Weekly Economic and Markets Review
8 January 2017

US December nonfarm payroll up 156K; December PMIs showing steady growth in KSA, UAE, US, Eurozone

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,602	1.22	1.22
Bahrain ASI	1,206	-1.15	-1.15
Dubai FM	3,628	2.75	2.75
Egypt EGX 30	12,824	3.88	3.88
KSA Tadawul	7,199	-0.16	-0.16
Kuwait SE	5,831	1.45	1.45
Muscat SM 30	5,793	0.84	0.84
Qatar Exchange	10,717	2.69	2.69
MSCI GCC	725	0.85	0.85
International			
DAX	11,599	1.03	1.03
DJIA	19,964	1.02	1.02
FTSE 100	7,210	0.94	0.94
Nikkei	19,454	1.78	1.78
S&P 500	2,277	1.70	1.70

Commodities	$/bbl	Change (%) weekly	Change (%) YTD
Brent crude ($/bbl)	57.1	0.49	0.49
KEC ($/bbl)	51.9	0.10	0.10
WTI ($/bbl)	54.0	0.50	0.50
Gold ($/t oz.)	1172.0	1.35	1.35

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.306	0.14	0.14
KWD per EUR	0.321	0.75	0.75
USD per EUR	1.053	0.13	0.13
JPY per USD	116.91	0.03	0.03

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Kibor – 3 month	1.44	0.0	0.0
Qibor – 3 month	1.83	5.3	5.3
Libor – 3 month	1.01	1.2	1.2

Fixed income	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.57	2.4	2.4
Dubai 2021	3.19	-13.8	-13.8
Qatar 2021	2.91	-3.7	-3.7
Saudi Arabia 2021	3.05	-0.6	-0.6
International			
UST 10 year	2.42	-1.4	-1.4
Bunds 10 year	0.31	9.9	9.9
Gilts 10 year	1.38	14.2	14.2
JGB 10 year	0.06	0.7	0.7

Source: Thomson Reuters Datastream

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Summary

The December US employment report was in line with expectations, and impacted the markets little. A gain of 156K and somewhat firm wage growth of 2.5%, and unemployment at 4.7%, all support (expected) further action by the Fed in 2017.

A series of PMIs were mostly in decent territory for the US, Eurozone, KSA, and the UAE, pointing to sustained growth particularly in the US and in the eurozone. For KSA and the UAE, the index was near 4-5 month highs, at 55.5 and 55, respectively. Egypt's index remains in the doldrums, at 42.8, though it was up a touch; and FX reserves rose to a 5-year high. It's only two months since the devaluation of the EGP and the IMF package, so further improvement could be in the cards.

Kuwait's finance minister intimated that planned VAT and corporate taxes may take a while to become concrete, perhaps not before 2019 or even 2020 (in line with our view).

International macroeconomics

USA: The signs from the US economy continue to be positive, and sentiment remains quite buoyed by expectations of enhanced growth, following the Trump election. The manufacturing PMI rose in December to 54.7, a 2-year high. (Chart 1.) In the survey, new orders jumped and employment improved. The non-manufacturing index was at 57.2.

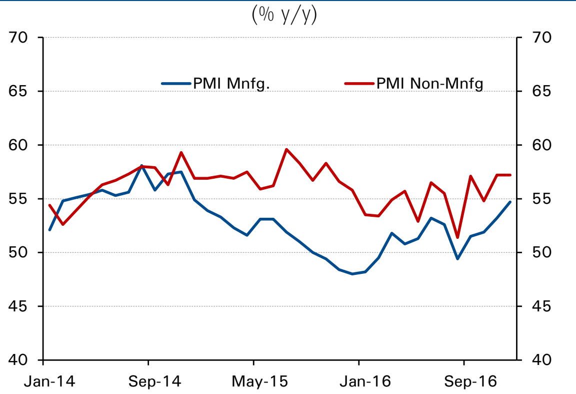
In December, nonfarm payrolls gained 156K new jobs and unemployment ticked up to 4.7%. The 3-month moving average of gains is now at 165K, and wage inflation averaged 2.5% in 2016, where it appears to be holding. No major surprises there, as most data appear to be in line with Fed and market thinking, and indicative of an economy growing near 2.0% and a (very) gradually tightening labor market. (Chart 2.)

This data, among others, and improved expectations, supported the Fed thinking of FOMC minutes of the December meeting. These confirmed and explained a more aggressive Fed stance, which was already seen in the December "dot plots" which showed a Fed anticipation of 3 hikes in the federal funds rate for 2017. In December, the Fed saw less downside risk to growth and inflation ahead and cited high uncertainty given the advent of a new administration and new policies. The markets, and ourselves, are more partial to 2 hikes for 2017, perhaps by mid-year and in December.

