Consumer sector fuels robust US economy; Saudi equity market upgrade could trigger capital inflows

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,585	0.17	4.25
Bahrain (ASI)	1,318	-1.16	-1.00
Dubai (DFMGI)	3,109	-1.30	-7.76
Egypt (EGX 30)	17,450	2.26	16.19
GCC (S&P GCC 40)	967	0.17	-1.76
Kuwait (Price Index)	6,633	-0.43	3.52
KSA (TASI)	7,871	0.38	8.92
Oman (MSM 30)	4,774	-0.57	-6.39
Qatar (QE Index)	8,574	-2.85	0.59
International			
CSI 300	3,898	-0.16	-3.28
DAX	12,097	1.77	-6.35
DJIA	24,103	2.42	-2.49
Euro Stoxx 50	3,362	1.92	-4.07
FTSE 100	7,057	1.95	-8.21
Nikkei 225	21,454	4.06	-5.76
S&P 500	2,641	2.03	-1.22

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.35	-2.9	40.9
Dubai 2022	3.44	0.4	29.8
Qatar 2022	3.58	-4.9	50.9
Kuwait 2022	3.30	0.1	49.9
Saudi Arabia 2023	3.69	-10.9	47.9
International			
UST 10 Year	2.74	-8.2	33.3
Bunds 10 Year	0.49	-3.6	7.0
Gilts 10 Year	1.35	-9.5	16.3
JGB 10 Year	0.05	2.3	-0.4

3m interbank rates	%	Change (bps) weekly	YTD
Bhibor	3.05	0.0	32.5
Kibor	2.00	6.3	12.5
Qibor	2.63	-0.3	-11.7
Eibor	2.33	7.1	53.4
Saibor	2.27	5.3	37.3
Libor	2.31	2.6	61.7

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.299	0.00	-0.64
KWD per EUR	0.371	0.62	4.54
USD per EUR	1.232	-0.24	2.71
JPY per USD	106.3	1.47	-5.69
GBP per USD	1.402	-0.83	3.72
EGP per USD	17.58	-0.06	-0.85

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	70.3	-0.26	5.08
KEC	64.4	-0.54	1.42
WTI	64.9	-1.43	7.48
Gold	1322.8	-1.96	1.26

Source: Thomson Reuters Datastream; as of Friday's close 30/3/2018

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Overview

Last week saw confirmation of robust US economic performance with GDP growth in 4Q17 upgraded to 2.9% alongside a host of upbeat indicators of consumer activity. There was also evidence of some pass-through to price pressures, with the key PCE inflation measure rising to a 10-month high of 1.6% y/y – still short of the Fed's 2% goal but lending some support to a more hawkish interest rate outlook. Key global equity markets-- although volatile on tech-firm regulation issues and lingering concerns over protectionism-- rallied around 2% after the previous week's steep sell-off, while the US dollar firmed.

The price of Brent crude oil finished the week flat at $70/bbl, but still up 7% for March as a whole and 5% in 1Q18. Sentiment was undermined by a surprise rise in US inventories, record high weekly US crude production and a slightly stronger US dollar. This was despite comments from the Saudi Crown Prince that Saudi Arabia and Russia have made a 'big picture' agreement on long-term oil market cooperation that could see collaboration extended for decades beyond the current supply agreement due to expire at end-year.

In the Gulf, there was positive news on Saudi reforms with FTSE Russell announcing that it would upgrade the stock market to Emerging Market status in March 2019, having postponed the move last year pending regulatory improvements. MSCI is considering a similar decision in June, and the two upgrades combined could eventually attract $30 billion in capital inflows, boosting government aims to increase inward investment. Kuwait was recently awarded Emerging Market status by FTSE, with the reclassification set to take place in two stages in September and December. The Saudi Tadawul edged up 0.4% w/w amid some profit-taking after the market's strong run, while Kuwait's KSE-15 rose 1.3%.

