Weekly Economic and Markets Review

NBK Economic Research Department I 22 July 2018

International & MENA

Trade war looms closer; Global growth prospects are lower; oil price fluctuates on uncertain production

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,770	1.77	8.45
Bahrain (ASI)	1,355	0.90	1.72
Dubai (DFMGI)	2,926	1.45	-13.18
Egypt (EGX 30)	15,416	-2.92	2.64
GCC (S&P GCC 40)	1,066	1.77	8.24
Kuwait (All Share Index)	5,211	-0.05	7.87
KSA (TASI)	8,450	1.05	16.93
Oman (MSM 30)	4,448	0.17	-12.77
Qatar (QE Index)	9,421	1.10	10.53
International			
CSI 300	3,493	0.01	-13.35
DAX	12,561	0.16	-2.76
DJIA	25,058	0.15	1.37
Euro Stoxx 50	3,460	0.16	-1.25
FTSE 100	7,679	0.22	-0.12
Nikkei 225	22,698	0.44	-0.29
S&P 500	2,802	0.02	4.80

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.50	6.9	55.1
Dubai 2022	3.89	-1.9	75.5
Qatar 2022	3.68	-1.3	60.9
Kuwait 2022	3.37	10.9	56.1
Saudi Arabia 2023	3.80	11.9	58.1
International			
UST 10 Year	2.89	6.2	48.2
Bunds 10 Year	0.37	9.0	-5.1
Gilts 10 Year	1.23	-4.1	4.4
JGB 10 Year	0.04	-0.9	-1.4

3m interbank rates	%	Change (bps) weekly	YTD
Bhibor	3.50	0.0	77.5
Kibor	2.06	6.3	18.8
Qibor	2.64	-0.5	-10.0
Eibor	2.52	-11.8	72.2
Saibor	2.61	0.1	71.1
Libor	2.35	0.8	65.3

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.303	-0.08	0.44
KWD per EUR	0.352	-0.17	-0.76
USD per EUR	1.172	0.28	-2.32
JPY per USD	111.4	-0.86	-1.14
USD per GBP	1.313	-0.76	-2.81
EGP per USD	17.85	0.06	0.68

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	73.1	-3.00	9.27
KEC	70.7	-1.31	11.35
WTI	70.5	-0.77	16.62
Gold	1229.5	-0.81	-5.88

Source: Thomson Reuters Datastream; as of Friday's close 20/7/2018

Overview

In its World Economic Outlook update, the IMF kept global growth rates at 3.9% for both 2018 and 2019 but expressed concerns about escalating trade tensions that could derail the economic recovery. It estimated that a trade war could shave about $500 billion of global GDP. Trade tensions took a turn to the worse when president Trump threatened to extend tariffs to all $500 billion of Chinese imports. Conversely, the EU and Japan signed a broad free trade agreement that will reduce considerably trade barriers between the two economic blocks. In a slight reference to Mr. Trump's protectionist moves, the president of the European Council declared that such an agreement goes against isolationism and disintegration.

Fed Chairman Powell, however, played down the risk of a trade war in his testimony to congress and was upbeat about US economic performance now and for years to come, reiterating the need for a gradual increase in interest rates. The Fed is trying to strike a balance between maintaining growth momentum and avoiding overheating. While one more interest rate hike is almost certain, a second hike is not.

Mr. Powell's testimony and the discussion about the flattening of the yield curve were later overshadowed by president Trump breaking away with longstanding US tradition of not commenting on monetary policy, saying that he was dissatisfied with the increase in the interest rate, which would "hurt all what has been done", and that the dollar was overvalued as the EU and China are manipulating their currencies. The markets reacted negatively.

