Yellen and Draghi offer few clues on monetary policy; GCC presses ahead with tax reform

Overview
In a quiet week for economic data, market attention was focused on the gathering of key central bank chiefs at Jackson Hole in Wyoming over the weekend, in particular for clues as to the likely path of monetary policy. In the event, neither US Fed Chair Yellen or ECB President Draghi offered much insight, preferring instead to discourage talk of significantly looser financial regulation and more restrictive international trade policy - both seen as part of the Trump administration’s agenda. However, the euro managed to strengthen against the US dollar in the absence of a clear steer from Yellen on future Fed interest rate hikes, with some now expecting the next increase to be delayed until next year.

Regional stock markets continued to edge higher, with the MSCI GCC index up 0.8% on the week. One supporting factor was the rise in Brent crude oil prices to $52 pb helped by a decline in US crude stock levels (and later Hurricane Harvey in the US). But as the US driving season draws to a close, refineries go into seasonal maintenance and US crude production carries on climbing, this catalyst may not last. Markets also continue to find support from the widely-anticipated decision by the FTSE to upgrade both Saudi Arabia and Kuwait to emerging market status in September; the Kuwaiti bourse has been easily the GCC’s best performer so far this year. Market activity could be slow this week ahead of the Eid holiday.

On the economic front, the UAE became the second country to announce a tax reform - this measure will have a small upward impact on inflation and bring in 0.5% of GDP in revenues. This follows a similar move by Saudi Arabia in June. The measure will improve the fiscal position. The tax will be introduced from October and followed in early 2018 by a value added tax (VAT) rate of 5%.

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International macroeconomics
USA: As a fight over the federal budget and debt ceiling loomed, the risk that the government would be forced to shut down has started to impact markets. Last week, President Trump expressed his willingness to force a shutdown if his funding priorities are not achieved. A new budget must be agreed and the debt ceiling lifted by the end of September if a shutdown is to be avoided.

The much anticipated meeting of central bankers at Jackson Hole last week ended up being disappointing for those awaiting further clues on the Fed’s monetary policy direction. Janet Yellen chose to focus instead on financial regulation and the progress made since the financial crisis, in an effort to push back on GOP plans to relax them.

Eurozone: The August eurozone (EZ) composite PMI index flash estimate came in slightly stronger than expectations, confirming continued firmness in eurozone growth. The index inched up to 55.8 during the month. Much of the strength continued to come from manufacturing, where the PMI

Key market indicators

<table>
<thead>
<tr>
<th>Stock markets</th>
<th>Index</th>
<th>Change (%)</th>
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<td>Regional</td>
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<tr>
<td>Abu Dhabi SM</td>
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<td>Sibor - 3 month</td>
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<tr>
<td>Libor - 3 month</td>
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<td>0.1   31.9</td>
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<tr>
<td>Bond yields</td>
<td>%</td>
<td>Change (bps)</td>
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<tr>
<td>Abu Dhabi 2021</td>
<td>2.23</td>
<td>-0.8  -30.1</td>
</tr>
<tr>
<td>Dubai 2021</td>
<td>2.96</td>
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<td>Qatar 2021</td>
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<td>Saudi Arabia 2021</td>
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<tr>
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<td>JGB 10 Year</td>
<td>0.02</td>
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Source: Thomson Reuters Datastream; as of Friday’s close 25/08/2017

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Monetary policy, especially as growth picks up and the euro strengthens, in a speech on Wednesday and at Jackson Hole Friday, ECB president Mario Draghi provided few clues as to when the central bank will end quantitative easing. The euro gained 1% during the week against the USD, hitting its highest level since early 2015.

China: In an effort to discourage outward investment, the government announced plans to limit Chinese investment in some sectors including real estate, hotels, entertainment, and sports clubs; investments in gambling will also be banned and restrictions will be placed on overseas private equity funds. According to the new rules, overseas investment must now be aligned with the official Belt and Road Initiative or it must support China’s high-tech sectors.

UK: Economic growth in 2Q17 was confirmed at 0.3% q/q. While the headline rate unchanged from July’s estimate, data on household consumption were disappointing. Many expected private consumption to hold up well compared to 1Q17’s figure of 0.4% q/q, instead, 2Q’s figure of 0.1% q/q was surprising, and seemed to suggest that the weak pound was “hitting household budgets”. Weaker business investment on Brexit uncertainty was also a factor in the slower headline rate.