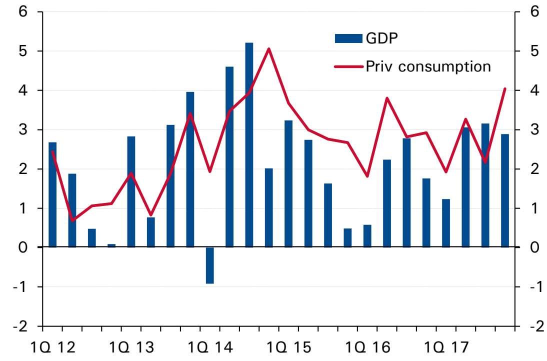
International macroeconomics

USA: Another encouraging week for economic data saw annualized GDP growth for 4Q17 revised up to 2.9% from the earlier estimate of 2.5% and beating the consensus. Performance was supported by robust consumer spending growth of 4%. For 2017 as a whole, GDP rose 2.3%. (Chart 1.)

Other higher frequency consumer-oriented indicators also remained upbeat, though perhaps pointed to some slowdown in 1Q18 versus the previous quarter. Consumer confidence eased back slightly to 127.7 in March, but remained close to February's 17-year high of 130 and signaled very strong employment conditions. The Case-Shiller index showed continued (some say concerning) buoyancy in the housing market, with prices beating expectations and up a very solid 6.4% y/y in January. Finally, personal income growth rose a decent 0.4% m/m in February, though spending was softer at 0.2% m/m. Strong consumer activity pushed the closely-watched core personal consumer expenditure inflation measure to a 10-month high of 1.6% y/y in February from 1.5% in January and closer to the Federal Reserve's 2% target.

Chart 1: US real GDP

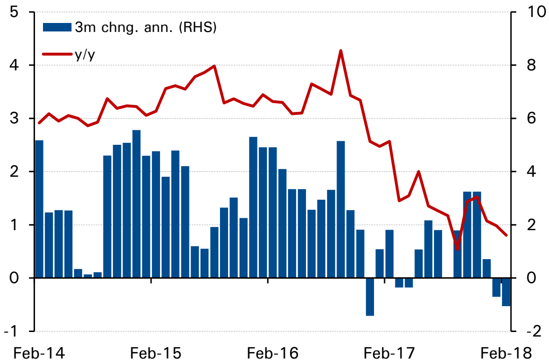
(% q/q, annualized)



Source: Thomson Reuters Datastream

Chart 2: Kuwait inflation

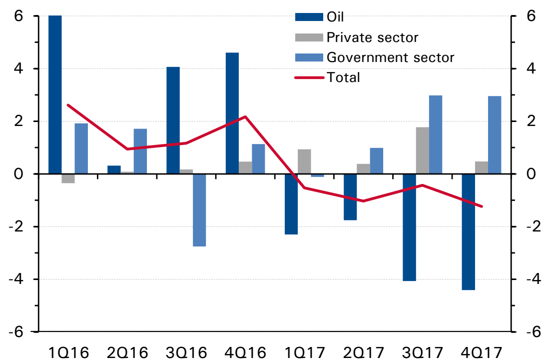
(%)



Source: Central Statistical Bureau

Chart 3: Saudi real GDP

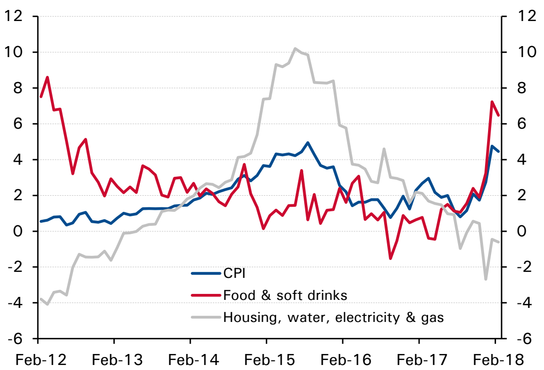
(% y/y)



Source: GASTAT

Chart 4: UAE inflation

(% y/y)



Source: FCSA

Eurozone: Economic sentiment in the Eurozone retreated for a third consecutive month on softer optimism towards the industrial sector. However, at 112.6, it remains elevated relative to prior years, pointing to continued, if tempered, confidence in the region. Meanwhile, inflation in some core Eurozone countries edged higher, which could see a neutral to positive flash Eurozone inflation reading this week.

