US tax reform signed into law; Saudi releases expansionary budget, sets more positive tone for 2018

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi SM	4,349	0.23	-4.34
Bahrain ASI	1,281	1.23	4.97
Dubai FM	3,365	0.29	-4.70
Egypt EGX 30	14,669	-0.08	18.82
S&P GCC 40	1,002	0.23	-13.23
Kuwait SE	6,414	1.30	11.58
KSA Tadawul	7,210	1.89	-0.01
Muscat SM 30	5,063	0.03	-12.44
Qatar Exchange	8,621	4.99	-17.39
International			
CSI 300	4,055	1.85	22.50
DAX	13,073	-0.23	13.86
DJIA	24,754	0.42	25.26
Euro Stoxx 50	3,553	-0.20	7.99
FTSE 100	7,593	1.36	6.30
Nikkei 225	22,903	1.55	19.82
S&P 500	2,683	0.28	19.85

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	65.3	3.19	14.84
KEC	61.51	1.92	18.52
WTI	58.5	2.04	8.84
Gold	1275.4	1.68	10.90

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.302	0.03	-1.21
KWD per EUR	0.355	0.00	11.53
USD per EUR	1.186	0.89	12.78
JPY per USD	113.260	0.61	-3.09
GBP per USD	1.336	0.31	8.30
EGP per USD	17.840	0.00	-0.89

Interbank rates	%	Change (bps) weekly	YTD
Bhibor - 3 month	2.65	-7.5	55.0
Kibor - 3 month	1.88	12.5	43.8
Qibor - 3 month	2.62	3.3	84.2
Eibor - 3 month	1.70	-1.9	22.8
Saibor - 3 month	1.90	0.1	-13.6
Libor - 3 month	1.67	7.4	67.7

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	2.95	14.0	42.1
Dubai 2022	3.06	4.2	-23.7
Qatar 2022	3.11	4.0	18.1
Kuwait 2022	2.84	11.0	n/a
Saudi Arabia 2023	3.24	4.0	n/a
International			
UST 10 Year	2.49	13.3	5.6
Bunds 10 Year	0.42	11.4	21.1
Gilts 10 Year	1.24	9.1	0.3
JGB 10 Year	0.05	0.6	0.3

Source: Thomson Reuters Datastream; as of Friday's close 22/12/2017

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Overview

US stocks hit another record high early last week, buoyed by the possible impact on corporate earnings of President Trump's $1.5 trillion tax reforms, which were finally signed into law on Friday and will take effect starting in 2018. In Europe, Spanish stocks fell 1.2% on Friday after the regional election resulted in a win for Catalan pro-independence parties. But the euro largely held ground, and broader market movements were subdued as traders wound down ahead of the year-end holidays.

Brent crude oil prices edged up to $65.3/bbl by end week, continuing to find support from the Forties pipeline outage a week earlier. While the OPEC/non-OPEC production cut agreement has been extended to end-2018, attention is already being paid to the group's strategy towards the end of the deal, with the Russian oil minister citing the need for a "smooth exit" to avoid a supply surge. But there are upside risks for 2018, too: given strong demand growth, Goldman Sachs, for example, sees the oil market rebalancing as soon as mid-year, paving the way for an earlier-than-scheduled end to current supply cuts.

In the Gulf region, the key event was the release of the Saudi government's budget, which revealed a much larger-than-expected rise in government spending for 2018, as well as a more gentle approach to medium-term fiscal consolidation that pushes the balanced budget target back to 2023, from 2020 before. The move is likely to result in an upward revision to our Saudi non-oil GDP growth forecast for next year from its current 1.3%, and sets a more positive tone for the broader regional economy that has undergone three successive years of austerity.

International macroeconomics

USA: President Trump signed the much-anticipated landmark GOP tax cuts into law last week, with new lower rates on corporate and household taxes to take effect in 2018. Congress also averted a government shutdown when lawmakers passed another stopgap spending bill that allows the government to continue operating through mid-January 2018. The hard work required for a more permanent solution for spending in fiscal 2018 and the debt ceiling has once again been postponed.