Eurozone: December's Eurozone flash inflation came in at its highest since September 2013, registering at 1.1%. This is well above its November reading (0.6%) and 2016 average (0.2%). Higher oil prices drove the increase. The jump drew little market reaction as the core inflation rate, which excludes energy and food prices, rose marginally to 0.9% in December. This all points to deflation as a fading issue for the central bank.

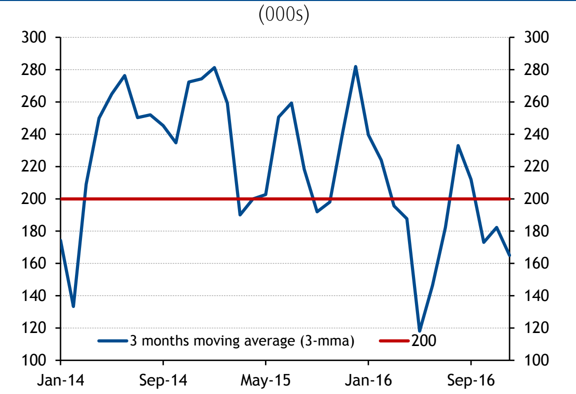
December's Eurozone Composite PMI registered a relatively strong final reading of 54.4, higher than estimated. It was led by the manufacturing sectors in Spain and Germany.

Chart 1: US PMI Indexes



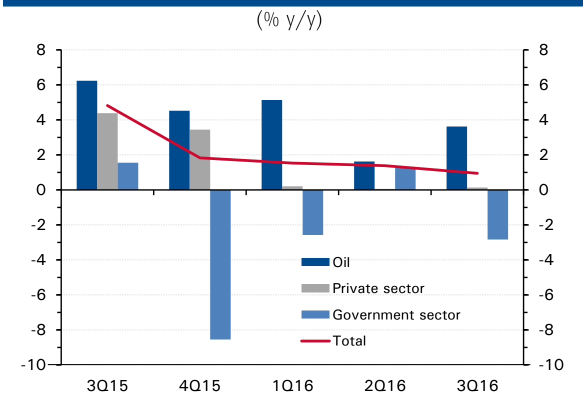
Source: Thomson Reuters Datastream

Chart 2: US Nonfarm payroll



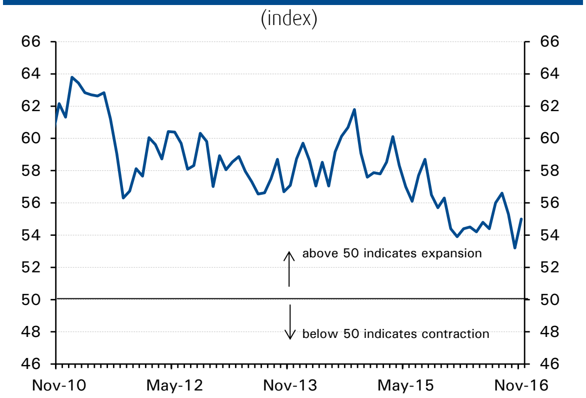
Source: Thomson Reuters Datastream

Chart 3: Saudi real GDP growth



Source: Saudi General Authority for Statistics

Chart 4: Saudi PMI



Source: Markit/Emirates NBD

GCC & regional macroeconomics

Kuwait: Finance Minister Anas Al-Saleh stated that plans to impose new taxes would not materialize in the "short or medium term". In a March 2016 package of proposed reforms, the cabinet planned to introduce a 5% VAT by the start of 2018 and a 10% corporate earnings tax by the start of 2019. Both will require new legislation, but draft laws have yet to be presented to the National Assembly. This supports our view that the two taxes are unlikely to be introduced before 2019, possibly not before 2020.

The current account surplus expanded slightly to KD 0.5 billion in 3Q16 from the previous quarter, with the improvement in oil prices helping to push export earnings higher. Declining remittances, down 11% y/y, also helped the current account. On the other hand, strong growth in net service outflows of 24% y/y weighed on the external balance. The surplus supported portfolio outflows of KD 1.5 billion.

NBK's real estate price indices continued to reflect some stabilization in December. Still, indices saw deeper declines in 2016 than the year before, decreasing by 7-12% during the year. Activity was also down during the year, with 2016 sales totaling KD 2.3 billion, off by 23%. Only the commercial sector saw an increase in sales.

