Trade frictions continue to dominate the agenda; EM currencies see further turbulence

Overview

The focus on the international trade climate continued last week with discussions to revamp the tripartite NAFTA agreement stalling on a breakdown in US-Canada talks on Friday, despite the US and Mexico striking a bilateral reform deal early in the week. President Trump indicated that if Canada doesn’t “make a fair deal for the U.S… Canada will be out”. A key sticking point is access for US dairy products in Canada but there is optimism that a pact will eventually be struck, with officials still claiming progress is being made ahead of the end-September deadline.

Having hit record highs earlier in the week, US equities ended softer on concerns over US trade with its neighbors and with China, and despite generally strong economic data including an upward revision to Q2 GDP growth to 4.2%. Meanwhile emerging market currencies including in Turkey, Indonesia, India and Argentina saw further turbulence, with Argentina pushing up interest rates to 60% highlighting investor concern over EM stability as global liquidity conditions tighten.

Brent crude oil prices saw another strong week, finishing up 2% w/w at $77/bbl and registering a 4% gain in August overall. The latest price climb was helped by a fall in US crude inventories and continued anxiety over the ability to replace further lost Venezuelan and Iranian output – the latter due to US sanctions which will take full effect from November.

In the MENA region, there was some positive news for Egypt with Moody’s revising its rating outlook to positive from stable citing “substantial progress” on reforms backed up by IMF support, while latest data show both tourism and remittances rising strongly. Meanwhile GCC equities rose on the week but finished August down 2.5% m/m, following August losses due to US sanctions which will take full effect from November.

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International macroeconomics

USA: News on the US economy remains broadly bullish, with a combination of strong growth, solid consumer confidence and gradually rising inflationary pressures. GDP growth in Q2 was revised up a touch to an annualized 4.2% from an already very strong 4.1% and versus 2.2% in Q1. The revision was driven by...
by higher business investment and inventories, which more than offset slightly softer (though still very sturdy) growth in consumer spending than previously recorded, at 3.8%.

The consensus view is for economic growth to decelerate to around 3% in 3Q18. July’s strong growth in consumer spending, at 0.4% m/m, suggests decent support for growth at the start of the quarter, while consumer confidence measures for August remained robust. Indeed the Conference Board sentiment measure hit its highest since the dotcom fever of 2000. (Chart 1.) One softer spot on the consumer side remains the housing market, with growth in the Case-Shiller house price index softening to 6.3% y/y in June.

Chart 1: US consumer confidence
(Conference Board measure, index)

Meanwhile, the core personal consumption expenditure deflator – the Federal Reserve’s preferred measure of inflation – rose as expected to 2.0% y/y in July up from 1.9% in June, and back in line with the central bank’s target for the first time since March. The headline measure rose to 2.3% from 2.2%. Steadily rising price pressures are one reason why the Fed is expected to lift interest rates by a further 25bps at the end of September.

Eurozone: The flash inflation measure in the Eurozone edged down to 2.0% y/y in August from 2.1% in July – its first drop since February and closer to the European Central Bank’s target of “just below” 2%. (Chart 2.) Core inflation – stripping out food and energy costs – also dipped to 1.0% from 1.1% in July. Easing price pressures support the ECB’s view that the recent spike in inflation will prove temporary, and that it should maintain a cautious approach to the withdrawal of monetary stimulus – due to be wound up by end-year – and future rate hikes. Meanwhile, Eurozone unemployment was stable at 8.2% in July, which although still high, is the lowest since November 2008. However this did not stop economic sentiment across the single currency area from softening in August, reflecting lower consumer confidence on unemployment fears particularly in weaker European economies.

Chart 2: Eurozone inflation
(Harmonized measure, % y/y)

GCC & regional macroeconomics

Kuwait: Headline inflation rose to 0.8% in July from 0.5% in June on the back of higher food prices. (Chart 3.) Food prices rose 0.8% m/m in July and to 1.2% y/y from 0.1% y/y in June. With food accounting for 17% of the CPI basket, July’s price rise contributed more than two-thirds of the increase in inflation overall. We expect inflation to trend flat-to-higher for the remainder of the year as the pace of declines in housing rents eases while food prices show a modest uptrend. Our forecast is for inflation to average 1.0% in 2018 overall, with risks of a slightly lower outcome.