GCC & regional macroeconomics

Kuwait: Inflation eased further in February to 0.8% y/y, from 1.0% in January and an average of 1.5% in 2017. (Chart 2.) The weakness is largely due to deflationary pressures from housing rent and food prices. Healthcare costs also continued to fall, while inflation eased in the transportation, communication, and education segments.

Real estate activity was up in February, though prices appeared to soften. Sales during the month stood at KD 189 million, up by 22% y/y. The strength came from the residential (26% y/y) and investment (46% y/y) sectors, while commercial sales remained weak. Prices in all sectors were softer in February, though residential land and home prices were broadly within their 12-month ranges. The exception was the index of investment prices, which slipped to its lowest level in more than four years.

The fiscal deficit narrowed in February to KD 2.5 billion for FY17/18 to-date (or an annualized 7.3% of GDP), helped by an improved oil price. Thus far in FY17/18, oil prices averaged 20% higher than assumed in the budget, reducing the deficit from a projected 17% of GDP to an estimated 10% of GDP by fiscal year-end, though this could be revised upward on account of higher spending.

Saudi Arabia: Preliminary estimates of real GDP growth for 4Q17 showed that the economy registered its fourth consecutive y/y deceleration. Growth weakened to -1.2% y/y largely as a result of contraction in the oil sector (-4.4% y/y) related to Saudi Arabia's obligations under the OPEC production cut agreement. (Chart 3.) Non-oil growth, though positive at 1.3% y/y in 4Q17, moderated slightly on the 2.1% y/y registered in Q3. This was mainly due to a slowdown in private sector activity (from 1.8% y/y in 3Q17 to 0.5% y/y in 4Q17), with growth in the government sector relatively good at 3% y/y in both quarters.

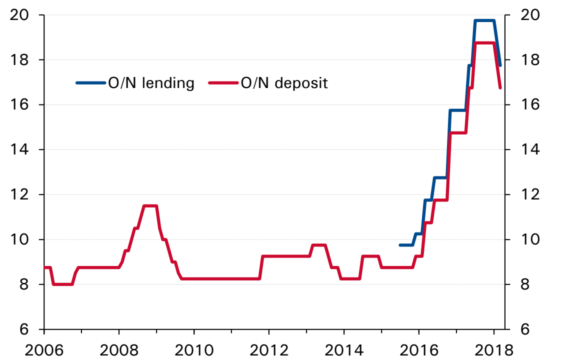
UAE: Inflation came down slightly in February, easing to 4.5% y/y from 4.8% in January with a slight moderation across most components. (Chart 4.) Food inflation slowed to 6.5% while housing costs continued to decline. Also, anecdotal evidence points to some companies lowering prices in an attempt to maintain market share and prop up consumption.

Qatar: Real GDP growth for 4Q17 moderated slightly to 1.8% y/y from 1.9% y/y in Q3. Output on a quarter-on-quarter basis actually fell by 2.3%, weighed down by a contraction in the hydrocarbon sector. The non-hydrocarbon economy fared better, however, rising 1.6% q/q and 3.7% y/y thanks to increased output in the wholesale & retail trade, financial services and real estate sectors especially.

Oman: The central bank, in a move to stimulate domestic corporate lending and the interbank market, loosened regulations for the calculation of the loan-to-deposit (LDR) ratio. From 1 April, banks will be able to include their money market positions, i.e. borrowings from other banks minus lending to other banks, in the calculation of their deposit bases. The LDR, however, will remain at 87.5%.

Chart 5: Egypt policy interest rates

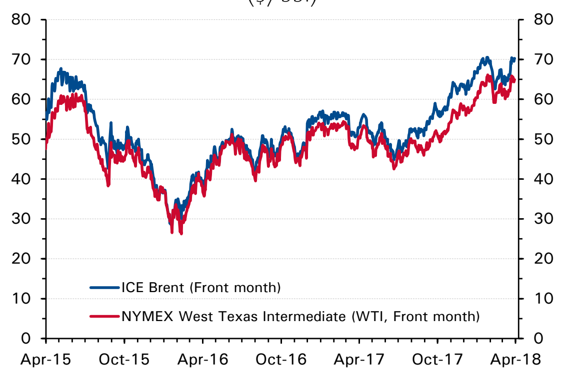
(%)



