G7 discord ratchets up fears over global trade outlook; Fed rate hike almost certain this week

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,663	1.25	6.01
Bahrain (ASI)	1,264	-0.16	-5.10
Dubai (DFMGI)	3,042	2.62	-9.74
Egypt (EGX 30)	15,924	-2.99	6.02
GCC (S&P GCC 40)	1,029	1.25	4.47
Kuwait (All Share Index)	4,806	1.47	-0.52
KSA (TASI)	8,344	2.25	15.47
Oman (MSM 30)	4,597	-0.22	-9.86
Qatar (QE Index)	9,242	4.07	8.43
International			
CSI 300	3,780	0.24	-6.23
DAX	12,767	0.33	-1.17
DJIA	25,317	2.77	2.42
Euro Stoxx 50	3,447	-0.18	-1.62
FTSE 100	7,681	-0.27	-0.09
Nikkei 225	22,695	2.36	-0.31
S&P 500	2,779	1.62	3.94

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.62	3.7	67.0
Dubai 2022	4.00	-0.9	85.9
Qatar 2022	3.85	-4.3	77.0
Kuwait 2022	3.48	-4.3	67.0
Saudi Arabia 2023	3.83	-0.3	61.0
International			
UST 10 Year	2.94	4.0	52.4
Bunds 10 Year	0.45	7.2	2.5
Gilts 10 Year	1.39	10.7	20.1
JGB 10 Year	0.05	0.3	-0.3

3m interbank rates	%	Change (bps) weekly	YTD
Bhibor	3.25	5.0	52.5
Kibor	1.94	0.0	6.3
Qibor	2.64	1.0	-9.9
Eibor	2.46	-10.0	65.9
Saibor	2.45	1.2	55.4
Libor	2.33	0.6	63.3

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.302	-0.09	0.18
KWD per EUR	0.357	1.25	0.68
USD per EUR	1.177	0.91	-1.92
JPY per USD	109.5	0.00	-2.79
GBP per USD	1.341	0.47	-0.75
EGP per USD	17.82	-0.17	0.51

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	76.5	-0.43	14.34
KEC	74.8	0.00	17.75
WTI	65.7	-0.11	8.81
Gold	1298.1	0.25	-0.63

Source: Thomson Reuters Datastream; as of Friday's close 8/6/2018

Overview

After an acrimonious build-up, the meeting of G7 leaders over the weekend did nothing to resolve current tensions over global trade with President Trump railing against unfair trade practices, refusing to endorse the usual end-summit written accord, though also calling for the removal of all tariffs among the group in a move that would be challenging under WTO rules.

Markets ended the week in cautious mood ahead of the gathering and key policy announcements due this week, with stocks mixed and the dollar partially recovering some previously lost ground. A 25bps interest rate hike by the US Federal Reserve when it meets on Wednesday has already been priced in, but the minutes will be scrutinized for changes in forecasts and language on whether one or two more increases are likely this year. Indications are that the European Central Bank will end its QE program by the end of the year.

It was a subdued week for the oil market, with the price of Brent crude finishing at $76/bbl, down 0.4% w/w. Sentiment towards crude in financial markets may have peaked. Speculators cut bullish bets on crude again last week, while market heavyweight JP Morgan expects oil prices to dip towards the end of the year and revised down its forecasts for US benchmark WTI to $62 in 2018 and to $58 in 2019 on weaker fundamentals.

The World Bank's latest Global Economic Prospects report is generally upbeat over the near-term outlook for the MENA region, with growth in the GCC revised up a touch to 2.1% on improved terms of trade thanks to higher oil prices, and higher investment. It also upgraded its growth outlook for Egypt substantially to a healthy 5.0% in FY2018 and 5.5% next year as policy reforms and the cheaper exchange rate boost domestic demand and net exports. However, the latest PMI for Egypt slipped back below the 50 'no change' mark in May.

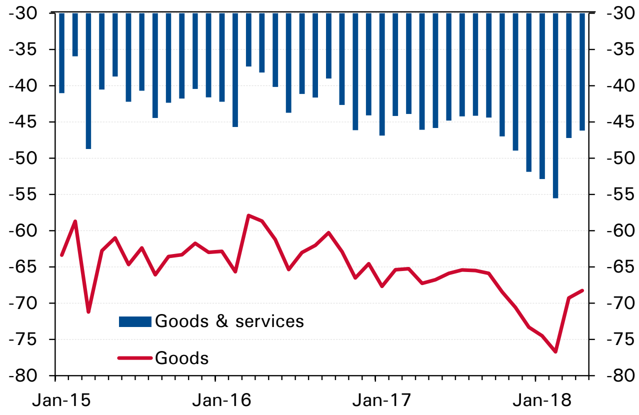
International macroeconomics

USA: Strong manufacturing survey data for May the previous week were followed up by robust reports on the services side, with the PMI (+2.2 points to 56.8) and ISM indices (+1.8 to 58.6) both registering unexpectedly strong gains. There were reports of longer delivery times and higher costs, signals of capacity pressures and possible tariff-related effects. The combined surveys suggest that May was a buoyant month for the US economy.