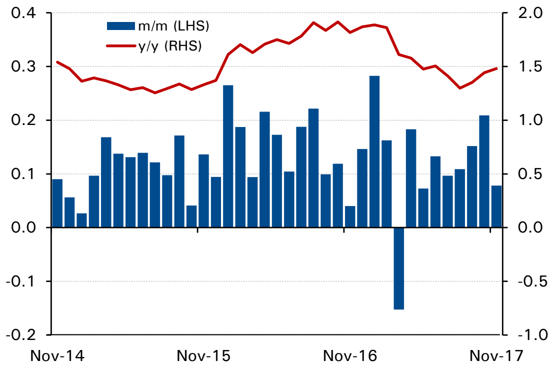
The economic data remained broadly positive last week. The Philadelphia Fed index rose to a solid 26.2 for December, reflecting strong confidence in business conditions. Growth in personal income and consumer spending remained robust in November. Durable goods orders slipped during November, but continued to indicate strong growth from a year ago. Orders excluding transportation equipment grew by 7% y/y. Housing starts and new home sales also recorded solid figures in November.

November's PCE price index continued to confirm subdued inflation. Though the index was up 1.5% y/y, prices rose a modest 0.1% m/m (0.9% annualized inflation). The figure was no surprise, as soft inflation was already reflected in November's CPI and wage data. (Chart 1.)

Eurozone: Catalonia's regional election, triggered by an independence referendum declared illegal, resulted in a victory for pro-independence

Chart 1: US PCE price index

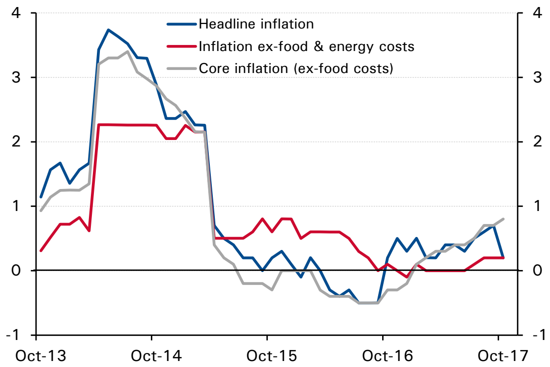
(%)



Source: U.S. Bureau of Economic Analysis

Chart 2: Japan consumer price inflation

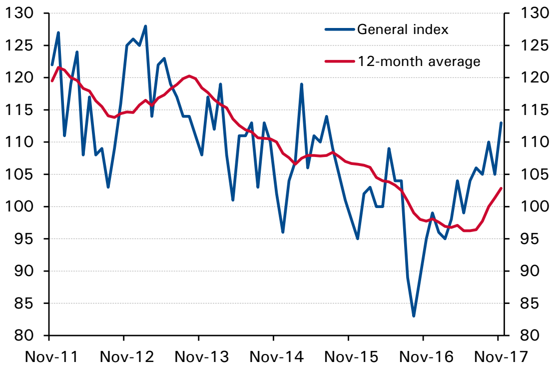
(% y/y)



Source: Thomson Reuters Datastream

Chart 3: Kuwait consumer confidence

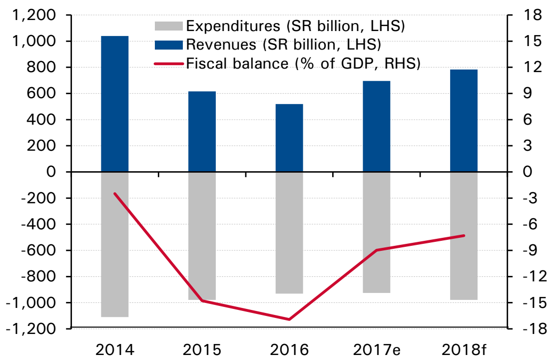
(index)



Source: ARA Research & Consultancy

Chart 4: Saudi budget forecast 2018

(KD billion)



Source: Saudi Ministry of Finance (MOF), SAMA

parties, who won 70 of the 135 seats. This was a set-back for PM Rajoy, who hoped the election would put a lid on Catalonia's bid for secession. Meanwhile, Italy passed its 2018 budget, which will allow for the dissolution of parliament and help usher in next year's election, expected much sooner than the May 2018 deadline.

Eurozone sentiment continued to gain momentum with December's consumer confidence exceeding expectations at 0.5 and registering its fifth consecutive monthly increase.

Japan: The Bank of Japan left monetary policy unchanged last week. With inflation still hovering far behind the 2% target, it maintained its massive quantitative easing program, held its short-term interest rate at −0.1%, and the 10-year government bond yield target at 0%. Headline inflation had eased from 0.7% y/y in September to a mere 0.2% y/y in October, reflecting persistent weakness in consumption. (Chart 2.) Core inflation (excluding food costs) ticked up slightly to 0.8% y/y, mainly on the back of higher imported oil prices, compounded by a weak yen.

