UK formally triggers Brexit; markets more realistic on US reforms; Saudi credit growth weak in February

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi (ADI)	4,444	-1.15	-2.26
Bahrain (ASI)	1,356	-1.42	11.11
Dubai (DFMGI)	3,480	0.55	-1.43
Egypt (EGX 30)	13,029	-0.29	5.54
KSA (TASI)	6,983	1.79	-3.15
Kuwait (Price Index)	7,029	-0.20	22.29
Oman (MSM 30)	5,551	-1.50	-3.38
Qatar (QE Index)	10,391	-0.52	-0.44
MSCI GCC	470	0.29	-1.02
International			
DAX	12,313	2.06	7.25
DJIA	20,663	0.32	4.56
FTSE 100	7,323	-0.19	2.52
Nikkei	18,909	-1.83	-1.07
S&P 500	2,363	0.80	5.53

Commodities	$/bbl	Change (%) weekly	Change (%) YTD
Brent crude ($/bbl)	53.5	5.37	-5.79
KEC ($/bbl)	50.8	5.62	-2.16
WTI ($/bbl)	50.6	5.48	-5.81
Gold ($/t oz.)	1247.4	-0.07	7.87

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.305	0.07	-0.22
KWD per EUR	0.324	-1.43	1.82
USD per EUR	1.065	-1.37	1.29
JPY per USD	111.38	0.04	-4.70

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Kibor – 3 month	1.56	0.0	12.5
Qibor – 3 month	1.95	-3.7	16.5
Libor – 3 month	1.15	-0.1	15.2

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.37	-5.9	-17.3
Dubai 2021	3.07	-3.3	-25.7
Qatar 2021	2.65	-5.9	-29.9
Saudi Arabia 2021	2.78	-10.9	-27.0
International			
UST 10 year	2.40	-0.5	-3.7
Bunds 10 year	0.33	-8.2	12.3
Gilts 10 year	1.14	-5.8	-10.0
JGB 10 year	0.07	0.7	2.2

Source: Thomson Reuters Datastream

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Summary

The major markets moved little in the aftermath of the failed attempt at health care reform in the US last week, and in anticipation of the well-advertised triggering of Brexit, this past Wednesday.

The US and international markets are trying to gauge what is next for the US: tax reform; infrastructure spending; and the timing and magnitude of those. Politics remains the key, and it is unclear how quickly those could evolve especially given the current poisonous and volatile atmosphere in Washington between the two parties. There is a contentious US Supreme Court nomination and a debt limit fight, among others, looming in the weeks ahead. The US Treasury is hoping for tax reform by August, which may well prove optimistic; health care reform may also be back on the table before the year is up.

When UK PM Theresa May triggered Brexit by filing an official request (under Article 50 of the Treaty of the EU), no one was surprised. The focus is now on the negotiations between the UK and the EU within the stipulated two-year timeframe, and the end result of that process, trade agreements in particular.

Oil prices firmed up somewhat by the end of the week, toward $52/bbl for Brent. The USD remained in a tight range, and US interest rates fell slightly. Regionally, Saudi credit growth was anemic in February. Equity markets were helped somewhat by oil prices, but moves were rather subdued on the week.

International macroeconomics

USA: US data remains very firm, especially on the business and consumer sentiment front. Regional PMI surveys are coming in in-line or beating expectations (Dallas, Richmond); the Chicago PMI advanced to 57.7 in March. March consumer sentiment hit a 17-year high in the Conference Board survey, at 125.6. Though most data is firm, sentiment and survey type indicators appear to be ahead of the "harder" data. Real GDP growth in 4Q16 was revised up to 2.1%, leaving the yearly growth rate at 1.6% for 2016.