Source: Thomson Reuters Datastream

Chart 6: Oil prices

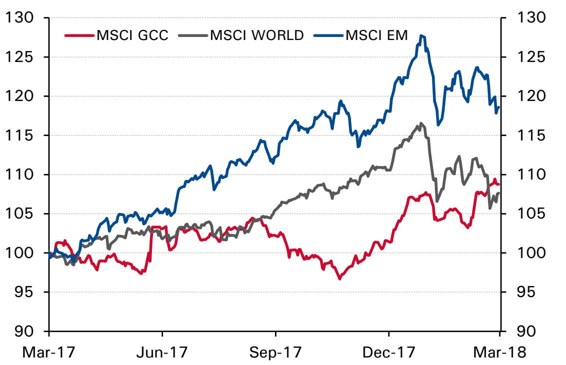
($/bbl)



Source: Thomson Reuters Datastream

Chart 7: Total equity return indices

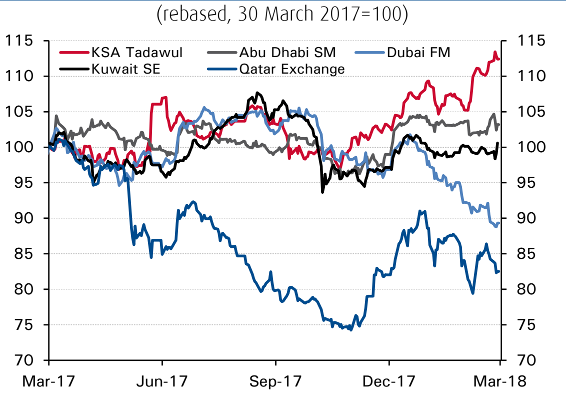
(rebased, 30 March 2017=100)



Source: Thomson Reuters Datastream

Chart 8: GCC equity markets

(rebased, 30 March 2017=100)



Source: Thomson Reuters Datastream

Egypt: As widely expected, preliminary results show President Abdel Fatah Al-Sisi being re-elected for a second term following last week's elections, winning an overwhelming 92% of the vote but turnout was low at 42% (48% in 2014). The election result is unlikely to lead to major shifts in economic policy, with the government continuing to pursue its reform agenda supported by the IMF program.

In a further sign of improving economic conditions, the central bank lowered key policy interest rates by 100 bps last week, leaving its overnight deposit and lending rates at 16.75% and 17.75%, respectively. (Chart 5.) The move follows a similar cut in February and further reductions are probable this year as inflation continues to fall with the pound more stable following the currency float in 2016.

Markets – oil

Oil prices held on to their $70 perch for much of last week, closing at $70.23/bbl (Brent) and $64.9/bbl (WTI). (Chart 6.) Suggestions that OPEC may be willing to extend the production cuts beyond the end of this year as part of a much longer supply management agreement with Russia – Saudi crown prince Mohammed bin Salman talked of a 10-20 year period – helped oil prices hold on to recent gains. And this is despite another week of record US crude production (+26 kb/d to 10.43 mb/d) and a rise in US crude inventories (+1.6 mb to 429.9 mb). Both Brent and WTI have now erased their losses of February and are up 5.1% and 7.5% year-to-date.

Markets – equities

Global equities ended the week higher as investors sought to take advantage of cheaper valuations and softer global trade rhetoric. The MSCI AC index was up 1.6% w/w, though declined by 2.3% q/q. (Chart 7.)

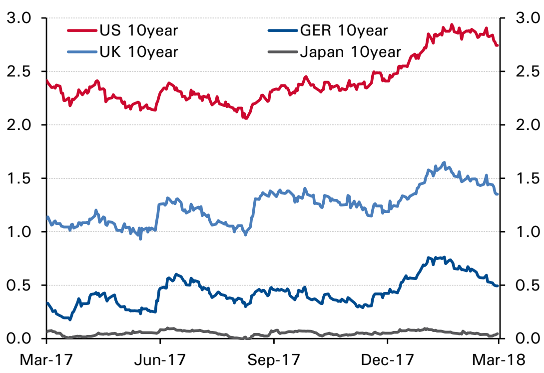
US equities trended higher as investors bought the dip in tech stocks triggered by the onset of tighter user data regulations. This saw the DJI and the S&P 500 increase by 2.4% w/w and 2% w/w, respectively. Sentiment also benefitted from an easing in trade war fears. However, concerns over monetary tightening and global protectionism saw the DJI (-2.5% q/q) and S&P 500 (-1.2% q/q) log their first quarterly declines since 2015.