GCC & regional macroeconomics

Kuwait: Credit saw a healthy gain in June, though growth slowed to 3.6% y/y on base effects (Chart 2). A net gain of KD 388 million in credit helped push 1H17 growth to an annualized 7.3% (year-to-date). The usual end-of-quarter rise in securities lending accounted for half the gain, but other business sectors were also up. By contrast, household credit was flat possibly due to seasonality related to the holy month of Ramadan. Private deposits saw a moderate decrease, with growth flat y/y.

The number of new civilian jobs among Kuwaitis was soft in 1Q17, dipping below 3,000 for the first time in three years, according to the latest figures from the Public Institute for Social Security. With private and oil sector jobs steady or improving, the weakness came from the public sector, which only added 1,300 jobs during the quarter, half the average during the previous four quarters. The sector saw employment growth slip to 2% y/y, it slowest pace in over seven years.

Consumer’s spending on POS came out strong during 2Q17 at 9% y/y (Chart 3). Growth has been moderating since early 2016, dipping slightly into negative territory in 3Q16. Since then, card spending has improved as the sector stabilized. Total spending, including ATM cash withdrawals, remained stable at 4.5% y/y.

CPI inflation was largely steady at 1.3% y/y in July, mainly on deflationary housing costs and weak food inflation. Excluding these, inflation was higher at 4.2% y/y, though this was that mainly due to the direct and indirect effects of fuel price hikes introduced in September 2016. (Chart 4.) If transportation costs are also excluded, inflation comes in somewhat milder at 2.3% y/y.

In a surprise move, the Al-Zour North Phase 2 power and water desalination project was cancelled. Kuwait Authority for Partnership Projects (KAPP) plans to merge the project with phase 3 and retender it at a later date. The project, which was set to be awarded in 3Q17, has faced...
Government spending was almost 30% of GDP in the MSCI EM, with the authorities paying 2.7% for Total inflows since crisis. Qatar Exchange showed a 29% increase in deposits since crisis, compared to a 27% increase in the UAE, Qatar: The finance ministry auctioned SR13 billion ($3.5 billion) worth of local currency sukuk and ended with a 295% bid-to-cover ratio. Demand was better than expected, with the authorities paying 2.7% for the 5-year issue, 3.2% for the 7-year, and 3.5% for the 10-year – an improvement on the rates paid for the most recent issuance in July.

In an effort to stimulate the private sector, which is one of the key aims of the Saudi Vision 2030, the government will begin privatizing the kingdom’s airports. Before being sold to private investors, though, each airport will first be transferred to a separate company owned by the Public Investment Fund (PIF), the country’s sovereign wealth fund.

As part of the kingdom’s plans to become the largest crude exporter to China, Saudi Aramco will be signing a deal with PetroChina, China’s second largest state-run refiner within the next six months. This will be to invest around $1.5 billion in the 260,000 b/d Anning refinery in Yunnan province. Aramco will be supplying a good proportion of the refinery’s crude intake. PetroChina, in return, is expected to take part in Aramco’s IPO next year.

UAE: In a bid to raise more public revenue, the UAE published a law on an excise tax last week. The tax will be levied on selected goods – tobacco, energy drinks and soft drinks – from the beginning of October. With the excise tax set at 100% on tobacco and energy drinks and 50% on fizzy drinks, it is expected to raise around $1.9 billion (0.5% of GDP) in annual fiscal revenue, according to the Emirates News Agency. The impact on annual inflation is expected to be limited.

Qatar: Latest data from the central bank reveal the continued impact of the regional dispute on Qatar’s banking sector. Although total deposits at commercial banks edged up QAR1bn in July (0.2% m/m and 12.8% y/y), there were large outflows of private sector (QAR9bn) and non-resident (QAR13bn) deposits. But these were more than offset by large inflows from the public sector (QAR24bn) – likely associated with a drawdown of overseas assets – as the authorities look to minimize the fallout on the local economy, including on banks’ liquidity and funding positions. This follows a similar pattern in June, when the crisis began (see chart 5 for cumulative figures). A fuller set of financial data for July could be released this week.

Oman: After declining for two successive years, nominal GDP grew 12.9% y/y in Q1 2017. The rise was driven by a recovery in petroleum sector output, which surged 30.9% y/y on the back of a 59% rise in the price of crude oil. The hydrocarbon sector accounts for around 30% of GDP in the sultanate. Growth in the non-hydrocarbon sector came in at a disappointing 5.3% y/y, below the 9-10% rates seen in recent years.