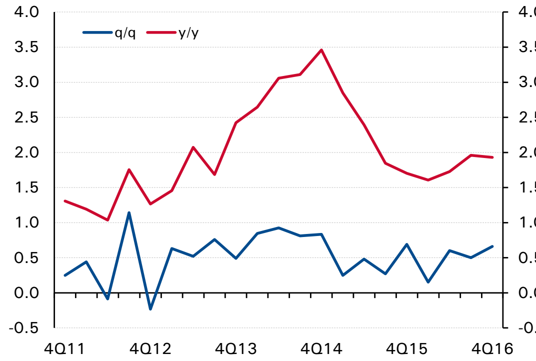
Personal consumption and income advanced 0.1% and 0.4%, respectively, for February, in line with the trend. The keenly watched PCE-deflator was above 2.0% y/y for the first time since 2012 (2.1%), though the core PCE-deflator remains steady at 1.8%. Overall, the data is consistent with the Fed's view of moderate growth, with inflation nearing the Fed's target. The picture is thus with keeping the Fed on track for very gradual rate rises ahead (market expects 2 more hikes this year).

Eurozone: March's Eurozone (EZ) inflation missed expectations, coming in at 1.5% y/y (expected at 1.8%), which is helping to back up ECB president Draghi's dovish outlook for 2017. The weakness was attributed to slower rises in energy and food prices, with the former affected by the recent drop in oil prices. The dovish stance was further emboldened by the EZ's March economic sentiment readings, which also came below expectations, landing at 107.9 versus an expected 108.3.

UK: And so it begins. After 9 months of fevered speculation, heated

Chart 1: UK real GDP growth

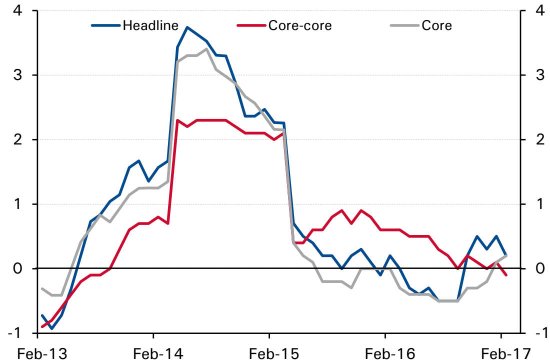
(% y/y)



Source: ONS, Thomson Reuters Datastream

Chart 2: Japan inflation

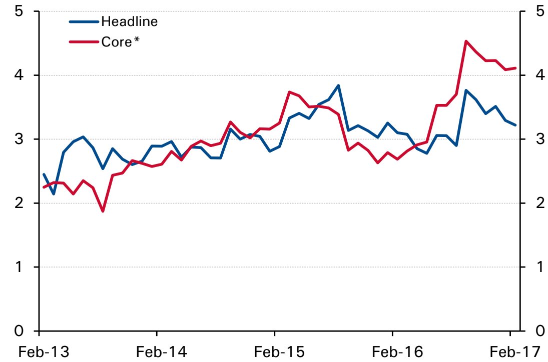
(% y/y)



Source: Thomson Reuters Datastream

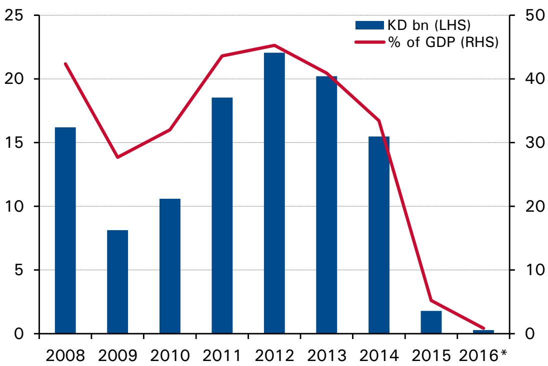
Chart 3: Kuwait inflation

(% y/y)



Source: Central Statistical Bureau, NBK estimates

Chart 4: Kuwait current account balance



Source: Central Bank of Kuwait, NBK estimates

conjecture and often acrimonious mud-slinging between Brexiteers and remainers, Britain finally triggered Article 50 last Wednesday, informing Brussels of its decision to withdraw from the European Union (EU). The exit process, in which Britain must extricate itself from a plethora of EU procedures and legal entanglements while negotiating countless new trade agreements, could take up to two years and likely more. Aware of the economic risks of leaving without any deal, PM Theresa May is thought to be finally coming around to the idea of securing a transitional arrangement before a full agreement is signed. The government will now be looking to introduce its 'Great Repeal Bill', which will transfer and incorporate a whole swathe of EU law into UK common law, thereby smoothing the transition.

