Equities fall as investors digest prospect of higher interest rates; Brent crude dips to $80

**Overview**

Global stock markets suffered heavy falls last week, with the US S&P 500 for example down 4% w/w for its biggest weekly fall since March. The declines were a reaction to the sell-off in global bond markets at the end of the previous week, with investors digesting the implications of tighter Fed policy against a backdrop of robust US economic data. Ironically, this drew funds back into ‘safe haven’ US treasuries, with 10-year yields easing slightly to below 3.2%. A soft US inflation figure of 2.3% for September, however, led some to question the until-now high-conviction call for another Fed rate hike this December and President Trump added to the pressure on the central bank with a rebuke of its “far too stringent” policy tightening.

Market weakness spilled over into oil, with the price of Brent crude falling 4% w/w to end just above $80/bbl and for its first weekly loss in five weeks. The dip was also fuelled by reports from both OPEC and the IEA, which saw demand growth forecasts for this year and next revised down due to slower growth in the world economy but also higher oil prices. Meanwhile on the supply side, OPEC production rose in September, with a further decline in Iranian output more than offset by higher production in other members especially Saudi Arabia, whose output rose to 10.5 million b/d. OPEC claims that this will help to offset the impact of lower Iranian output, but has become more positive on demand growth forecasts for next year.

In its latest WEO report, the IMF revised its global economic growth forecasts for next year down mainly on trade tensions, but has become more positive on the Gulf region helped by higher oil prices. Growth in Saudi Arabia, for example, is seen rising to 2.4% next year from 2.2% in 2018 (both up 0.5% from April forecasts) on higher oil production and non-oil activity, while growth in Kuwait is seen at 4.1% next year. It also remained positive on Egypt, with growth projected to pick up 5.5% in 2019 from 5.3% in 2018 on recovering tourism, rising natural gas output and progress on economic reforms backed by IMF support.

**International macroeconomics**

**USA:** Consumer price inflation as measured by the CPI rose at a slower-than-expected 2.3% y/y rate in September, down from 2.7% in August mostly on a base effect after a strong rise a
year earlier. (Chart 1.) The core rate, which excludes energy and food costs, was unchanged at 2.2%. Although the CPI is not the Federal Reserve’s favored measure of inflation, the soft number was seen by some as reopening the debate over a December rate hike, previously seen as solid. But the Fed could counter that lower inflation means that price-adjusted wages are rising more strongly, adding fuel to an already strong consumer sector. Consumer sentiment as measured by the University of Michigan’s survey, for example, remained robust in October, albeit slightly down from September.

#### Chart 1: US CPI inflation (% y/y)

The core rate, which excludes energy and food costs, was unchanged at 2.2%

#### Chart 2: Kuwait credit and deposits (% y/y)

UAE: In a bid to expand its debt market, the UAE issued a much-awaited law that will allow the federal government to issue sovereign debt. Prior to the law, bond issuances were only being carried out on an emirate level, including Abu Dhabi and Dubai. Banks in the UAE will also now be able to buy central government bonds in dirhams or in foreign currencies, allowing them to manage liquidity and meet the global Basel III regulatory requirements.

Dubai’s economic growth moderated in 3Q18, according to the Dubai Economy Tracker (DET). The DET headline rate averaged 54.8 in 3Q18, lower than the 55.8 recorded in the previous quarter. This was largely a reflection of slower growth in output and new orders.

#### Chart 3: Dubai Economy Tracker (index)

Meanwhile, activity in Dubai’s real estate market continues to slow down, as reflected in the latest transactions data. During the first nine months of 2018 there were 39,802 transactions, (-24% y/y) worth Dh162 billion (-21% y/y).
Bahrain: The parliament approved a draft 5% value-added tax law during an ‘extraordinary’ session last week, paving the way for the tax to be levied for the first time in 2019. The approval of the draft tax law came on the heels of a $10 billion GCC financial aid package provided by Saudi Arabia, the UAE and Kuwait, which will be disbursed in stages as an interest-free loan, conditional upon Bahrain following through with economic reforms. The kingdom released a 33-page ‘Fiscal Balance Program’ report soon after, in which it lays out its reform plans which include balancing the state budget by 2022. Bahrain is scheduled to receive its first installment, reportedly worth up to $2 billion, before the end of this year.