Meanwhile, public finances data for H1 show the deficit narrowing to OR2.4bn from OR3.5bn a year earlier. Government spending was almost flat at 0.5% y/y (and investment outlays were cut), but revenues rose 28.9% y/y on the back of rising oil prices. Despite the improvement, we still expect a large fiscal deficit for the year of some 13% of GDP, and – absent a jump in oil prices – several more years of fiscal consolidation will be needed.

Egypt: The US indicated it will reduce its military and economic aid to Egypt due to its poor human rights record. The move is not likely to have

**Chart 5: Qatar commercial bank deposits**
(Change between May and July, QAR bn)

**Chart 6: Benchmark crude oil prices**
(5/bbl)

**Chart 7: Total return indices**
(rebased, 25 August 2016=100)

**Chart 8: GCC markets**
(rebased, 25 August 2016=100)
much economic impact, but could affect relations with the US. The announcement, which coincided with a visit by US advisor Jared Kushner to Cairo in an effort to revive Israeli-Palestinian peace talks, surprised many especially given improved relations with the US under President Trump.

**Lebanon:** Moody’s downgraded Lebanon’s sovereign rating to B3. A rising debt burden was the key driver for the downgrade, though progress towards a fully-functioning government saw Moody’s place a stable outlook on the rating.

**Markets – oil**

International crude benchmarks Brent and WTI closed on Friday up at least 0.75% d/d to $52.41/bbl and $47.85/bbl, respectively, as Hurricane Harvey threatened to disrupt crude production and refining on the US Gulf Coast as well as imports to the region. (Chart 6.) 17% of total US crude output and 45% of total US crude refining is situated along the Gulf Coast. Earlier in the week, on Wednesday, prices were boosted slightly (+1.5% d/d) after the EIA confirmed that US crude stocks recorded an eighth consecutive weekly decline. Crude inventories fell by 3.3 mb to 463 million barrels last week—a level last recorded in January 2016—while gasoline stocks also fell, by 1.2 mb, to 229 million barrels. The decline in crude stocks, while less than the previous week’s fall of 8.9 million barrels, was, nevertheless, received positively by the markets as the US driving season comes to an end. The question now is whether stockpiles will continue to decline in the coming weeks, when US refineries go into their typical autumn maintenance period. And this with US crude production continuing to rise: last week, output climbed by 26,000 b/d to 9.5 mb/d, which is the highest since July 2015.

**Markets – equities**

Equity markets were trading sideways last week in anticipation of the central bankers’ meeting in Jackson Hole on Thursday. Nevertheless, most markets managed to close the week in positive territory with the MSCI all country world index up 0.7%. US equities made advances on renewed optimism around tax reform but continued political tension in the White House kept stock gains in check. The S&P 500 and DJIA advanced 0.7% and 0.6%, respectively. Meanwhile, European equities edged lower with the Euro Stoxx 50 down 0.2% despite positive data releases. Emerging market equities outperformed with the MSCI EM up 1.9%. (Chart 7.)

Regionally, most markets advanced on the week led by Saudi Arabia. The MSCI GCC closed up 0.8% as oil prices recovered slightly. The Saudi market is gaining momentum and outperforming the region as we head closer to the widely-anticipated decision by FTSE to potentially upgrade the market to Emerging Market status. Kuwait is also on the watchlist for a potential upgrade. That is not what is driving the market there just yet, but rather the auction sale of Zain’s treasury shares to Omantel which took place last Thursday. Slow activity is expected this week as we head toward the Eid holiday. (Chart 8.)

**Markets – fixed income**

Yields did not move much last week as investors sat on the sidelines ahead of the Jackson Hole meeting. Both US Treasury and German bund yields edged lower, with the US 10-year down 2 bps to 2.17%, while 10-year bunds dropped 3 bps to settle at 0.38%.

In US markets, news regarding the White House and Congress making
progress on tax reform saw yields being pushed higher earlier in the week. Their rise, however, was contained by continued political tension and President Trump’s comments about a possible government shutdown when a new debt ceiling will need to be enacted by the end of September. (Chart 9.)

GCC sovereign yields were down in line during the week. Bonds maturing in 2021 for Saudi Arabia, Oman, and Qatar declined by 12, 9 and 6 bps, respectively. Kuwait’s 2020 yields were 4 bps lower. Other rates were mostly unchanged during the week. (Chart 10.)

Saudi Arabia issued SR 13 billion ($3.5 billion) worth of local currency Sukuk which was nearly three times oversubscribed (see Saudi Arabia).
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