US equities rise despite government shutdown threat; oil prices edge back below $70

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi SM	4,625	0.75	5.16
Bahrain ASI	1,333	1.24	2.08
Dubai FM	3,531	1.04	4.78
Egypt EGX 30	15,411	1.11	2.62
S&P GCC 40	1,034	0.75	4.99
Kuwait SE	6,639	1.20	3.61
KSA Tadawul	7,539	2.74	4.27
Muscat SM 30	5,024	-1.25	-0.46
Qatar Exchange	9,200	0.70	7.91
International			
CSI 300	4,285	1.43	6.31
DAX	13,434	1.43	4.00
DJIA	26,072	1.04	5.47
Euro Stoxx 50	3,649	1.01	4.14
FTSE 100	7,731	-0.62	0.56
Nikkei 225	23,808	0.65	4.58
S&P 500	2,810	0.86	5.11

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	68.6	-1.80	2.60
KEC	65.4	-0.80	2.99
WTI	63.4	-1.45	4.88
Gold	1331.9	-0.11	1.96

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.300	-0.24	-0.38
KWD per EUR	0.363	0.00	2.37
USD per EUR	1.222	0.29	1.87
JPY per USD	110.760	-0.24	-1.70
GBP per USD	1.385	0.89	2.49
EGP per USD	17.670	0.06	-0.34

Interbank rates	%	Change (bps) weekly	YTD
Bhibor - 3 month	2.78	0.0	5.0
Kibor - 3 month	1.88	0.0	0.0
Qibor - 3 month	2.70	8.6	-3.8
Eibor - 3 month	1.83	0.9	3.0
Saibor - 3 month	1.89	0.0	-0.4
Libor - 3 month	1.74	2.5	5.0

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.10	11.4	15.6
Dubai 2022	3.12	4.8	-2.2
Qatar 2022	3.35	15.4	27.6
Kuwait 2022	3.04	9.4	23.6
Saudi Arabia 2023	3.30	5.4	8.6
International			
UST 10 Year	2.64	8.7	22.8
Bunds 10 Year	0.57	3.8	14.2
Gilts 10 Year	1.34	0.2	15.1
JGB 10 Year	0.08	0.5	2.9

Source: Thomson Reuters Datastream; as of Friday's close 19/1/2018

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Overview

US equities continued their relentless climb last week with the S&P 500 closing up 0.9% at a record 2810 and brushing off the looming prospect – subsequently realized – of a federal government shutdown. Markets were comforted by expectations that the shutdown would be short and that the effects of previous such episodes (the most recent in 2013) have not been long-lasting.

The dollar, however, remains more vulnerable, hitting a three-year low on a trade-weighted basis despite recent strong economic news and rising treasury yields. One potential explanation for dollar weakness is growing confidence about growth elsewhere in the global economy.

After a stellar start to 2018, Brent crude oil prices edged back to just below $69. Although OPEC members have reiterated their commitment to the current production cut deal, speculation is mounting that the agreement could unwind before the planned year-end cut-off date, prompting a supply surge. Some analysts also expect a further price pull-back in coming weeks should US production increase further in response to the price increase and as global demand eases along seasonal patterns.

In a relatively quiet week for the GCC, regional equities continued to advance, building on two successive weeks of strong gains. There was, however, further evidence of a weak residential property market in Dubai, with prices falling 6-8% y/y in 4Q17 according to Asteco on stronger supply that is expected to persist into 2018. Although non-oil growth in the UAE is set to accelerate this year against a backdrop of a stronger world economy and rising infrastructure spending, this is unlikely to translate into a material pick up in property prices.

