economic data continued to support a strong story of improving growth. 3Q17 GDP growth was revised upward to a solid 3.3% q/q annualized, from 3.0% before. (Chart 1.) Consumer confidence also came in strong, rising to 129.5 in November, a new 17-year high. New home sales rose to a solid 685,000 in October, while the ISM manufacturing index ticked up to 58.2.

While still softer than most would like, inflation appeared somewhat sturdier in October's PCE price index. The index showed core prices rising by 0.2% m/m, with the annual pace inching up to 1.4% y/y.

Eurozone: Political uncertainty subsided in Europe as Germany's Social Democrats softened to the idea of forming another coalition with Angela Merkel's Christian Democrats. Talks, if pursued, will begin early next year. Meanwhile, November's EZ flash inflation came in slightly weaker than expected at 1.5% y/y, while core inflation was steady at 0.9%. (Chart 2.)

Chart 1: US GDP growth

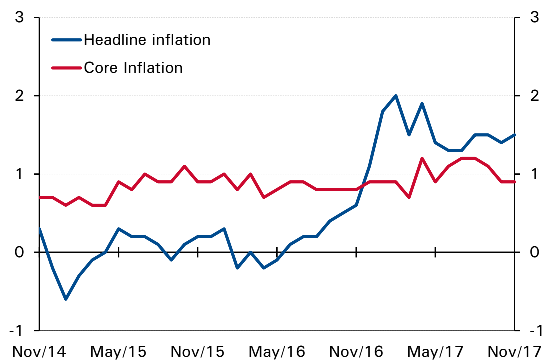
(% y/y)



Source: U.S. Bureau of Economic Analysis

Chart 2: EZ inflation

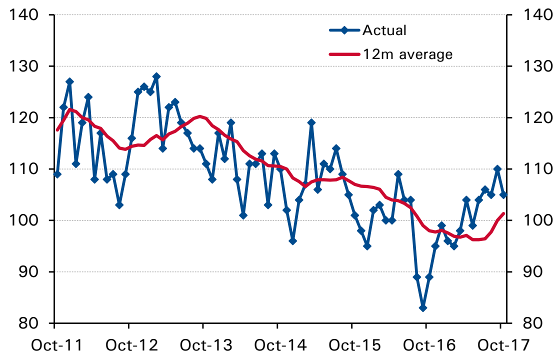
(% y/y)



Source: Thomson Reuters Datastream

Chart 3: Kuwait consumer confidence

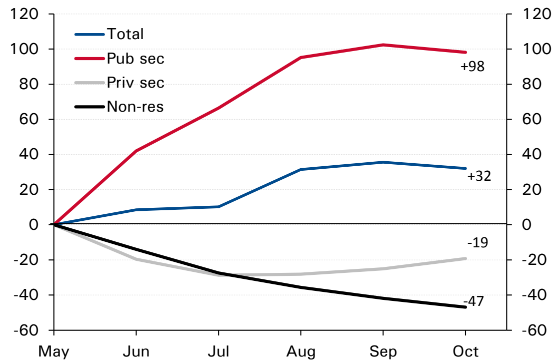
(index)



Source: Ara Research & Consultancy

Chart 4: Qatar bank deposits

(cumulative change since May, QAR bn)



Source: QCB

China: China will release a set of guidelines, or "code of conduct", for outbound investment. The document, yet to be released, will guide enterprises on how to identify risks and curb irrational investment.

The National Bureau of Statistics' manufacturing purchasing managers' index (PMI) stood at 51.8 in November, up from 51.6 in October and beating market expectations.

Morgan Stanley raised its outlook on China's growth. The investment bank believes China's economy will expand by 6.8% y/y in 2017 and by 6.5% y/y in 2018. It cites progress in economic transitions, reforms, and improved consumption.

GCC & regional macroeconomics

Kuwait: Consumer confidence retreated slightly in October, with the Ara index sliding back to 105. Continued improvement in oil prices as well as the stock market rally managed to keep the confidence index above the 100 threshold. Most of the sub-indices declined in October, with the exception of the current employment and durable goods sub-indices that remained steady from the previous month. (Chart 3.)

Qatar: Preliminary banking sector data for October revealed that the government stopped injecting money into the system for the first time since the diplomatic crisis started in June – a sign that conditions in the sector have stabilized. Although public sector deposits edged QAR 4 billion lower in October, they are still up QAR 98 billion since May. (Chart 4.) These massive injections have pushed overall deposit growth up to a 3-year high of 20% y/y in recent months. Encouragingly, too, private sector deposits edged up for the third month in a row. Non-resident deposits continued to fall, but the rate of decline has steadily eased; their share of total deposits has fallen to 17% from 24% in May.

Interestingly, credit growth picked up further, rising to a robust 16% y/y led by surging appetite for funds from the public sector, which now accounts for a very large 42% of all bank credit.