China: Housing price rises decelerated for the twelfth month in a row in November, with the average cost of new housing in 70 major cities rising 5.1% y/y, while sales volumes fell to levels last witnessed in late 2015.

GCC & regional macroeconomics

Kuwait: The current account surplus improved in 3Q17, rising to KD 0.4 billion (4.6% of GDP). The current account has widened thanks to higher oil exports (+12% y/y) and investment income (+16% y/y), and contracting worker remittances (-8% y/y). These have been partly offset by robust growth in imports of goods (+14% y/y) and services (+34% y/y). The current account is likely to record a surplus in 2017 of 4.8% of GDP, following a 4.5% of GDP deficit in 2016.

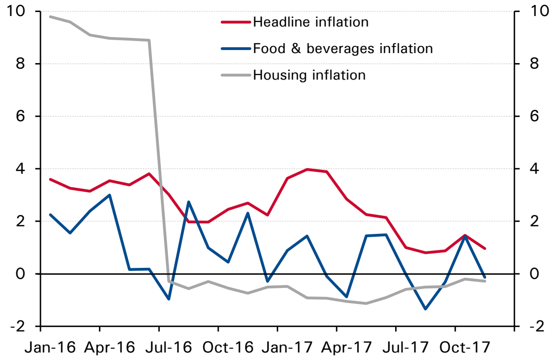
Consumer confidence continued to improve, with the Ara index rising to a 28-month high of 113 in November. (Chart 3.) Recently, the index has been boosted particularly by an improvement in the current employment subcomponent, which rose to 198 in November, the second highest figure since the survey's inception in 2008.

The fiscal deficit in the first eight months of FY17/18 through November came in better than expected. According to preliminary Ministry of Finance data, the deficit for the period was KD 2.4 billion (after the transfer to the Future Generations Fund), or an annualized 10% of GDP. This is below our full-year expectations for a deficit of 12.5% of GDP.

The central bank increased its coupon rate on 3-month bills issued last week by 25 bps to 2%, as it sought to nudge bank deposit rates higher. The CBK had refrained from lifting its discount rate after the Fed rate hike on 13 December, in an effort not to push up lending rates and put pressure on a recovering non-oil economy. At the same time, the CBK indicated it could take measures to push deposit rates higher.

Saudi Arabia: The government unveiled in the 2018 budget, its largest ever package of spending measures to boost the Saudi economy, especially the private sector. Spending is set to rise by 5.6% next year to SR 978 billion ($260 billion) while revenues are projected to increase by 12.5% to SR 783 billion ($208 billion). (Chart 4.) Based on these estimates, the authorities expect to record a fourth consecutive fiscal deficit in 2018, albeit a narrowing one, at 7.3% of GDP (SR 195 billion). This is a slight improvement on 2017's deficit of 8.9% of GDP.

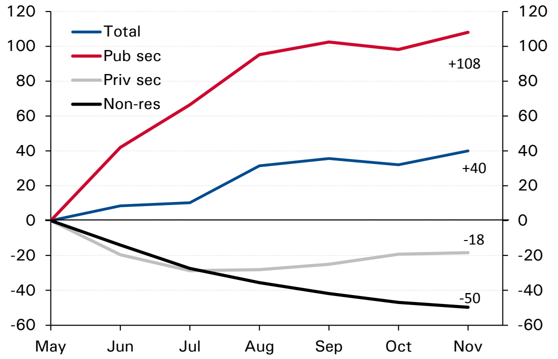
Chart 5: Dubai consumer price inflation



Source: Dubai Statistics Center

Chart 6: Deposits at Qatari banks

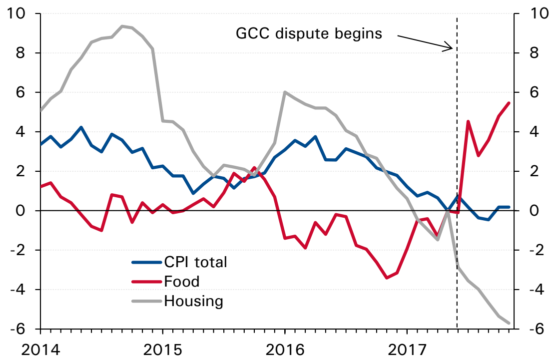
(Cumulative change since May, QAR billion)