International macroeconomics

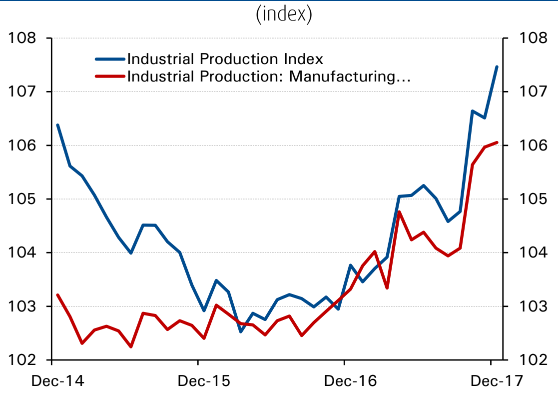
USA: The Senate blocked a third temporary spending measure last week after lawmakers failed to reach an agreement on spending in 2018, forcing a federal government shutdown. This raises the pressure on the two parties to agree on a deal, including spending allocations for 2018, immigration reform, and funding for a border wall. If the shutdown drags on, it could begin to have a negative impact on the economy.

The data continued to paint a picture of robust economic conditions. The industrial production index rose to new highs in December, with the 0.9% monthly increase more than double the market's expectation. The index rose to 107.5. (Chart 1.) The manufacturing index disappointed by rising only slightly to 106.1, but continued to hold at strong levels. Later in the week, the Philadelphia Fed manufacturing conditions index eased for January to 22.2, though the level remains robust.

Eurozone: Greece passed a slew of reforms tied to the third review of its latest bailout program, which is due to end in August 2018. The measures include provisions that limit union organized strikes, and improve bankruptcy procedures and non-performing loans. Eurozone finance ministers are expected to approve the next bailout tranche on 22 January, which could release around EUR 6-7 billion.

Chart 1: US industrial production

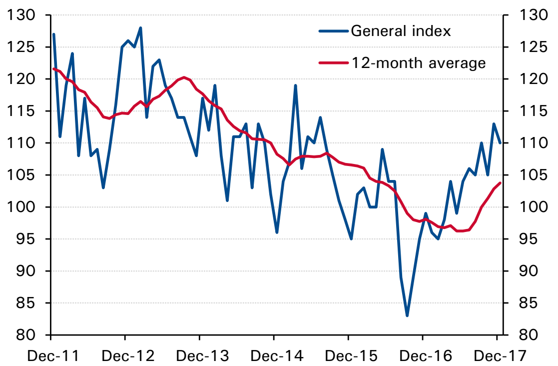
(index)



Source: U.S. Board of Governors of the Federal Reserve System

Chart 2: Kuwait consumer confidence

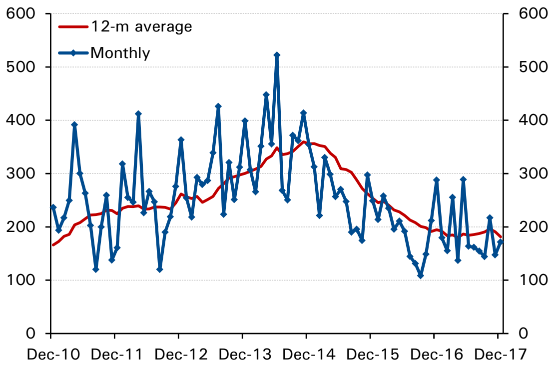
(index)



Source: Ministry of Justice

Chart 3: Kuwait real estate activity

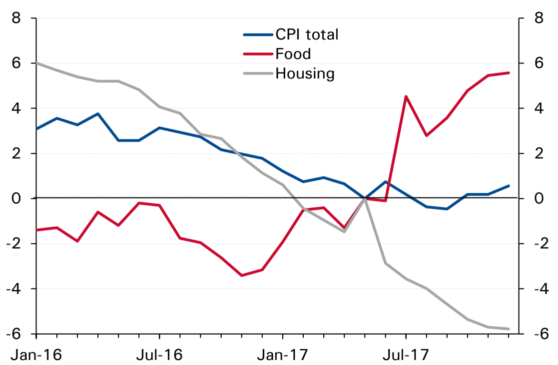
(KD million)



Source: Ministry of Justice

Chart 4: Qatar consumer price inflation

(% y/y)



Source: MDPS

China: GDP grew by 6.9% in 2017, up from 6.7% in 2016 and above the 6.5% official target mainly on account of expansionary fiscal policy. In 4Q17, growth was 6.8% y/y, beating consensus estimates. The upbeat figures were due, in part, to the recovery in global activity. Retail sales grew 10.2% in 2017, and industrial output rose 6.6%. Investment activity was also strong.