Meanwhile, the international trade deficit in goods and services unexpectedly narrowed to $46 billion in April from $47 billion in March helped by stronger exports (+10% y/y) and softer imports (+8% y/y). (Chart 1.) Imports of steel and aluminum held up but will be watched closely in coming months. The report signals a boost to GDP growth from net trade early in the second quarter.

Chart 1: US trade balance

($ billions per month)



Source: Thomson Reuters Datastream

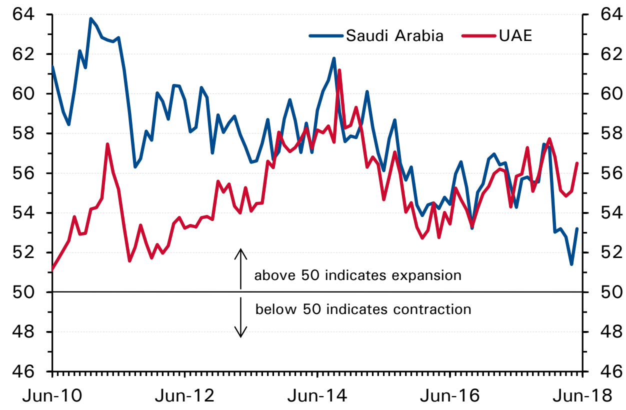
Eurozone: There was a slew of soft Eurozone data last week. The May Eurozone PMI was unchanged at 54.1 and 1Q18 GDP growth (0.4% q/q) expanded at its slowest pace since mid-2016. A slip in in German and French April industrial production further alluded to a slowdown in growth in 2Q18. Yet the ECB is expected to end its QE by the end of the year, as two powerful ECB board members alluded to last week on the grounds that the recent slowdown is temporary.

GCC & regional macroeconomics

Kuwait: Various parliamentary committees appeared to ease their opposition to the draft sovereign debt law, requesting that the government borrowing program be linked to key budget reforms and capital spending. However, the opposition to this law is still very strong. The committees also cited concerns over the government's liquidity, emphasizing the depletion of the General Reserve fund. The fund currently tops $87 billion, with $14.6 billion used over the past three years to help plug previous deficits. The new law, if approved, would allow the Kuwaiti government to borrow up to KD 25 billion, with maturities of up to 30 years.

Saudi Arabia: According to the latest PMI survey, private sector activity recovered slightly in May. The headline rate rebounded from April's all-time low of 51.4 to 53.2. Firms reported an uptick in new orders and output, though export orders continued to fall for the fourth month in a row. Input price pressures appeared to ease, with both purchase prices and staff costs rising at a much slower rate. Managers continued to be broadly optimistic about their firms' future growth prospects. (Chart 2.)

Chart 2: Saudi foreign reserve assets



Source: SAMA

UAE: The PMI increased from 55.1 in April to a four-month high of 56.5 in May, thanks to healthy gains in new orders (including export orders) and output. (Chart 2.) Employment conditions also appear to have improved, with the employment index rising to a four-month high of 51.2.

To take advantage of the higher oil price environment and catalyze economic growth, the Abu Dhabi government approved a three-year Dh50 billion ($13.6 billion) economic stimulus program. The authorities intend to make it easier to do business in Abu Dhabi, spur employment growth and increase tourism activity.

Dubai also unveiled its own plans to improve the business climate and stimulate foreign investment. It plans to waive some charges on aviation and real estate transactions, freeze school fees and reduce business fees.

Qatar: The IMF, in a report following its recently-completed Article IV mission to Qatar, expects Qatar's real GDP growth to quicken to 2.6% in 2018 from 2.1% in 2017. The IMF says that the economic and financial impact of the tension with its neighbors has been 'manageable'. The economy is expected to benefit from continued infrastructure investment (non-hydrocarbon growth to rise to 4.1% in 2018 from 4.0 in 2017), a slower pace of fiscal consolidation and the scaling up of LNG production. The fiscal deficit is expected to narrow to 1.4% of GDP this year from 6% in 2017. The outlook is based on oil prices remaining above $60/bbl in 2018-19.