Regionally, economic expansion is strengthening somewhat on account of higher oil output following OPEC's decision to raise production. Our projections see growth average 2.4% over 2018 and 2019. The oil price, however, is witnessing large fluctuations given uncertainties about oil production and the impact of the expected US sanctions on Iran. In Bahrain, bondholders are anxious again as there are no signs yet of the promised aid by Saudi Arabia, UAE and Kuwait. Apparently, these countries are waiting for Bahrain to come up with a plan to rein in fiscal deficits and reduce its large public debt. Dubai real estate continues to show weakening sings. Inflation in Kuwait remains subdued in June, at 0.5%.

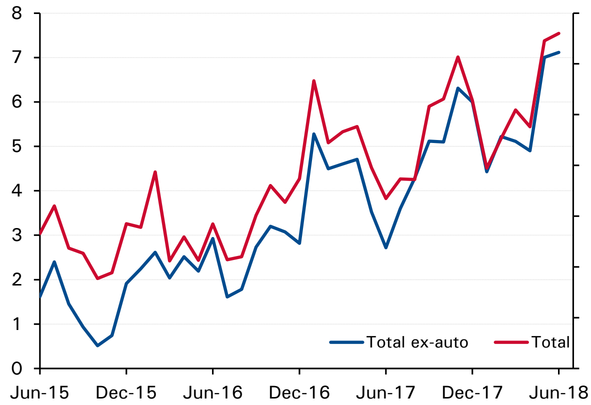
International macroeconomics

USA: Mr. Trump doubled down on his trade position with China. He now seeks to impose tariffs on all imports from China, worth about $500 billion in 2017. Mr. Trump earlier this month imposed 25% tariffs on $34 billion of Chinese goods, with another $16 billion to follow. He is also considering a 10% tax on $200 billion worth of imports, which are expected to take effect early in 3Q18. Meanwhile, in its world economic outlook update for July, the IMF has indicated that rising trade tensions could "derail the [global] recovery" and may negatively impact the medium-term growth outlook. These views were echoed in a draft communiqué released by the G-20.

At the same time, Mr. Trump expressed his frustration with the Fed's monetary policy of gradually raising rates, claiming that the stronger dollar is putting the US at a disadvantage. These comments came on the heel of a testimony by Fed Chair Powell, in which he expressed strong confidence in the US economy and the Fed's commitment in pursuing its incremental but cautious tightening. Mr. Trump's comments reverberated in currency and bond markets, with the US dollar index retreating 0.7% d/d soon after his remarks, finishing the week down 0.3%.

Chart 1: US retail sales

(% y/y)



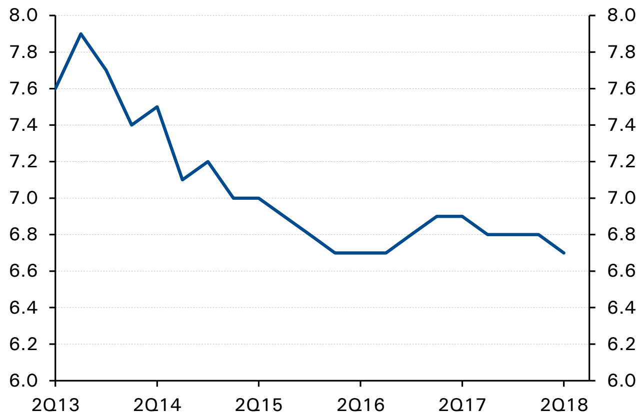
Source: Thomson Reuters Eikon

Meanwhile, US economic performance remains solid and points at robust growth in the second quarter – the Atlanta Fed revised its 2Q18 forecast higher to 4.5% q/q from 3.9%. Retail sales were up for a fifth consecutive month in June (0.5% m/m, 6.6% y/y, chart 1), with May's numbers revised higher. The sector was supported by lower income taxes and an improving number of people in work. June's Industrial production rebounded (0.6% m/m) lifted by the manufacturing (stronger auto production) and mining sectors (higher energy prices). The Philadelphia Fed business outlook survey came in better than expected, with input costs increasing due to capacity constraints amidst strong demand. Finally, jobless claims fell by 8,000 last week to settle at 207,000, the lowest since December 1969, reflecting the ongoing tightening in the labor market.