GCC & regional macroeconomics

Kuwait: Ara's consumer confidence index retreated in December to 110, but remained at improved levels. The index averaged 104 in 2017, well above its 2016 average of 98. The pick-up in confidence has been supported by stronger oil prices, easing fiscal consolidation, a stabilizing real estate market, and a buoyant equity market. (Chart 2.)

Real estate activity saw strong base effects from a year before in December 2017, with sales down 40% y/y to KD 171 million. (Chart 3.) Still, 2017 as a whole saw improving conditions, with transaction volumes up 6.5%, though sales were 6.9% lower on softer prices. The residential sector was particularly strong, as sales values rose 22%. Meanwhile, sales in the investment and commercial sectors were down 19% and 37%, respectively. Prices in all sectors continued to stabilize in December.

The 9-month FY17/18 fiscal deficit was better than expected through December, at KD 2.5 billion (after the Future Generations Fund transfer), or an annualized 8.5% of GDP. We still expect the full-year to see a 10% of GDP deficit. After a nearly 2-year hiatus, the Ministry of Finance began publishing monthly interim figures according to new reporting standards and classifications. The new figures better reflect actual spending, but may still understate the totals that are reported at the close of the fiscal year.

Qatar: Inflation picked up to 0.6% y/y in December from 0.2% in November. (Chart 4.) Although inflation will remain low over the coming months, the brief flirtation with falling prices recorded in August and September has now likely passed. December's rise was linked to higher "core" inflation, which stood at 1.1% y/y versus 0.8% in November – possibly a sign of increasing pass-through from import prices due to the weaker US dollar last year. Inflation in 2017 stood at just 0.4% though is seen rising to 2.5% in 2018, slightly below the regional average.

UAE: Having stabilized between 2015 and 2016, residential property prices in Dubai faced renewed downward pressures in 2017. The impact of more stringent loan-to-value rules (introduced back in 2013) has been compounded by the effects of increased supply and higher interest rates. According to Asteco, the prices of apartments and villas fell by 7.8% y/y and 5.6% y/y, respectively, in 4Q17, the fastest drop for several quarters.

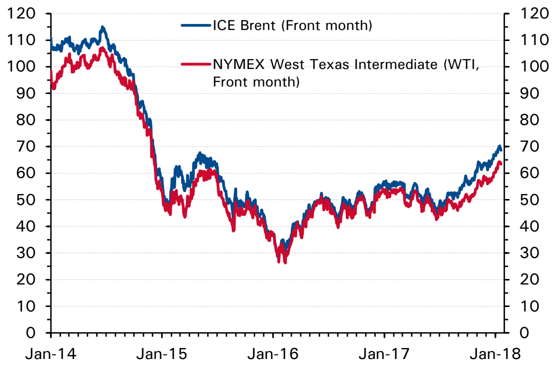
Egypt: Fitch upgraded its rating outlook to "positive", though the sovereign rating was unchanged at B-. Egypt's rating by the three major rating agencies remains 4-5 notches below 2010 levels, despite the significant improvement in conditions over the last year since the pound was floated and authorities implemented reforms.

Markets – oil

Oil prices reversed course last week, with Brent closing down 1.8% at \$68.6/bbl and WTI down 1.5% to \$63.4/bbl. (Chart 5.) While prices are still up 3.7% on average this month, concerns that US shale production is on the cusp of recording "explosive" growth in 2018, as the IEA described it last week, has knocked a little bit of the stuffing out of oil's bull run,