Sterling fell 1% on Wednesday, having finally given up on buying the rumor in favor of selling the fact. The currency was also not helped by the Scottish parliament's vote, a day before Brexit, to approve a second independence referendum.

At least official GDP and consumer credit figures brought some comfort to policymakers. The ONS confirmed that UK economic growth in 4Q16 reached 0.7% q/q and 1.9% y/y. (Chart 1.) 4Q's y/y growth is slightly down on the 2.0% that had been previously estimated but is still a healthy figure nonetheless. For 2016 as a whole, output was 1.8%. Net exports were the biggest drivers of q/q growth, even though their contribution to y/y growth was negative. Robust consumer spending was the main factor behind the UK's surprising economic performance in 2016.

China: China's official Purchasing Manager's index (PMI) rose to an almost five-year high of 51.8 in March, thanks to healthy gains in output, new orders and exports. This is in contrast to the Caixin/Markit PMI, which saw manufacturing activity lose some momentum after it slipped from 51.7 in February to 51.2 in March. Whilst the official PMI tends to monitor the larger state owned companies, the Caixin/Markit PMI tends to focus more on the small to medium sized private firms, which according to anecdotal evidence, did not benefit as much from the month long construction boom as the bigger industrial companies did.

Japan: Headline consumer price inflation in Japan weakened to 0.3% y/y in February, moving further away from the Bank of Japan's 2% inflation target. (Chart 2.) The weakness in the headline rate stemmed mainly from the softness in food prices and from a relatively stronger yen which had helped lower import costs. Nonetheless, core inflation, which excludes food costs, maintained its upward momentum and rose to an almost two-year high of 0.2% y/y in February against a backdrop of higher energy prices.

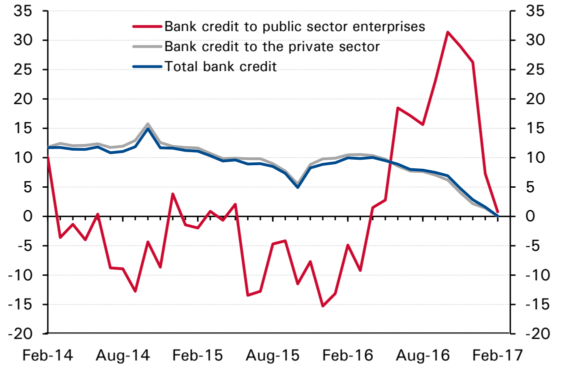
GCC & regional macroeconomics

Kuwait: Inflation in consumer prices was steady at 3.2% y/y in February, as inflation across most components was little changed. (Chart 3.) Food inflation maintained its weakness as global food prices remained subdued. Core inflation, which excludes food items, was unchanged (4.1% y/y), thanks to lower price pressures from housing.

Sources indicate that the Ministry of Finance could tap the domestic debt market for around KD 1 billion in FY17/18 to finance a deficit that we expect to be around KD 4-4.5 billion. This would increase the public debt to around 19% of GDP by March 2018. During FY16/17, the government issued KD 2.2 billion in debt domestically and another $8 billion (KD 2.4 billion) internationally, increasing the debt to KD 6.3 billion or 18% of GDP by the end of March 2017.

Chart 5: Saudi credit growth

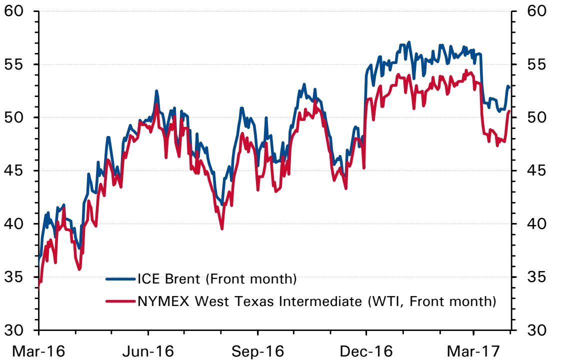
(% y/y)



