> Economic Research
+965 2259 5500
econ@nbk.com

Vaccine rollout and Biden stimulus plan offer hope amid growth concerns

Highlights

- **Financial markets largely shrugged off US political turmoil that ended with President Trump's impeachment, focusing more on the prospect of another large fiscal stimulus and the start of Covid-19 vaccine rollout in several countries.**
- **President-elect Biden outlined a $1.9 trillion fiscal package aimed at supporting an economy showing signs of flagging. The Fed meanwhile has pushed back on speculation that it could start to dial back monetary stimulus later this year.**
- **The EU and UK reached a last-minute Brexit deal securing zero tariffs and quotas on most goods, though says little about services. The Eurozone economy is suffering a renewed downturn amid concern over a sluggish vaccine rollout.**

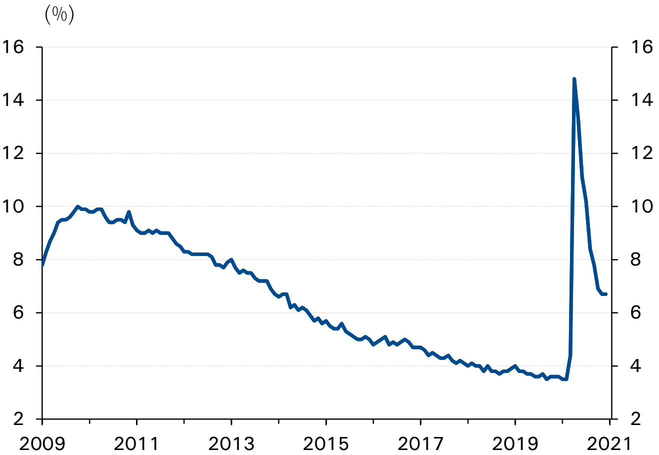
Financial markets largely shrugged off the political turmoil in the US that ended with President Trump impeached for a second time by the House of Representatives, focusing more on the prospect of large fiscal stimulus early in incoming president Joe Biden's term. Sentiment has also been helped by the rollout of vaccines against Covid-19 (albeit largely so far only across the developed world and varied by country), which should start to alleviate economic pressures over coming months. Global equities continued to make gains, with the US S&P up another 4% in the month-and-a-half to mid-January, while benchmark US bond yields climbed. Brent crude also benefitted from a large Saudi supply cut and expectations that improved growth will translate into stronger oil demand, reaching an 11-month high of $56/bbl and reversing all pandemic-era losses.

Biden to target early fiscal stimulus

Ahead of Joe Biden's scheduled inauguration as US President on January 20 and with the Democrats' victory in the Georgia Senate race giving them a clean sweep of control across both houses of Congress, attention is turning to the speed and scale of fiscal stimulus needed to support an economy battered by a still-raging coronavirus. President Trump signed off a $0.9 trillion (4% of GDP) stimulus bill in late December, including $600 checks for individuals, an extension of unemployment benefits until March and $325 billion in small business aid. But this should be followed up with a $1.9 trillion package once Biden is inaugurated, including additional individual checks of $1,400, a further extension of jobless benefits, aid for state and local governments and a rise in the minimum wage to $15/hour.

While the Democrats' still only knife-edge control of the Senate may rein in their more ambitious spending programs, December's weak jobs market report injected fresh urgency to act promptly, with non-farm payrolls falling for the first time since April and unemployment stuck at 6.7%, well down from the crisis peak of 14.8% but still above the pre-pandemic 3.5%. (Chart 1.) The concern is that job market deterioration will hit spending, causing an economic relapse, particularly if stimulus is delayed or inadequate. Still, there are grounds for cautious optimism. Most of December's job losses were in the virus-vulnerable leisure & hospitality sector. With the mass vaccine rollout beginning in mid-December, a declining virus caseload (helped also by the return to warmer weather) could pave the way for rehiring across the sector over coming months, defusing the downside risks to demand. The roaring performance of US equities (+4% in the 1.5 months to mid-January) and climb in US treasury yields (10-year up 26 bps to 1.10%) suggests that markets are indeed positioning for a better economic climate.