Chart 5: Benchmark crude oil prices

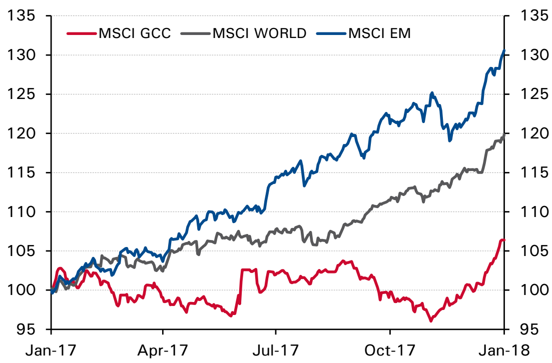
($/bbl)



Source: Thomson Reuters Datastream

Chart 6: Total equity return indices

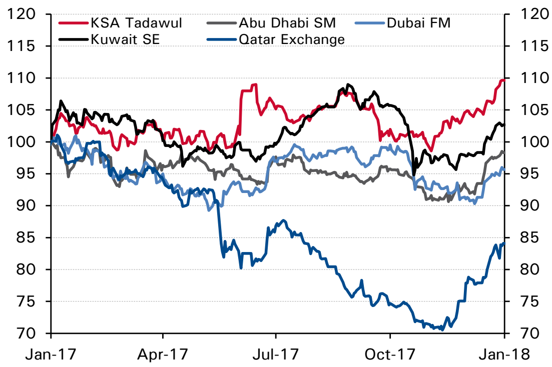
(rebased, 19 January 2017=100)



Source: Thomson Reuters Datastream

Chart 7: GCC equity markets

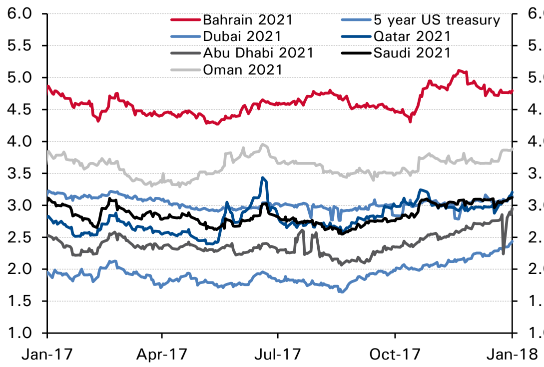
(rebased, 19 January 2017=100)



Source: Thomson Reuters Datastream

Chart 8: GCC bond yields

(%)



Source: Thomson Reuters Datastream

which stands at six consecutive months and counting. Last week's increase in US crude production, the biggest weekly increase since October, by 258,000 b/d to 9.75 mb/d, only seemed to confirm shale's potential gains this year, even though, on the positive side for prices, crude stocks continue to decline. Last week's sizeable stock drawdown of 6.9 million barrels brought US crude inventories down to 412.7 million barrels, their lowest level in almost two years.

Markets – equities

International markets finished the week higher, still supported by positive data, oil prices, and earnings season. The MSCI world index was up 0.8% on the week. (Chart 6.)

US equities continued to reach new highs , with the DJIA jumping above 26000, adding 1000 points in just eight trading days, its fastest pace ever, with the index up 1.0% on the week. The S&P 500 increased by 0.9%, to finish at 2810. Meanwhile, European equities moved sideways amid a lack of catalysts. Emerging markets continued their rally, adding 1.8%.

In the GCC, performance was solid, with Saudi leading the way. The MSCI GCC index was up 2.3% on the week.

Talk of settlements with those involved in Saudi's anti-graft crackdown boosted the Kingdom's market, helping it outperform its peers and to increase by 2.7%. Abu Dhabi and Dubai also fared well, supported by positive earnings, adding 0.8% and 1.0%, respectively. Meanwhile, a recent row between Qatar and the UAE and mixed results from major Qatari banks left the Qatari market up just 0.7%. (Chart 7.)

Markets – fixed income

Benchmark yields were higher again on hawkish rhetoric from the ECB and rallying equity markets. As such, US 10-year Treasury yields were up 9 bps to settle at 2.64%, and Bunds increased by 4 bps to reach 0.57%. GCC benchmark yields continued to track the selloff, increasing between 4 and 15 basis points. (Chart 8.)

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