Chart 3: Consumer Price Inflation
(% y/y)

Real estate sales in July were the highest in four years, at KD 500 million, more than double the previous month and triple the value from a year earlier. The record sales were driven by a rise in activity in all three real estate sectors, but most notably the investment (i.e. apartment) sector, which saw a sharp rise in building sales during the period, followed by the residential sector where sales were more than double June levels.
Saudi Arabia: Official foreign reserve assets declined by $5.1 billion (-1.0% m/m) in July to $501 billion as the authorities drew down some of their overseas deposits and investments in foreign securities. Reserves were still up 1.4% y/y, however. (Chart 4.)

![Chart 4: Saudi official foreign reserve assets](image)

**Egypt:** Egypt’s tourism revenues rose by 77% in the first half of 2018 to $4.8 billion compared with the same period last year, due to an increase in the number of tourists by 41% to about 5 million. This highlights the gradual recovery of the tourism sector thanks mainly to the currency float in late 2016 that has made the country a relatively cheap destination for foreign visitors. In addition, remittances from Egyptian expats increased by 21% during FY2017/2018 to a new record of about $26.5 billion. Meanwhile, Moody’s changed the outlook on the Government of Egypt’s long-term issuer ratings to positive from stable and affirmed its B3 rating. The decision reflects structural improvements in the fiscal and current account balances, backed by implementation of the IMF reform program.

**Turkey:** Following a one-week long holiday, the Turkish lira came under renewed pressure last week, even after the central bank stepped in to help restore investor confidence. The central bank changed overnight borrowing limits, ending the unrestricted funding it s

... for a substantial increase in the interest rate. But this measure alone may not deliver stability unless it is accompanied by a comprehensive and credible economic reform program and an improvement in Turkey’s international relations.

**Markets – oil**

Concerns over the US-China trade war and President Trump’s threat to walk out of the WTO pushed Brent and WTI lower d/d on Friday to $77.4/bbl and $69.8/bbl, respectively. (Chart 5.) Nevertheless, both prices were still up more than 1.5% w/w and closed the month higher (Brent: +4.3% m/m; WTI: +1.5% m/m) for the first time since June. Oil’s gain so far in 2018 stands at almost 16%, with recent momentum coming on signs that the physical market is tightening again. These include further crude stock drawdowns in the US (-2.5 mb in w/w 24 August) and importers cutting their imports of Iranian crude as US sanctions are re-imposed.

![Chart 5: Crude oil prices](image)

**Markets – equities**

Trade talks remained the dominant theme among global markets last week. International markets were marginally higher, with the MSCI AC world index rising by 0.5%, supported by a successful trade deal between the US and Mexico. (Chart 6.) Indeed, the S&P 500 and Nasdaq closed at record highs last Monday following the deal. However, continued US trade tensions with China and now with Canada continued to weigh on investor sentiment. The US and Canada failed to strike a new trade deal by Friday’s initial deadline. Nonetheless, the two sides are set to resume talks later this week. The Trump administration is also reportedly adamant about imposing tariffs on an additional $200 billion worth of Chinese goods as early as this week.

Escalating trade tensions did not bode too well for European markets either, especially after President Trump reportedly condemned the European Union’s planned and current trade

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**Source:** SAMA

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**Source:** Thomson Reuters Datastream
policies. The Euro Stoxx 50 index was down 1.0%. The MSCI EM index also remained under pressure as growing global trade concerns were compounded by currency contagion effects from Argentina, Turkey and other emerging markets. Indonesia’s rupiah fell to a 20-year low against the US dollar, prompting the central bank to intervene. The Indian rupee also fell to a record low last week. Regionally, the MSCI GCC index was up 1.7% w/w, mainly supported by higher oil prices. (Chart 7.)

Market universe

Investors continued to monitor the US-China trade war. Although both economies are expected to face growth slowdowns in the coming quarters, US 10-year Treasury yields rose by 3 basis points on Wednesday following the announcement of a preliminary trade deal with Mexico and better-than-expected consumer confidence data. This was despite renewed US-China trade tensions and US tariffs on $200 billion worth of Chinese goods that took effect on Thursday. The 10-year Bund yield, however, fell by 1 basis point amid renewed trade fears. (Chart 8.) GCC yields were mixed, with the higher oil price environment somewhat overshadowed by fresh global trade concerns. (Chart 9.)

Markets – fixed income

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