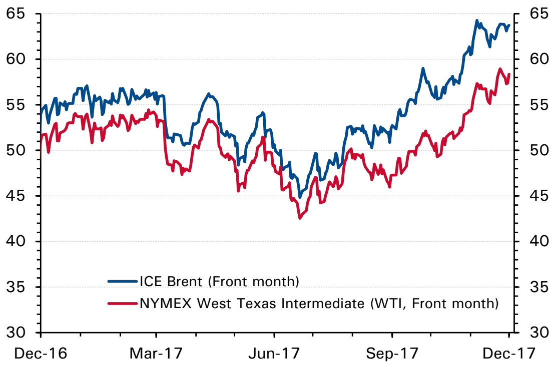
Bahrain: S&P cut Bahrain's long-term sovereign credit rating by one notch from BB- to B+, placing it deeper in non-investment grade category amid concerns over the nation's weak external position and ability to finance its stubbornly high fiscal deficits. But S&P raised its outlook on Bahrain from negative to stable on expectations of financial support from its GCC peers. In an attempt to allay renewed fears about the currency's peg to the US dollar following the ratings cut, the Central Bank of Bahrain reaffirmed its commitment to the peg. This is Bahrain's second ratings downgrade this year, following Moody's two-notch downgrade from Ba2 to B1 back in July.

Markets – oil

Without much fanfare, OPEC and its partners from outside the block, led by Russia, agreed to extend current production cuts from March 2018 to the end of 2018. While producers were largely satisfied with the increase in the oil price, the fact that global oil inventories were still more than 150 million barrels above the group's target was reason enough to prolong the agreement. The apparent ease with which proceedings were wrapped up belied the nervous anticipation that had built up in the weeks running up to the meeting. In the end, Russia did not scupper the deal, or restrict its involvement to three months post-expiration, as some were arguing. Moreover, Nigeria and Libya, which had been exempt from the deal, agreed to limit production to peak 2017 levels – a small coup for OPEC.

Chart 5: Benchmark crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

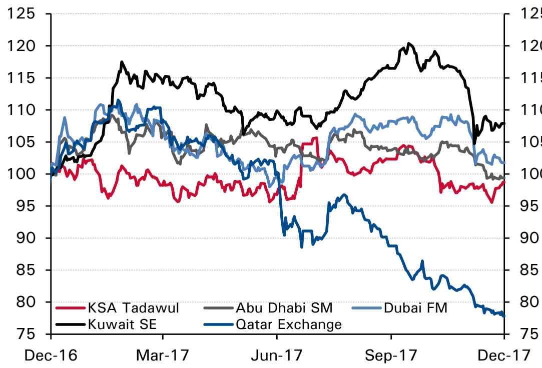
Chart 6: Total equity return indices

(rebased, 1 December 2016=100)

Source: Thomson Reuters Datastream

Chart 7: GCC equity markets

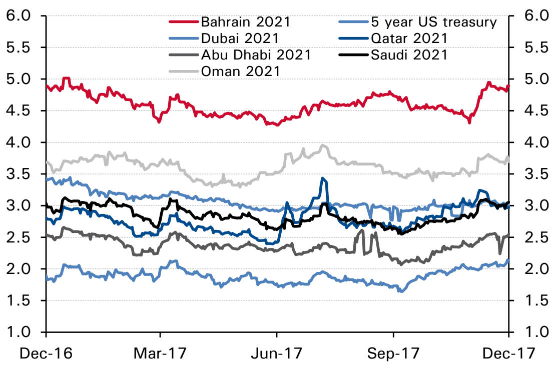
(rebased, 1 December 2016=100)



Source: Thomson Reuters Datastream

Chart 8: GCC bond yields

(%)



Source: Thomson Reuters Datastream

Markets breathed a sigh of relief, with Brent and WTI rallying between 1-2% to close on Friday at $63.73/bbl and $58.36/bbl, respectively. (Chart 5.) Admittedly, many of the hard questions facing the group were pushed back to next year's June meeting: how should OPEC deal with burgeoning US shale and how should the group negotiate an orderly exit from the agreement that avoids flooding the market with crude?

Markets – equities

International markets were focused on the developing Flynn story and a last minute US tax cut delay (subsequently overcome), with the MSCI World All Country index closing almost flat at 0.2% for the week. US equities continued their rally, posting significant weekly gains. An extensive set of economic data was released during the last week of November, all supporting the highly-anticipated Fed interest rate hike and the stock market. The data included a revised 3.3% annual growth in third-quarter GDP, slightly more robust core PCE inflation, a pickup in activity in the housing market and a solid ISM manufacturing index.

The markets suffered a slight setback towards the end of the week on reports Michael Flynn will cooperate with investigators regarding election interference by Russia. The S&P 500 and DJIA ended the week up 1.5% and 2.9%, respectively. European equities were down 1.5% on the week, mainly on what appeared to be another delay in tax reforms, which subsequently passed during the weekend. Emerging market equities were also down 3.2% for the week on a decline in technology stocks. (Chart 6.)

A short week for the GCC markets ended mostly up amid rising oil prices. The MSCI GCC index closed up 1%. Kuwait Boursa was up 0.7% on the week, but remained below the 400 point level. The Qatari and Dubai markets continue to trend downwards, with the indices down 0.4% and 1.2%, respectively. Saudi's Tadawul was the biggest winner, up 1.8% for the week. (Chart 7.)

Markets – fixed income

Fixed income benchmarks continued to be contained within tight ranges as fundamentals wrestled with politics for market direction. US yields were set to record their biggest increase in two months on the back of strong data and positive tax reform developments, but were pulled down late in the week by renewed uncertainty over the investigation into Russian election meddling. German bunds, on the other hand, benefitted from possible coalition talks, but sentiment was offset by a North Korean missile launch, weaker than expected inflation, and the renewed US political uncertainty. US 10-year yields were up 2 bps to settle at 2.36%, while German bunds were little changed at 36 bps. GCC yields were mostly up, tracking US Treasuries, despite firm oil prices. (Chart 8.)

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