Chart 1: US unemployment rate

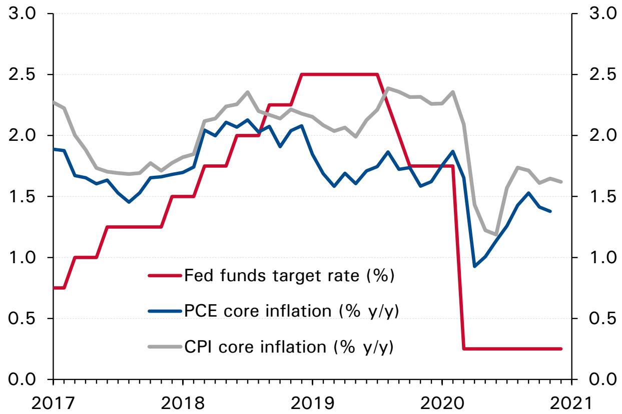


Source: Refinitiv

The Federal Reserve for now looks prepared to hold steady, having cut interest rates to near-zero last year and committed to ongoing bond purchases of around $120 billion per month. Fed officials have increasingly called for further fiscal stimulus and if delivered over coming months are likely to see less need for additional monetary loosening. Indeed, some analysts see the Fed starting dialing back its stimulus as early as late this year, as vaccine rollout, ultra-loose policy and a bounce back in spending as virus effects unwind fuel a strong recovery and potential pick-up in inflation, which on a core CPI basis was steady at 1.6% y/y in December. (Chart 2.) Fed officials have recently pushed back on such suggestions however, with chair Jay Powell stating that there will be no increase in the interest rate any time soon and until there are clear signs of inflation perking up. Their new willingness to tolerate above-2% inflation for a while would anyway give them some additional room for maneuver. Powell added "... the public will need to see us allow inflation to move moderately above 2% for a time before the new framework will be seen as fully credible".

Chart 2: US inflation and policy interest rates*

(%)



Source: Refinitiv * Shows upper bound of Fed Funds target rate

EU and UK reach last-minute Brexit deal

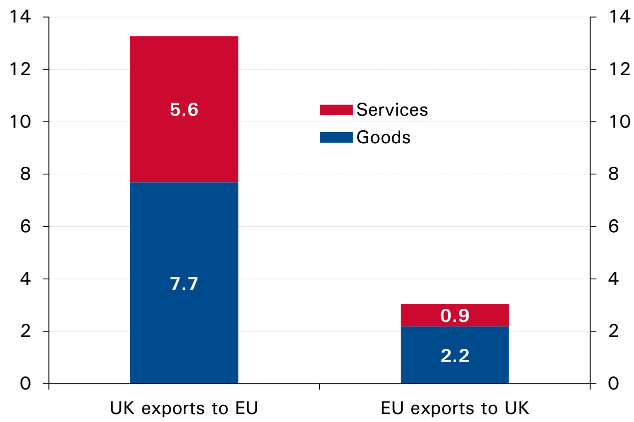
The Eurozone economy is suffering from a renewed downturn due to implementation of stricter lockdown measures to address surging virus cases and hospitalizations even as vaccines begin to be rolled out. The composite PMI remained below 50 at 49.1 in December (albeit above November's 45.3), with contractions in France (49.5), Spain (48.7) and Italy (43.0) though expansion in Germany (52.0) – the latter benefitting from manufacturing's relative strength versus services. GDP is estimated to have fallen 2-3% q/q in 4Q20 and could stagnate or even fall again in 1Q21, with medium-term recovery hopes also pinned on vaccine distribution that has got off to a sluggish start. Meanwhile, the ECB meets on January 21 and having expanded and extended its asset purchase plan (to €1.35 trillion until March 2022) in December is expected to leave policy on hold. This is despite core inflation remaining at its record low of 0.2% y/y in December, well below the near-2% target.