Saudi Arabia: Preliminary estimates for 3Q16 GDP revealed that growth slowed from 1.4% y/y to 0.9% y/y. (Chart 3.) While the oil sector expanded by 3.6% y/y in 3Q16 on account of higher oil production (due to seasonal factors and ahead of the OPEC meeting in Algiers), the non-oil sector continued to contract, slowing by -0.7% y/y, as the government continued to rein in spending. In fact, the non-oil economy dipped into recession in 3Q16 with the second consecutive quarter-on-quarter decline (-0.6 q/q).

Meanwhile, December's headline PMI rose to a 4-month high of 55.5, which pointed to an improvement in non-oil private sector activity. (Chart 4.) The index posted back-to-back gains in December on improving output and new orders. Firms indicated a rise in new business, helped by rising sales and marketing efforts. Export orders also increased, for the 6th month in a row.

SAMA announced last Thursday that it would allow banks to provide mortgage financing for up to 85% of the value of a first home, up from the maximum 70% that was previously permitted. Last March the authorities had raised the loan-to-value ratio from 70% to 85% for specialist mortgage companies in an attempt to stimulate the Saudi housing market and provide more affordable housing for citizens.

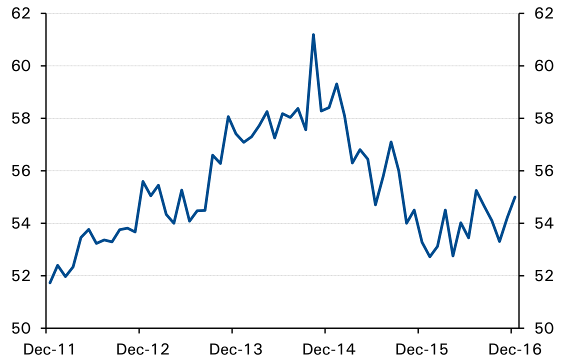
UAE: The UAE's headline PMI increased from 54.2 in November to a 5-month high of 55.0 in December, as new orders and output held strong. (Chart 5.) New orders came in at a strong 56.2 in December and output rose to an over one-year high of 62.7, thanks to robust domestic conditions. After contracting for five consecutive months, new export orders rebounded on the back of some improvement in external demand.

Taking its cue from the Abu Dhabi Stock Exchange (ADX), the Dubai Financial Market (DFM) also announced that it will introduce short-selling within the next couple of months. The ADX and now the DFM hope that the new practice will draw in more foreign investors and boost traded volumes.

Qatar: Lending growth continues its downward trend, as private sector credit growth slowed to 6.4% y/y in November. (Chart 6.) Private sector deposits were relatively tame, showing slight growth at 1.2% y/y.

Chart 5: UAE PMI

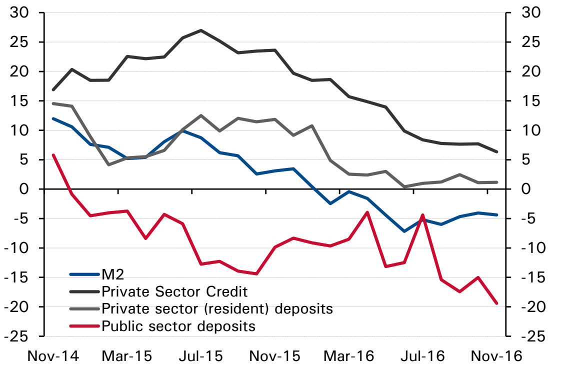
(index)



Source: Markit/Emirates NBD

Chart 6: Qatar credit and deposit growth

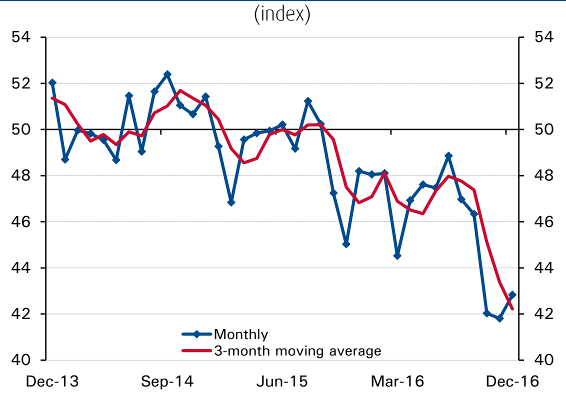
(% y/y)