Eurozone: In a sign of hope for the global trade community, the EU and Japan formally agreed on an outline free-trade deal, creating in turn a major free-trading economic bloc that covers 600 million people and nearly a third of global GDP. The official signing follows four years of negotiations and an initial agreement last year. Within the new framework, 99 percent of tariffs that cost businesses in the EU and Japan nearly €1 billion ($1.17 billion) annually will be eliminated. Meanwhile, speaking at her annual summer press conference in Berlin, Chancellor Merkel, outlined possible responses to the threat of US tariffs on European cars, in light of Mr. Trump's escalating trade rhetoric, negatively impacting european markets.

China: Real GDP growth eased slightly to 6.7% y/y in 2Q18 from 6.8% y/y in 1Q18, which was as expected. (Chart 2.) The slowdown comes amid tighter monetary conditions, with the government continuing to clamp down on risky lending. A brewing trade war with the US may also begin to weigh on growth going forward.

Chart 2: China's quarterly real GDP

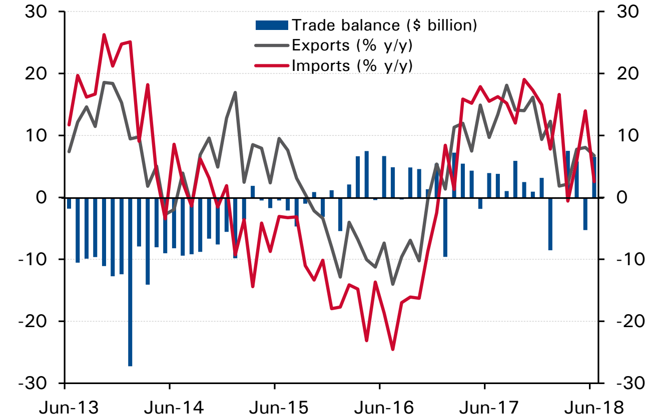


Source: Thomson Reuters Datastream

Japan: Export growth eased from 8.1% y/y in May to 6.7% y/y in June (chart 3), mainly after shipments to the US fell for the first time in just over a year amid lingering trade war concerns. Japan has come under pressure as the US is considering tariffs on Japanese car and auto-part exports

Japan's June headline inflation increased as expected (0.7% y/y), with pressures stemming mostly from higher energy prices. Core inflation, excluding food and energy, however, grew by only 0.2% y/y. With both measures still very far below the Bank of Japan's 2% target, the Bank is unlikely to start tightening its loose monetary policy anytime soon.

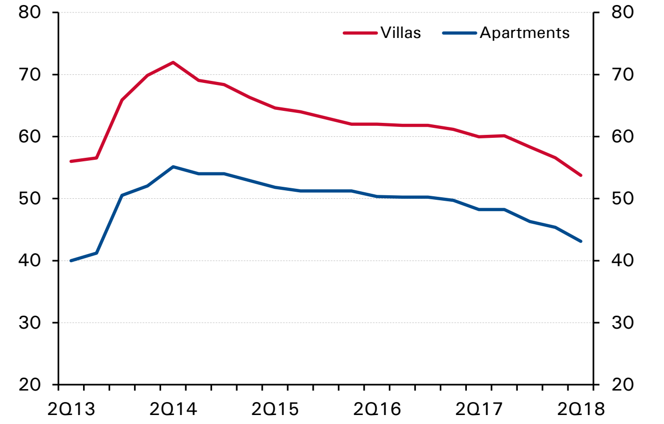
Chart 3: Japan trade



Source: Thomson Reuters Datastream

Chart 4: Dubai residential property prices

(index)



Source: Asteco

UK: A turbulent week in British politics saw Theresa May's government accept amendments by hardline Eurosceptic MPs to the soft Brexit version, tabling amendments to keep Britain in the EU customs union in the event of a 'no-deal' Brexit. Sterling came under pressure from the political fallout, it dropped on Thursday to below $1.30—its lowest since September 2017—after UK retail sales data for June fell to 0.5% m/m. The weaker sales figures came on the heels of underwhelming wage and inflation data.