Source: QCB

Chart 7: Qatar inflation

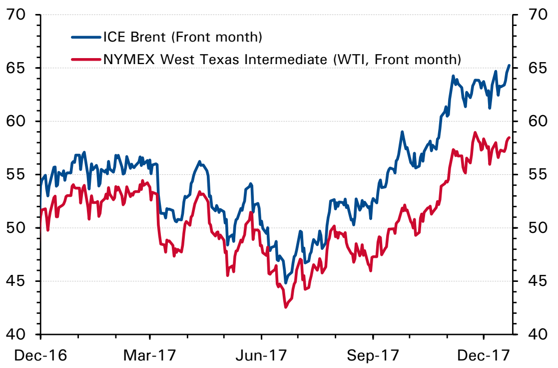
(% y/y)



Source: MDPS

Chart 8: Benchmark crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

Moreover, the expansionary budget will also be supplemented by an additional SR 133 billion ($35 billion) from the Public Investment Fund (PIF) and the National Development Fund (NDF). Revenue projections appear to be based on an oil price of $59/bbl (Brent), with minimal scope for crude production gains given Saudi Arabia's commitment to an extension of the OPEC production cut agreement to end-2018.

UAE: Inflation in Dubai's consumer price index eased to 1.0% y/y in November (chart 5), underpinned by continued weakness in the food & beverages and housing segments. Inflation in food & beverage prices slipped back into negative territory in November, amid continued softness in international food prices and a strong dirham. This follows a brief acceleration in the previous month, when prices jumped by 1.4% y/y following the introduction of an excise tax on some soft drinks. Inflation in housing costs remained subdued as residential property prices continue to face downward pressures, mainly against a backdrop of higher housing supply. We expect inflation to trend upwards in 2018, on the back of new taxes, including the 5% VAT, which is due to be levied from 1Q18.

Qatar: After declining in October, government deposits in the banking system rose again in November, in a sign that although pressures might be easing, they have not disappeared altogether. Government deposits rose QAR 10 billion m/m (3%) in November, and are now up QAR 108 billion (54%) since the start of the diplomatic crisis. (Chart 6.) This more than offset further non-resident outflows, though at QAR 3 billion (2%) m/m, the pace of decline continues to ease. Overall deposit growth edged back to 16% y/y in November, but due to the government injections, remains above the pre-crisis pace of 12%.

Credit growth remains strong, at 15% y/y, but much of this reflects borrowing by the central government; private sector credit growth is weaker, at 8%.

Meanwhile, inflation remained very weak in November at 0.2% y/y – unchanged from October but slightly up from negative rates in earlier months. (Chart 7.) The most striking feature was a further fall in housing costs (mostly rents), down 0.4% m/m to -5.7% y/y. This was the fifth successive monthly fall in housing costs leaving them down 5% since May, and coincides with other official data suggesting that the housing market has come under additional pressure since the diplomatic crisis began. Food price inflation also picked up, but "core" pressures remain very soft, likely reflecting weaker conditions in the real economy of late.

Egypt: The IMF approved the payment of the third tranche of its loan following a positive assessment of progress on economic reforms in November. With the $2 billion payment, the IMF will have disbursed half of its $12 billion loan to Egypt.

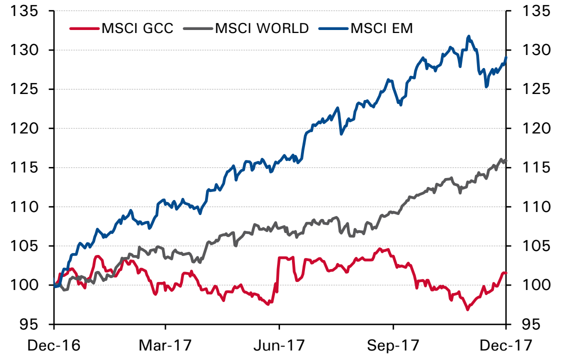
Markets – oil

Oil prices closed on Friday at their highest levels since 2015 after Saudi Arabia and Russia pledged to exercise a gradual withdrawal from the OPEC production cut agreement when it expires at the end of 2018. The prospect of a managed rather than a disorderly exit from the deal, which many fear could lead to oil flooding the market, helped push Brent and WTI up by as much as 3% week-on-week to $65.3/bbl and $58.5/bbl, respectively. (Chart 8.) Brent is on track to finish the year 15% higher.