Source: SAMA

Chart 6: Crude oil prices

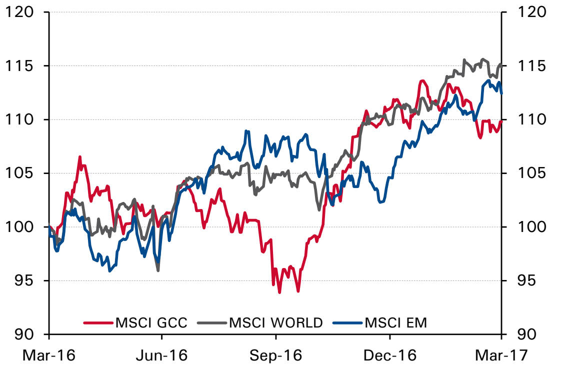
($/bbl)



Source: Thomson Reuters Datastream

Chart 7: Global stock markets

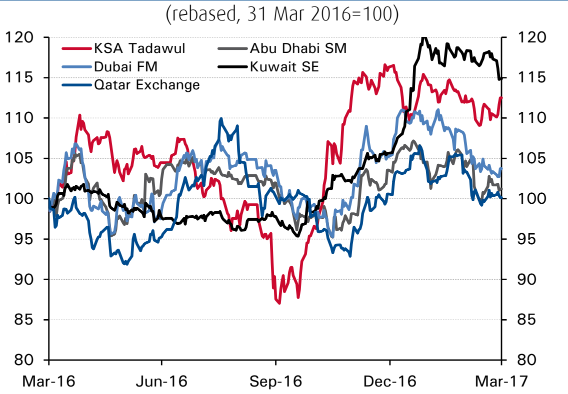
(rebased, 31 Mar 2016=100, total return)



Source: Thomson Reuters Datastream

Chart 8: GCC stock markets

(rebased, 31 Mar 2016=100)



Source: Thomson Reuters Datastream

The current account surplus widened to an over one-year high of KD 0.7 billion in 4Q16. (Chart 4.) Despite the improvement, the surplus in 2016 was 1% of GDP, its lowest in nearly 25 years. The goods balance expanded for a third straight quarter, as higher oil prices pushed oil exports up. Meanwhile, import growth continued to slide.

Saudi Arabia: Private sector credit growth slowed to 0.3% y/y in February. This is the slowest rate of growth since 2008. (Chart 5.) Overall credit growth, including public sector credit (0.8% y/y), also slowed to an 8-year low, of 0.1% y/y.

The Saudi government has lowered the income tax rate paid by Saudi Aramco to 50% from 85%, ahead of its potential (partial) IPO in 2018. The authorities are keen to make owning a share (up to 5%) of the energy giant as attractive as possible to investors, many of whom may have been concerned about the company's high income tax structure. This move, along with expectations of a firmer oil price, could increase the valuation of Aramco to between $1-2 trillion, making the IPO potentially the largest in corporate history.

Qatar: Last week Qatar pledged to invest £5 billion ($6.3 billion) in the UK and showed its support for a potential free trade agreement between the GCC and the UK. Qatar delivers 90% of the UK's LNG imports and holds £40 billion worth of investments in the country. The UK, desperate to secure free trade agreements now that it is officially exiting the EU, is prepared to double the amount of export finance available to £4.5 billion to support trade with Qatar

Egypt: The CBE, at its meeting on 30 March, kept policy rates unchanged, with the deposit rate at 14.75% and the lending rate at 15.75%. Authorities saw that inflationary pressures, while still elevated in February, were diminishing and considered the key policy rates appropriate.

Markets – oil

Oil prices closed the week up more than 4% w/w at $52.8/bbl and $50.6/bbl for Brent and WTI, respectively. (Chart 6.) A lower-than-expected rise in US crude inventories of 867,000 barrels rather than the forecasted 1 million barrels, helped push oil prices up slightly and reverse some of the negative sentiment surrounding crude stock builds.

