Interest rates up on the week; June US payrolls gain 222K; oil prices off; Qatar situation persists

Summary
Positive data and “hawkish” central bank communication weighed on markets last week. Following weeks of slightly lower Interest rates and a flatter yield curve, rates and the curve went in the opposite direction in the past two weeks. The moves were driven by more hawkish rhetoric by major central banks (ECB, BoE) and by further signs that the Fed was getting ready to “taper” or start reducing its huge portfolio as early as September of this year. The strong June payroll report in the US supported a less accommodative Fed.

The ECB, in turn, may also reduce the size of its bond purchases next year. The news weighed more heavily on the longer maturities in advanced markets. The US 10-year closed the week at 2.39%, Bunds were at 57 bps, and US rates rose across the board.

Higher rates in Europe and expectations thereof contributed to the higher euro in the past few days. The euro reached its highest levels in over a year. Meanwhile, equities continued to advance in advanced economies, while the Qatar situation and lower oil prices weighed on the GCC markets, in the first week of full trading following Ramadan.

International macroeconomics
US: US payrolls added 222k new jobs in June. The unemployment rate was little changed at a low 4.4%. Wage inflation remained contained and steady near 2.4% y/y. The firm employment report should not change anything for the Fed or the markets. The Fed should still be on track for further rate hikes, at the pace it set itself. Similarly, the report will not change the Fed’s view to start “tapering” its massive fixed-income holdings later this year. The markets will hold on to their view, expecting less “tightenings” than implied by Fed talk and by the Fed’s “dot-plots”. The markets, and we, are very doubtful as to another 25 bps hike this year. The discrepancy is in part due to the mild inflation (price and wage) outlook.

Eurozone: Eurozone economic performance started 2H17 on a positive footing with France and Germany’s June services PMIs revised higher, to 56.9 and 54, respectively, while Spain’s came in at an impressive 58.3, greatly beating expectations. The Spanish government has also revised its growth forecasts higher to 3% and 2.6% for 2017 and 2018, respectively, deeming the previous expectations as conservative.

China: The services industry in China is growing, but at a slower pace, according to China Caixin services PMI. The June figure came in at 51.6, lower than the 4-month high of 52.8 reported in May. Caixin’s manufacturing PMI was at 50.4 in June, up from May’s 49.6. The domestic economy is growing but at a slower pace, in line with the cooling of the real estate sector.
Dec-12  Oct-16  Nov-16  Aug-16  Jul-17  Jun-17  Jan-17  Feb-16
ness conditions. The commercial bidding for Al Zour North phase 2 has
however, it is still a strong figure, as 2015 and 2016 were
exceptional years. The commercial bidding for Al Zour North phase 2 has
not yet been announced; it was expected by the end of June, but there are
no updates so far.

Saudi Arabia: The headline PMI fell for a second consecutive month in
June, to 54.3 from 55.3 in May. (Chart 2) June’s reading, while still
comfortably indicative of continued expansion in the Saudi non-oil sector
was, nevertheless, the lowest in 8 months. Overall business conditions
remain healthy, but output and new orders improved at the slowest pace
in 8 months. Employment growth picked up pace, but only slightly.

UAE: The headline PMI rose from 54.3 in May to 55.8 in June on the back
of higher new orders and output data. New orders climbed to an almost
two-year high of 60.7 in June and output jumped to 60.2, thanks to
relatively resilient domestic economic conditions.

Qatar: Bahrain, Egypt, Saudi Arabia, and the UAE are disappointed in
Qatar’s response to their 13-point ultimatum. The foreign ministers of the
four nations met on Wednesday, 5 July, and stated that the economic
sanctions and political boycott will continue for now, but they have
stopped short of expanding them or expelling Qatar from the GCC. The
latter would require the approval of both Kuwait and Oman, which is
uncertain. The next meeting of the four nations will be in Manama,
Bahrain, but the exact date has not been set yet.

Qatar Petroleum (QP) announced that it will raise LNG production by 30%
to 100 million tons a year. While this follows the lifting of the 12-year
moratorium on gas development in the offshore North field earlier in the
year, the timing of this announcement was obviously designed to send a
signal to the anti-Qatar coalition and the world that Qatar remains
unbowed by the diplomatic dispute and sanctions and is determined to
show itself a reliable energy partner.