Egypt: The PMI edged back below the 50 'no change' mark in May at 49.2 from 50.1 in April. The output, new orders and new export orders components also all slipped back below 50, though are still well above the lows of around 35 recorded in late 2016 at the time of the currency float. The figures, while slightly disappointing, could reflect a wait-and-see attitude before the expected removal of subsidies in July and are not decisive enough to signal a deviation of economic growth from its current path: official data shows growth at a robust 5%+.

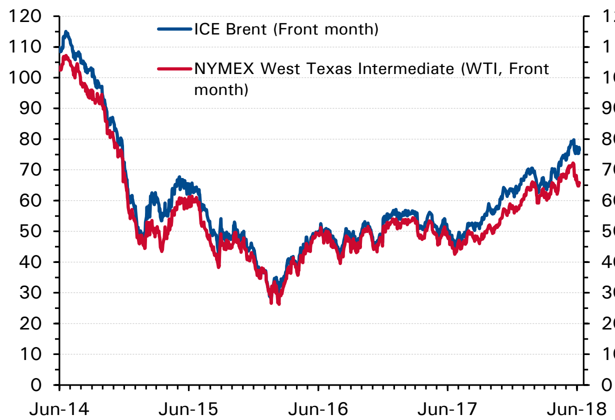
Jordan: In an attempt to diffuse public anger over austerity measures, King Abdullah replaced Prime Minister Hani Mulki with former World Bank economist Omar Al-Razzaz and urged his new administration to hold talks over proposed tax hikes – part of a package agreed with the IMF in 2016 in exchange for a $0.7 billion loan. Although Al-Razzaz will proceed with the reform agenda that seeks to lower high levels of public debt and boost economic growth, he will likely ask the IMF for more time to implement the measures to lower the risk of socio-political instability. In turn, the IMF welcomed the call for a national dialog over tax legislation, and expressed willingness to complete the second review under the program and release $70 million shortly. Meanwhile, leaders of Saudi Arabia, Kuwait, UAE, and Jordan will hold talks on Sunday to discuss ways to provide support for Jordan, and avoid an escalation of the crisis that has gripped the country over the past two weeks.

Markets – oil

Oil prices declined last week, with bearish sentiment linked to the prospect of Saudi Arabia and Russia increasing supplies after the OPEC meeting on 22 June continuing to dominate the market outlook. Brent closed down 0.4% w/w at $76.5/bbl and WTI finished 0.1% lower w/w at $65.7/bbl, (chart 3) amid another week of reduced 'long' exposure by money managers: hedge funds' positioning on oil (the net long position) is at its lowest since last October, at 438,186 contracts for Brent (-3.1% w/w) and 313,450 contracts for WTI (-3.3% w/w).

Chart 3: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

Earlier, on Thursday, it had looked as if oil might end the week higher after news filtered through that Venezuela was a month behind on its crude deliveries, but against the seemingly relentless increase in US crude production (+31 kb/d to 10.8 mb/d in the w/e 1 June) and a larger-than-expected crude stock-build (+2 mb to 436.6 mb), oil prices weren't able to hold on to their gains.

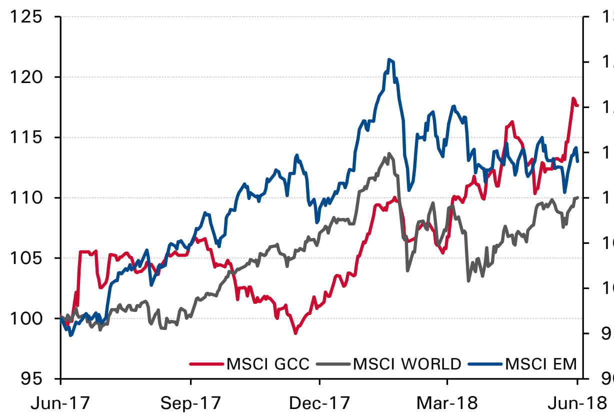
The OPEC meeting is expected to be among the most contentious in years, with producers Saudi Arabia, Russia and the GCC states with spare production capacity looking to ramp up output (to prevent oil prices rising) likely to encounter stiff resistance from the likes of Iran, Venezuela and those with little room to expand production. Moreover, the OPEC secretariat, appears likely to reject Iran's request of last week to discuss the reapplication of US sanctions on the Islamic Republic at the upcoming meeting.

Markets – equities

Global markets finished higher overall, with the MSCI AC World index up 1.1% w/w. (Chart 4.) Encouraging news out of Italy and stronger US data helped global stocks start the week on a positive note. They were later held back by trade tensions ahead of the G7 meeting. Investors were also cautious in anticipation of three major central bank meetings this week.