Markets – equities

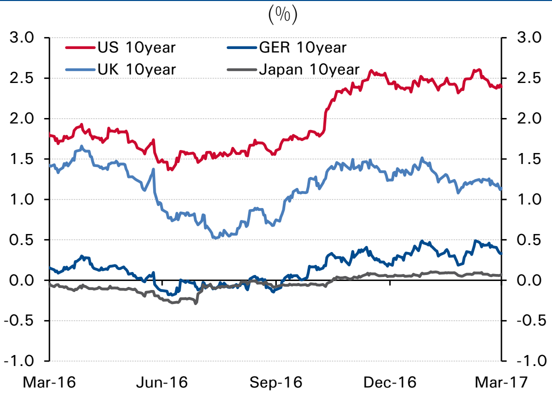
Equities made some gains this week, with the MSCI World advancing 0.6%. US markets seemed to have absorbed the healthcare bill setback (for the Trump administration), with the S&P 500 and DJIA up 0.8% and 0.3%, respectively. (Chart 7.) European equities outperformed, with the Euro Stoxx 50 closing the week up 1.6% despite weaker-than-expected inflation numbers and the UK government triggering Article 50 and kick-starting the process to exit the EU. Meanwhile, emerging markets lost ground, with the MSCI EM down 0.7%.

Regional markets continued with their lackluster performance last week, with the MSCI GCC index up a mere 0.3% despite an advancing Saudi market. Saudi's Tadawul was up 1.8%, probably on the back of rebounding oil prices. Dubai was also up 0.5%, while all other GCC markets retreated.

This week saw the last trading day for First Gulf Bank as a separate entity on the Abu Dhabi Securities Exchange. The bank is merging with the National Bank of Abu Dhabi. The deal creates the biggest financial institution in the UAE and the second largest in the Arab world.

Chart 9: Global bond yields

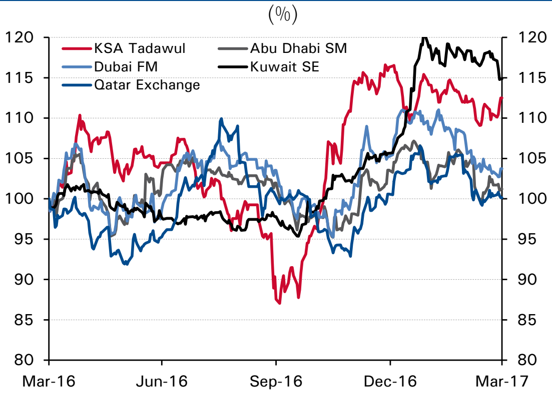
(%)



Source: Thomson Reuters Datastream

Chart 10: GCC bond yields

(%)



Source: Thomson Reuters Datastream

Markets – fixed income

International bond markets started last week moving mostly sideways, as investors saw little direction. US rates remained in a tight band, while Bunds and Gilts rates trended slightly lower following the official start of Brexit. Bund rates later dipped lower as EZ inflation numbers missed expectations. Remarks by ECB staff also contributed to the decline in yields. Their comments pointed to the ECB's dovish stance in 2017, adhering to Draghi's script for 2017. Their views for 2018, however, were more hawkish. Some market analysts are interpreting their outlook remarks to mean forward guidance on hiking rates possibly as early as June, following the French elections; forward guidance on tapering QE may happen as soon as October, following the German elections. Yields on 10-year bunds dropped 8 basis points on the week, while US 10 years were down.

GCC yields on paper maturing in 2021 were lower on the week. Yields dropped across all sovereign debt by 3-11 bps. Meanwhile, Kuwait's 2022 bond traded at 2.62%, down 3 bps from a week ago, and 19 bps since its issuance on Tuesday 14 March 2017.

Saudi Aramco is close to issuing a $2 billion domestic private placement sukuk. The oil giant, however, will be paying a premium as investors are jittery over oil prices. Aramco will be offering a 7-year sukuk at 25 basis points over 6-month SAIBOR.

Saudi Arabia is also looking to amend the structure of its soon-to-be-issued $10 billion international sukuk. It initially planned to have the Islamic debt instrument split between a mudaraba agreement (Islamic investment management partnership) and murabaha facility (trades commodities with a special purpose vehicle). The government now wants to facilitate the structure to make comprehension and trading less complex to international investors unfamiliar with the instrument.

Al-Ahli bank of Kuwait has set an initial price guidance for a benchmark USD issuance. The bank is looking to price its bond at 175 bps over mid-swaps for a tenor of 5 years.

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