After years of wrangling, a trade deal between the EU and the UK was agreed just days before the post-Brexit transition period ended on December 31st, avoiding a potentially chaotic return to WTO trading terms. The deal provides for zero tariff, zero quota exchanges on most goods, though says little about services including the important financial services sector. As part of the deal, both sides will be free to pursue regulatory divergence (seen as a key economic benefit for the UK), but will also be able to resort to rebalancing measures (such as tariffs) in future if divergence is seen as unfairly distorting trade by an independent arbiter.

The deal helps limit disruption for the UK economy – for whom goods and services exports to the EU amount to 13% of GDP versus 3% of EU GDP for trade in the opposite direction. (Chart 3.) However, some short-term impact is expected including through the need for customs checks at the border, while the exclusion of financial services has already seen much equity trading in EU-based firms diverted from London due to the EU not recognizing the 'equivalence' of UK regulatory standards. Further side deals on services trade may be agreed this year. Aside from pursuing new international trade deals (which could ultimately include membership of the Trans-Pacific Partnership), radical changes in UK economic policy seem unlikely in the near term, especially while the government focuses on the Covid pandemic. On this – despite a record number of virus cases in early January and the imposition of harsher lockdown measures that could tip the economy back into recession in 1Q21 – the outlook is more constructive. An early and aggressive vaccine drive is targeting inoculating the elderly and vulnerable by mid-February which could allow a significant easing of restrictions by the Spring and a strong economic recovery from the summer, following an estimated 11% drop in GDP last year.

Chart 3: EU-UK trade in goods and services, 2019

(% of exporting region's GDP)



Source: UK ONS / Eurostat / NBK

Japan's 2021 budget tops $1 trillion

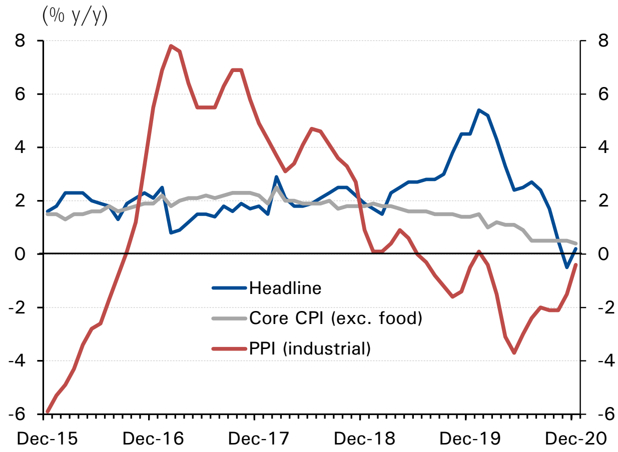
Japan issued its first budget of more than $1 trillion (¥107 trillion) for 2021, as Prime Minister Yoshihide Suga battles a spike in coronavirus cases and struggles to kick-start the economy. Overall spending increased by 3.8% from last year's initial budget, including ¥66.9 trillion in general spending, ¥23.8 trillion in debt servicing and ¥16 trillion in transfers to regional and local governments. The IMF expects public debt to have reached 266% of GDP last year, with the budget deficit widening to 14.2% of GDP due to pandemic-related spending. The initial budget is a base estimate, however, with actual spending likely to rise further with probable additional stimulus to support the pandemic-stricken economy. Last year Japan announced three additional pandemic-related budgets worth ¥73 trillion ($702bn) in total. Meanwhile, after a sharp rebound in 3Q20, Japan's decision to declare a state of emergency in Tokyo (and surrounding areas), covering 60% of the country's economy, is likely to trigger a contraction in GDP in 1Q21, according to analysts. This will add to the burden of policymakers trying to ease the economic fallout from the pandemic.

Chinese manufacturing cools, but recovery intact

Chinese manufacturing activity cooled in December, with both the official NBS survey of large state firms (51.9) and the smaller firms-focused Caixin/Markit PMI (53.0) indices registering a slowdown from November on weaker export orders. However China's post-pandemic economic recovery remains broadly intact, with the latest IMF article IV forecasting growth of 7.9% this year, despite ongoing concerns about debt levels, potential trade frictions and disruptions of financial flows with Hong Kong which could affect long-term growth. Based upon more recent trends in economic activity and a surge in exports in December, it would not be surprising if growth this year could exceed the earlier projections.