GCC & regional macroeconomics

Kuwait: Real estate sales eased to KD 209.5 million in June from KD 264 million in May, with a notable decline in both residential and investment sales and transaction volumes. Commercial sales and transactions, however, rebounded strongly from the previous month, with volume more than doubling since May. Prices across all sectors appear to be recovering, with the exception of building prices.

Kuwait's headline inflation edged higher in June, expanding by 0.5% y/y, driven by a pick-up in food, healthcare, transportation, communication, and recreation prices. Core inflation, which strips out food and energy, was steady at 1.7% y/y.

UAE: Residential property prices in Dubai remained under pressure in 2Q18, mainly against a backdrop of higher supply and further shifts in the composition of demand, away from luxury housing to more affordable housing units. According to Asteco, the prices of both apartments and villas fell at faster rates (-11% y/y) on average in 2Q18 than in the previous quarter. (Chart 4.) Residential sales prices are projected to continue to face downward pressures, in at least the near-to-medium term, on the back of still higher supply.

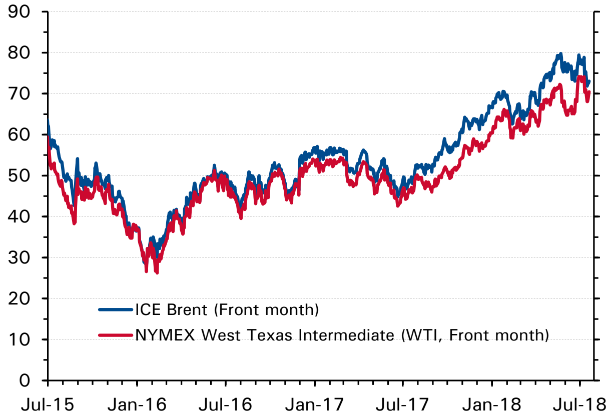
Bahrain: The Executive Board of the IMF recently concluded its 2018 Article IV consultation with the kingdom. While the Board welcomed the resilience of growth in Bahrain, it reiterated the need for more "comprehensive" fiscal reforms against a backdrop of rising public debt and low foreign exchange reserves. Meanwhile, investors are becoming increasingly anxious that Saudi Arabia, the UAE and Kuwait have not released details yet of their joint financial support program for Bahrain.

Markets – oil

Oil prices recorded a third consecutive week of declines, despite the dismissal of supply concerns by Saudi Arabia. Brent was down about 3.0% w/w to $73.1 and WTI down by 0.8% w/w to $70.5/bbl. (Chart 5.) Again, prices were pressured by Libya reporting resumption in crude exports (after force majeure had been declared there last month) and Nigeria and Canada indicating that volumes were rising after outages in their respective countries. The US, concerned about rising gasoline prices, indicated also that it might release crude from its 660 million barrel strategic petroleum reserve (SPR). However, a rise in US crude inventories (+ 5.8 mb w/w) caught the markets by surprise, coming in the middle of the peak summer driving season. US crude production hit another milestone last week, when the EIA reported that output reached a record 11 mb/d (for w/e 13 July).