Source: Thomson Reuters Datastream

Chart 7: Egypt PMI

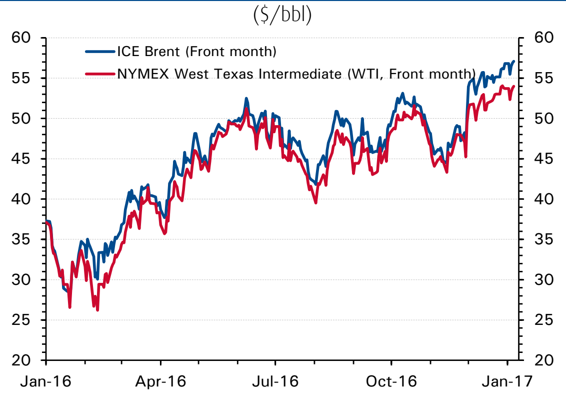
(index)



Source: Markit

Chart 8: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

Liquidity concerns have not eased as public sector deposits continued their contracting trend in November, falling by -19.4% y/y and money supply (measured as M2) continued to shrink, contracting by -4.4% y/y.

Oman: Oman announced its 2017 budget. It is expecting a deficit of OMR 3 billion, at an oil price of USD 45 per barrel. The announcement was in line with earlier rumors. The strategy will focus on further cuts in subsidies and current expenditures, and will boost non-oil revenues. We are skeptical of this target; disappointing spending cuts in 2016 saw the government overshoot its deficit target. We foresee a slightly larger deficit at OMR 3.7 billion in 2017, or 14% of GDP. As of 1 January 2017, Oman has implemented its cost reflective tariffs (CRT) system for electricity consumption by government, commercial and industrial customers. The system is a move away from the subsidized pricing scheme. It aims at pricing dynamically the utility's cost based on real time demand.

Egypt: The PMI improved in December but, at 42.8, it remained weak. This somewhat confirmed expectations that activity would pick up following the EGP float in November. The PMI averaged 42.2 in 4Q16, consistent with GDP growth of less than 1%; growth had slowed to 1.6% y/y in 3Q16. We expect GDP growth to pick up to 2-3% y/y in the first half of 2017. (Chart 7.)

The current account deteriorated in 3Q16, as the deficit widened to USD 5.0 billion (5.4% of GDP). The deterioration came largely from declines in tourism and worker remittances, partly offset by an improving trade balance. FDI inflows remained robust while portfolio flows were negative on outflows in domestic bonds.

CBE's official reserves rose ounce again in December, rising by USD 1.2 billion to USD 24.3 billion or 4.7 months of imports. The level was the highest in over five years and comes almost two months after Egypt clinched a USD 12 billion IMF loan and floated its currency.

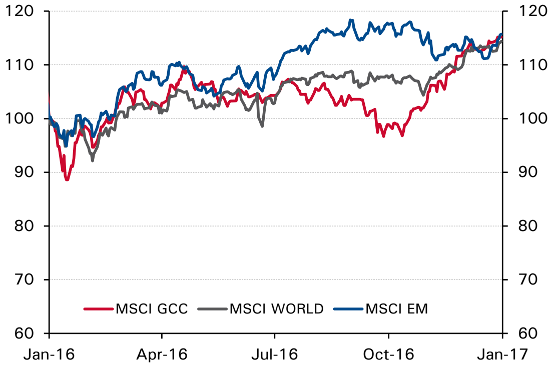
Turkey: Turkey's consumer price inflation accelerated more than expected in December, surging from 7.0% y/y in November to 8.5% y/y, following tax hikes on alcohol and tobacco, and as a weaker lira and higher oil prices pushed up costs in the transport segment. Inflation in the transport segment jumped from 9.6% y/y in November to 12.4% y/y in December. This acceleration in inflation increases the odds of another policy interest rate hike in the near-to-medium term by the central bank, to help rein in inflation and help contain the depreciation of the lira.

Markets – oil

Oil prices started 2017 very much where they left off last year, buoyed by the prospect of OPEC and non-OPEC controlling/cutting production. Brent was still trading around $56-57/bbl last week; close to an 18-month high, while WTI was trending at around $53/bbl. (Chart 8.) All eyes will be on OPEC crude loadings/production data and OECD stock data to monitor OPEC quota compliance and to assess the rate of stock drawdowns, respectively. On that note, last Thursday it was reported by a Reuters' Gulf source that Saudi Arabia has cut its January oil output by 486,000 b/d to 10.058 mb/d, which would be the 4.6% reduction that the kingdom had promised. Furthermore, Saudi Aramco has reportedly begun talks with its customers about cutting crude loadings in February by 3-7%, although, interestingly, the cuts will affect heavier rather than the more valuable lighter grades of Saudi Arabia's crude.