Monetary policy will continue to focus on supporting the recovery and avoiding a sharp exit, even though the authorities have been signaling that a gradual withdrawal of stimulus is on the cards. Inflation remains low but edged up to 0.2% y/y in December after November's decline, due to higher food and energy prices. (Chart 4.) Producer prices are also stabilizing amid rising commodity prices, having spent almost all of 2020 in deflation territory. Finally however, strong demand for the Yuan is causing some discomfort for the authorities, with the currency surging to a two and a half year-high of RMB6.46/$1 recently, partly reflecting dollar weakness but also yield-chasing investors looking to take advantage of Chinese interest rate premiums and the country's strong post-pandemic economic recovery.

Chart 4: Chinese inflation



Source: Refinitiv

India's economy on track for 4Q20 improvement

Following the much softer pace of contraction witnessed in 3Q20 (7.5% y/y compared to 24% in 2Q20), economic activity is expected to have improved further in 4Q20 as business activity indicators have been consistently higher compared to Q3. The services PMI, despite easing in December from November's level, remained in expansion territory at 52.3, while the manufacturing PMI was little changed at 56.4, suggesting that the recovery is still ongoing, though maybe moderating. Stronger business activity over the quarter is consistent with recovering demand and looser Covid restrictions as the number of new virus cases has declined significantly in recent months (16,000 on January 12 versus more than 90,000 in early September).

A sustained economic recovery in India will depend on a pickup in the global economy, which in turn will depend on reduced new virus cases and the effective rollout of vaccines. This will drive foreign demand and exports, leading to better business confidence and encouraging firms to hire more workers, thus alleviating some of the weakness in the labor market and promoting a pickup in private income and consumption. The consensus forecast is for GDP growth to contract 9.3% in FY20/21 (running April to March), and expand by 9.2% in FY21/22, but this could be revised up in light of the improved economic activity seen during 4Q20.

Oil rallies on Saudi's production cut decision

Oil prices have surged in recent weeks, propelled by vaccine optimism and, more recently, by tighter supply-side dynamics thanks to Saudi Arabia's unilateral production cut. By mid-January, Brent crude was up $5 in 2021 so far to an 11-month high of $56/bbl, a rise many are also increasingly seeing in the context of an emerging broader commodities uplift driven by Chinese and emerging market demand. (Chart 5.) Brent closed 2020 at $51.8/bbl, reducing its losses for the year to 22%, having been down as much as 71% ytd in mid-April. US President-elect Joe Biden's stimulus package and recent US crude inventory drawdowns as well as dollar weakness have been supportive of the oil rally.

The Saudi decision to pare back its own production by 1 mb/d in February and March – framed by Saudi energy minister Prince Abdulaziz as a preemptive move to head off fresh oil demand weakness – appears well-judged, though viewed in some quarters as a concession to head off potential output increases from OPEC+ members. Russia will be allowed to increase its production by 65 kb/d and Kazakhstan by 10 kb/d in each of the next two months. In aggregate, OPEC+ output will therefore fall by 925 kb/d in February before the cuts ease to 850 kb/d in March. For Kuwait and the UAE, production will remain at 2.33 mb/d and 2.63 mb/d, respectively, having increased by 1.4% in January under OPEC+'s December decision to increase aggregate output by 500 kb/d from January. The demand outlook for 1Q21 appears murkier, with Europe's demand for transportation fuel in particular expected to undershoot expectations given the lockdowns in place there and the slow pace of vaccine rollout. A northern hemisphere cold snap could provide a fillip to heating fuel demand, though. The International Energy Agency may revise its oil demand outlook for 2021 in its forthcoming report; currently, the agency pegs growth at 5.7 mb/d, a significant improvement from 2020's estimated decline of 8.8 mb/d.

Chart 5: Brent crude oil price

($ per barrel, end of month*)

Source: Refinitiv * Latest figure is for January 15

Head Office

Kuwait
National Bank of Kuwait SAKP
Shuhada Street,
Sharq Area, NBK Tower
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait France SA
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
34h Floor, NBK Tower
Shuhada'a street, Sharq Area
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353