Prices also took some comfort from another week – the fifth consecutive – of declining US commercial crude stocks. Last week's inventory fall of 6.5

Chart 9: Total equity return indices

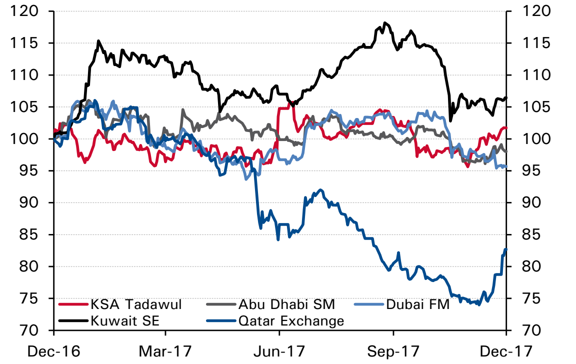
(rebased, 22 December 2016=100)



Source: Thomson Reuters Datastream

Chart 10: GCC equity markets

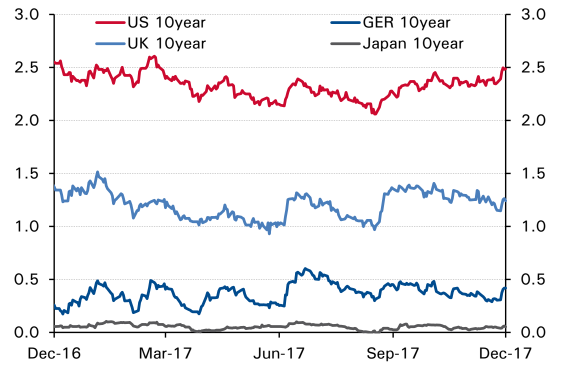
(rebased, 22 December 2016=100)



Source: Thomson Reuters Datastream

Chart 11: Global benchmark yields

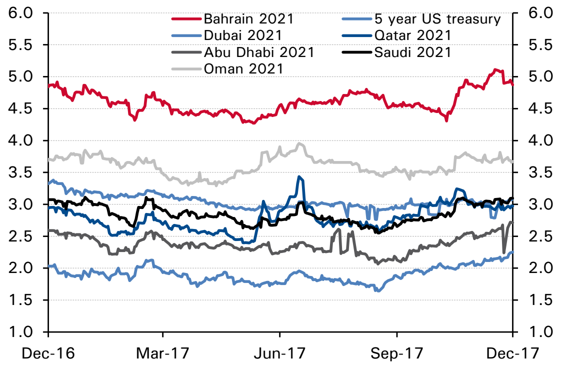
(%)



Source: Thomson Reuters Datastream

Chart 12: GCC yields

(%)



Source: Thomson Reuters Datastream

million barrels to 436.4 million barrels was greater than anticipated. US crude production, meanwhile, continued its seemingly relentless climb, notching up another shale-era high of 9.78 mb/d by mid-month, but, as with the oil rig count (747 on 22 Dec.), the weekly gain was much less (+9,000 b/d).

Markets – equities

International markets continued to advance, with the MSCI World All Country index closing up 0.7%. The passage of the US tax bill helped push US equities to new highs, as investors prepared themselves for the windfall that will follow the new corporate tax rate. The S&P 500 and DJIA ended the week up 0.3% and 0.4%, respectively. European markets retreated on uncertainty following the victory of secessionist parties in Catalonia's regional election. Emerging markets were up 1.5% for the week. (Chart 9.)

GCC markets were all up last week, with the MSCI GCC index closing up 1.7%. The Saudi market rose on the announcement of an expansionary budget, while Qatar was supported by data that showed a slowdown in non-resident deposit outflows. This saw Qatar outperform the rest of the GCC, increasing by 5% on the week. (Chart 10.)

Markets – fixed income

US tax reform, solid US and eurozone economic momentum, and year-end dynamics saw a global sell-off in fixed income benchmarks. 10-year US Treasury yields were up 13 bps on the week, 10-year Bunds 11 bps, and 10-year Gilts 9 bps. (Chart 11.)

Nonetheless, this saw little reversal in the recent yield curve flattening trend. Solid economic momentum and monetary tightening is pressuring the short-end, while stubborn inflation continues to contain the long-end. Indeed, the 2-10 year US Treasury spread bounced back by a modest 8 bps this week, and remains near historic lows at 60 bps.

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