Chart 9: Total return indices

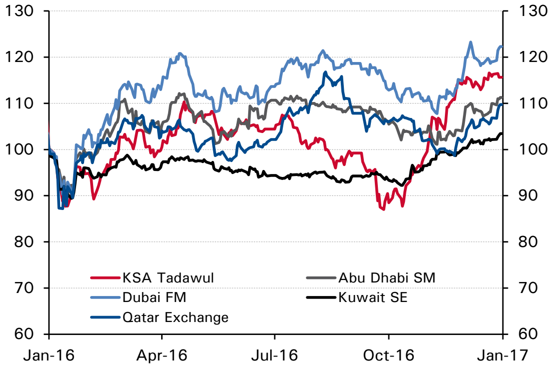
(rebased, 31 Dec 2015=100)



Source: Thomson Reuters Datastream

Chart 10: GCC markets

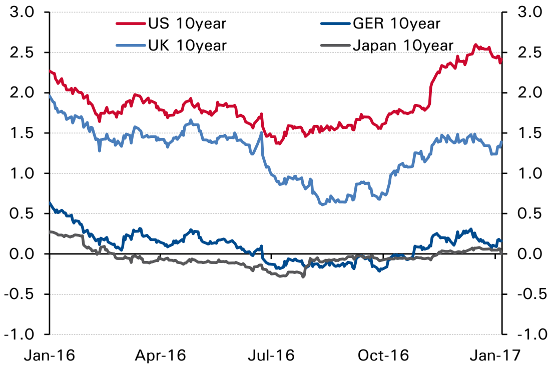
(rebased, 31 Dec 2015=100))



Source: Thomson Reuters Datastream

Chart 11: Global benchmark yields

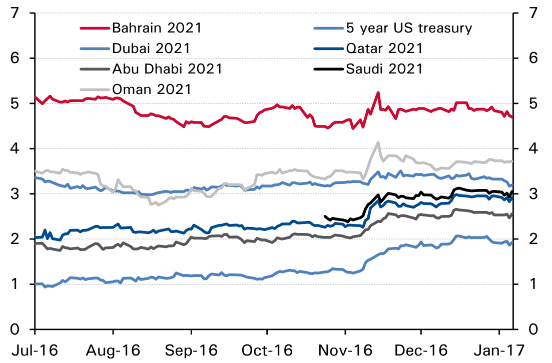
(%)



Source: Thomson Reuters Datastream

Chart 12: GCC yields

(%)



Source: Thomson Reuters Datastream

Markets – equities

Equity markets started the year on the front foot supported by positive data releases from the US and other major economies. The MSCI World index closed the first week of 2017 up 1.7%. The S&P 500 and DJIA gained 1.3% and 1.1%, respectively. European equities also advanced, with the Euro Stoxx 50 up 1% on the week. (Chart 9.)

Emerging markets outperformed for the second consecutive week, with the MSCI index up 1.8%. Strong retrenchment of capital flows following the US election had seen EMs lag international markets towards the end of 2016. According to the IIF, EM portfolio inflows in 2016 were the weakest since 2008.

GCC equity markets were lifted by the positive sentiment that swept international markets, with the MSCI GCC index up 0.8% on the week. (Chart 10.) Dubai and Qatar outperformed, with their general indices up 2.8% and 2.7%, respectively. These markets tend to be more affected by international developments. Meanwhile, the Saudi market was flat as market observers held off in anticipation of earnings announcements.

Markets – fixed income

Benchmark bonds began the week mixed, as markets reacted to data and the FOMC meeting minutes. Yields on US 10-year Treasuries edged lower following the release of the Fed's meeting minutes. The somewhat less hawkish tone of the minutes, coupled with uncertainty over the impact of any future fiscal stimulus, saw investors buy back into Treasuries. Meanwhile, stronger EU stock market performances and stronger than expected inflation and PMI data encouraged a European bond selloff, with 10-year Bunds and Gilts both up in yields, bucking their declining trend from last week. Friday's US payroll release, however, pushed benchmark yields up across the board. (Chart 11.) Despite that, US 10-year Treasuries ended the week down 1 bp, while 10-year Bunds were up 10 bps, tightening their spread. (Chart 11.)

Firmer oil prices and international investor interest benefited Dubai and Qatari yields, while Abu Dhabi and Saudi Arabia saw little change. Dubai's 5-year benchmark yield was down 14 bps on the week, while Qatar saw a decline of 4 bps for paper of the same maturity. Meanwhile, Abu Dhabi was up 2 bps and Saudi was flat on the week. (Chart 12.)

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