Chart 5: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

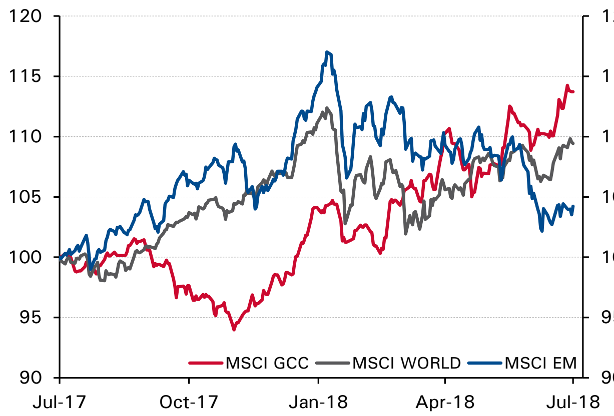
Markets – equities

Renewed trade fears, and unprecedented remarks by Mr. Trump on currency and monetary policy capped the rise in international stocks, despite an encouraging earnings season, a positive testimony by Fed Chair Powell, and strong US data that initially helped push most global equities higher throughout the week. As such, the MSCI AC index was up 0.1% w/w, with US and European markets little changed, while emerging markets edged lower. (Chart 6.)

Strong bank earnings helped the MSCI GCC index rise 1.2% w/w, led by a strong performance in the UAE (ADX +1.8% w/w & DFM +1.4% w/w) and followed by Saudi (+1.0% w/w/), while Kuwait was flat. (Chart 7.)

Chart 6: International equity indices

(rebased, 20 July 2017=100)



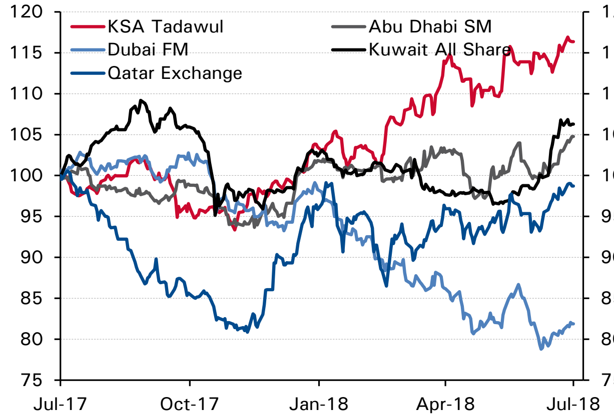
Source: Thomson Reuters Datastream

The week also saw Aramco bid for a strategic stake in SABIC, the largest listed company in the Gulf, in a bid to boost its market valuation ahead of the IPO, and thus, in effect, possibly delaying it.

Meanwhile, Kuwait Finance House (KFH) and Ahli United Bank (AHB) began a due diligence process for a potential merger. The Public Institute for Social Security owns an 18% stake in AUB and a 6% stake in KFH, while the Kuwait investment Authority owns 24% of KFH.

Chart 7: GCC equity markets

(rebased, 20 July 2017=100)



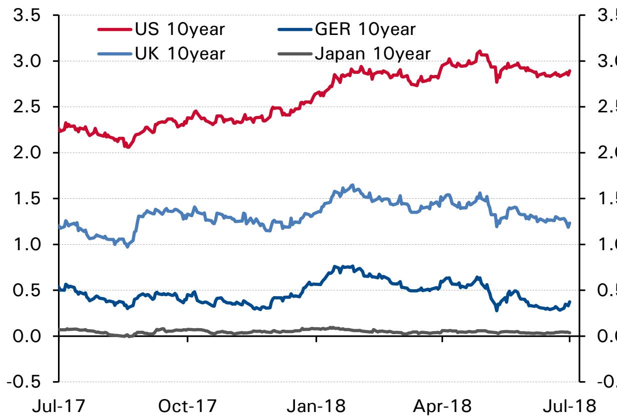
Source: Thomson Reuters Datastream

Markets – fixed income

Benchmark yields were higher last week, despite being dampened by trade fears, as stronger US data and a positive testimony by Fed Chair Powell lent further support to the gradual tightening of US monetary policy. US 10-year yields increased by 6 bps to 2.89%, tracked by 10-year bunds which added 9bps to settle at 0.37%. (Chart 8.) Markets expect two more rate hikes this year but there is dissent within the FOMC committee, with some members arguing for a halt to the rate increase. Meanwhile, GCC yields moved higher in tandem, with most debt maturing in 2022/23 up between 7-12 basis points.

Chart 8: Global bond yields

(%)



Source: Thomson Reuters Datastream

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