Chart 4: Total equity return indices

(rebased, 8 June 2017=100)



Source: Thomson Reuters Datastream

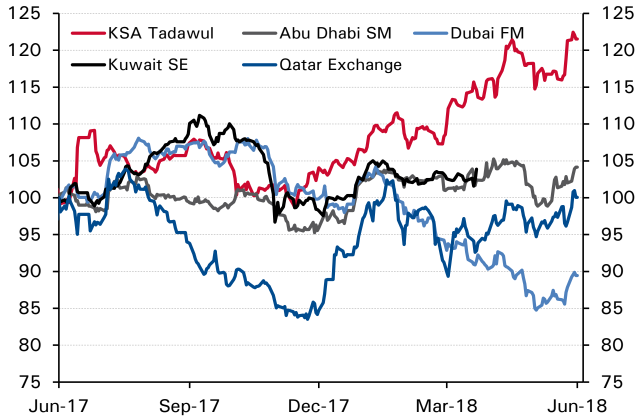
The DJI and the S&P 500 were up 2.8% w/w and 1.6% w/w, respectively, lifted by the consumer sector, which helped offset weakness in energy shares driven by lower oil prices. In Europe, the Euro Stoxx 50 was little changed in the wake of softer data. Meanwhile, emerging markets eked out gains of 0.9% despite trade uncertainties, supported by a weaker dollar and a $50 billion IMF to Argentina.

The MSCI GCC index outperformed global markets (2.6% w/w), led by Qatar (+4.1% w/w) on foreign flows, and supported by the appointment of a new labour minister in Saudi Arabia

(+2.2% w/w), and Abu Dhabi's (1.2% w/w) and Dubai's (2.6% w/w) respective economic stimulus plans. Kuwait also edged higher, finishing the week up 1.5% w/w. (Chart 5.)

Chart 5: GCC equity markets

(rebased, 8 June 2017=100)



Source: Thomson Reuters Datastream

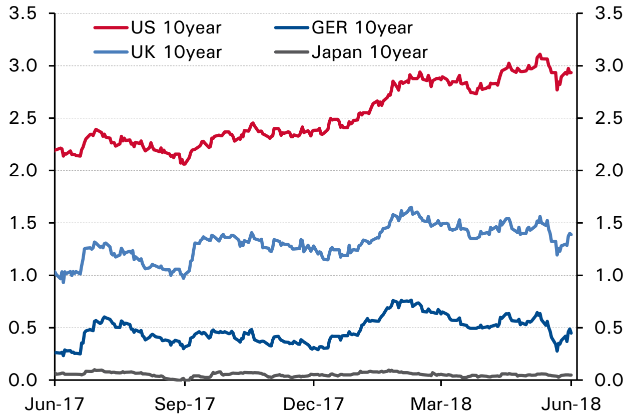
Markets – fixed income

Easing political tensions, firmer US data, and relatively hawkish ECB speak, despite soft Eurozone data, pushed yields higher. US and German 10-year yields increased 4 bps and 7 bps over the week to 2.94% and 0.45%, respectively. (Chart 6.) GCC yields meanwhile were mixed but avoided large changes. (Chart 7.)

The ECB, the Fed, and the BOJ will all hold monetary policy meetings this week. Remarks by ECB board members hinted at ending the QE program by December 2018, at the latest, despite softening growth, with forward guidance expected in July. As for the Fed, markets are expecting a rate hike with 91% certainty. However, the Fed could also change its monetary policy stance from accommodative to neutral, while keeping its median dot plot forecast unchanged.

Chart 6: Global bond yields

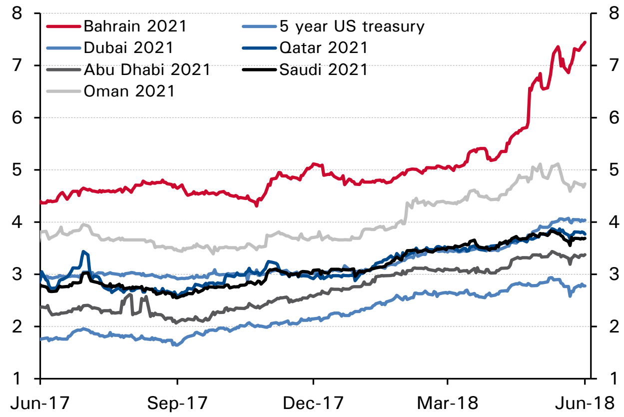
(%)



Source: Thomson Reuters Datastream

Chart 7: GCC bond yields

(%)



Source: Thomson Reuters Datastream

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