In Europe, stocks tracked their US counterparts higher, taking in stride a weaker reading of economic sentiment, with the Euro Stoxx 50 up 2% w/w, although down 4.1% q/q. Emerging markets, however, were still spooked by the hostile trade rhetoric, with the MSCI EM index down 0.3% w/w, but outperforming over the quarter with a 0.4% rise. (Chart 7.)

GCC equities were mixed, with the MSCI GCC index up 0.1%. Saudi and Kuwait diverged from their regional peers, benefitting from news on index reclassification (see below). Saudi's upgrade to FTSE Russell's secondary emerging market index and the release of an indicative list of the Kuwaiti stocks soon-to-be included in the same index. Meanwhile, sentiment across the rest of the region was subdued. (Chart 8.) Over the quarter, Saudi rose 8.9% q/q, followed by Abu Dhabi (4.3% q/q), and Kuwait (3.6% q/q). Dubai, however, was the worst performer, down 7.8% ytd.

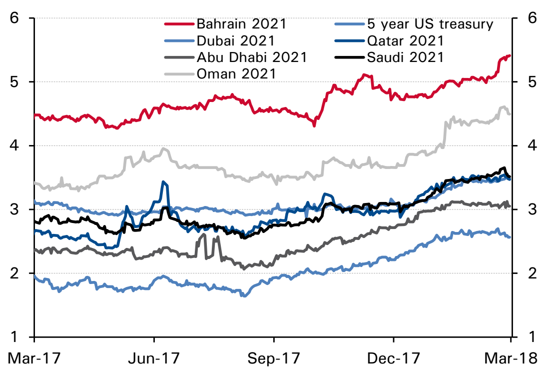
FTSE Russell announced the inclusion of Saudi into its secondary emerging market index. It is expected to account for 2.7% the index – 4.6%, if Saudi ARAMCO's IPO is successful – possibly attracting close to $5 billion dollars in initial passive inflows. An upgrade to MSCI's emerging market index, likely to be announced in June 2018, may add another $10 billion in passive flows. All in all, Saudi could see potential foreign inflows totaling

Chart 9: Global bond yields



Source: Thomson Reuters Datastream

Chart 10: GCC bond yields



Source: Thomson Reuters Datastream

$30 billion, including active inflows, over the next few years.

FTSE Russell also announced the phase-in of Kuwaiti listed stocks will take place in two steps. First in September 2018, then in December 2018, at which time they will have reached their full weight within the FTSE Russell's emerging market index, expected at 0.4%. Analysts are expecting inflows of around $800 million dollars.

Boursa Kuwait implemented its new exchange structure (phase 2 of its development plan) on April, 1 2018, with a one-year phase-in period for some listings, in a bid to boost the market's liquidity and attractiveness, particularly to foreign investors.

Markets – fixed income

Mixed economic data and volatility in equities saw yields on benchmark bonds tighten. US 10-year treasury yields fell 8 basis points w/w, to 2.83%, and bunds shaved 4bps, to reach 0.49%. (Chart 9.) Meanwhile, GCC benchmark yields were mostly lower, with Saudi 2023 and Qatar 2022 down 11 bps and 5 bps, respectively. (Chart 10.)

Bahrain sold a 7-year $1 billion Sukuk at 6.875%. The pricing reflects a steep increase from its previous offering in September 2017, when it issued a Sukuk of similar tenor for 5.25%. The hike in pricing could reflect investors' concerns over the fiscal position and rising debt levels, as well as higher short-term rates. A 12-year and a 30-year conventional bond, which were offered simultaneously with the Sukuk, were not pursued amid disagreement over pricing. The Kingdom is rated as B+ by S&P, B1 by Moody's, and BB- by Fitch, placing it firmly as non-investment grade.

Saudi Arabia closed an increased US$16bn syndicated loan that refinances a US$10bn facility signed in 2016. Pricing on the deal is 30% lower than on the original loan, which paid 120bp over Libor, bringing pricing on the new deal to 84bp over Libor.

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