The magnitude of the country’s LNG expansion plans took many by
surprise, however.

Egypt: The June PMI pointed to more stagnation with the index at 47.2
(Chart 3), a reading consistent with 2% growth, though other indicators
suggest GDP growth improved to 3-4% in 2017. Export orders slipped, but
remained the sole source of strength. Inflationary pressures rose following
months of cooling. Inflation has remained high, at an annualized monthly
pace above 20% in May and 30% y/y.

In a bid to fend off accelerating inflation and protect its floating currency,
the central bank decided to raise its policy rates by 200 bps for the second
policy meeting in a row. The overnight deposit rate now stands at 18.75%
and the overnight lending rate at 19.75%. This came at odds with most
analysts’ expectations.

Central bank foreign reserves reached their highest level since February
2011, registering at USD 31.1 billion, or 8 months of imports.
Markets – oil

Wednesday saw Brent and WTI fall by 4%, to $47.8/bbl and $45.1/bbl, respectively, after a reported increase in OPEC exports. According to Thomson Reuters, OPEC exported 25.92 mb/d in June, a rise of 450,000 b/d m/m and 1.9 mb/d y/y. The dramatic fall brought an abrupt end to 8 consecutive days of price rises since late June. (Chart 4.)

The increase in exports came despite the group’s pledge to maintain production cuts until March 2018, so either production increased in June (we are still awaiting official data) or stocks were monetized. The impact on global markets would be the same either way—an increase in supplies at a time when the market was assumed to be tightening.

Oil prices declined by the end of the week, with Brent and WTI down by 2.5% and 3.9% to $46.7/bbl and $44.23/bbl, respectively, also due to the expansion in US drilling activity and increase in rig counts. The total US rig count is up to 763, an increase of seven in the week ending July 7. This offset the rise brought on by the EIA (API) report on declining US crude and gasoline stocks. US stockpiles contracted by 6.3 million barrels, three times the expected figure.

Markets – equities

Strong data (followed by central bank “hawkishness”) led support to equities this week. Advanced markets, however, continued to move sideways, with the MSCI world index “flat”. In the US, strong PMI and jobs data also helped offset some Fed related pressure. The DJIA and the S&P 500, were up 0.3% and 0.1%, respectively. In Europe, shares were supported by positive economic news, with the Eurostoxx 50 up 0.6%. Emerging markets, on the other hand, edged lower, down 0.3%. (Chart 5.)

Profit taking in Saudi, following its impressive rise on MSCI inclusion news last week, and the looming deadlines of the Qatari rift, followed by a refusal to adhere, dictated regional market movements this week. Both the TASI and the QSI saw major volatility, and finished the week in the red. Other GCC markets were also down or little changed as investors sought profit taking. The Tadawul all equities index declined 3.0% on the week. (Chart 6.)

Markets – equities

Markets – oil

Markets – equities
Markets – fixed income

The perceived new hawkishness of global central banks lingered on this week, and was exacerbated by strong US data (ISM and jobs) and the ECB. Some downplaying of hawkish sentiment by EU central banking officials and geopolitical risk over North Korea initially provided a cap on yields. However, stronger than expected manufacturing and jobs gains in the US and evidence of tapering considerations following the ECB minutes, saw yields on US treasuries and Bunds shoot up. US 10-year treasuries were up 9 bps over the week, to settle at 2.39%; while 10-year bunds added 10 bps, registering at 0.57%. (Chart 7.)

The sell-off of Qatari bonds picked up following the political deadlock, with some spillover into Saudi debt. Qatari yields moved up significantly, with debt maturing in 2021 ending at 3.41%, up 31 bps on the week, and 100 bps since the start of the crisis. Saudi paper maturing in 2022 saw its yield jump 19bps.

The rest of the GCC sovereign yields tracked international yields higher, with bonds maturing in 2021 for Abu Dhabi and Dubai up 6-8 bps, while Kuwait’s 2022 bond was up 6 bps. (Chart 8.)
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