Qatar: Economic growth improved to 2.5% y/y in 2Q18, from 2.0% y/y in the first quarter, led by a sizeable increase in non-hydrocarbon sector activity (+6.1% y/y). (Chart 4.) In contrast, oil and gas output was down 1.1% compared to a year ago, although the sector did grow 3.9% on q/q basis. The manufacturing, construction, finance, real estate and government sectors all posted annual gains, but trade activities fell for the sixth consecutive quarter in year-on-year terms.

Chart 4: Qatar real GDP (% y/y)

Egypt: Egypt’s annual inflation rate accelerated for the third month to an eight-month high, reaching 16% in September from 14.2% in August, while core inflation slowed slightly to 8.6% from 8.8% a month earlier. In this light, it is unlikely that the central bank will reduce its main policy interest rate soon, as had been expected. On a monthly basis, consumer prices rose 2.5% after two months of deceleration, largely driven by a 4.8% jump in the price of food and beverages as well as the increase in oil prices. Meanwhile, the Central Bank of Egypt agreed to enter into a “new repurchase transaction” with a consortium of international banks for a total amount of $3.8 billion. In this context, Egypt started a roadshow in South Korea on Sunday as part of an effort to sell around $5 billion in bonds, possibly in the first quarter of 2019. The aim of the roadshow is to secure financing at a lower rate than the rates required by foreign investors and domestic banks, and thus reduce the public debt burden.

Turkey: The government has launched a program in partnership with the private sector to combat inflation, which climbed to almost 25% last month. As part of the program, the private sector has agreed to cut prices on its products by at least 10% until the end of the year. It will also freeze energy prices (currently one of the biggest contributors to inflation) and expedite value-added tax rebates.

Markets – oil

Oil prices fell last week on anxieties about the prospects of global economic growth and amid the broader sell-off in global equities. Brent and WTI closed the week down more than 4% at $80.4/bbl and $71.3/bbl, respectively. (Chart 5.) This was the biggest weekly loss since May, and came just over a week after Brent reached a near four-year high of $86/bbl on concerns that oil producers lacked the spare capacity to fully offset Iranian supplies lost due to US sanctions.

Chart 5: Crude oil prices ($/bbl)

While those concerns have not dissipated, last week the narrative shifted towards one of weakening global oil demand, especially after the International Energy Agency downgraded oil demand growth estimates for this year and next by 110,000 b/d to 1.3 mb/d and 1.4 mb/d, respectively. Dismissing supply crunch fears, the agency noted that the oil market was “adequately supplied for now”, but reacted to weakening global economic growth, and US-China trade concerns.

Also weighing on oil prices last week was the EIA’s report that both US production (+100 kb/d to 11.2 mb/d) and crude stocks had increased (+5.9 mb to 410 mb) in the w/e 5 October. The EIA expects US crude production to top 11.8 mb/d in 2019, an increase of 1.1 mb/d this year.
In another report, the IEA projected petrochemicals demand to expand substantially over the next decade and overtake transport to become the biggest driver of global oil consumption. By 2030 petrochemical products such as plastics, fertilizers and detergents will account for more than 30% of global oil consumption, up from the current 14% (13 mb/d). State-run oil and gas firms in the GCC such as Saudi Aramco, Qatar Petroleum and Kuwait Integrated Petroleum Industries Company (KIPIC) are among those investing heavily in petrochemicals and downstream integration. Aramco is spending more than $100 billion on refining and petrochemical projects and is looking at purchasing the PIF’s $70 billion stake in Saudi Arabia’s largest petrochemicals firm, SABIC. KIPIC is due to award in April 2019 $10 billion worth of contracts to construct and integrate petrochemicals production (Olefins-3 project) with the country’s new Al-Zour refinery.

**Markets – equities**

Expectations of higher future interest rates and concerns over the global outlook sparked a third consecutive week of selling, with the MSCI AC index shedding 4.1% w/w. The previous week’s bond market sell-off, buoyed by US data and upbeat Fed comments, further solidified investors’ concerns over tighter monetary policy, and helped trigger on Wednesday the worst single day sell-off of US equities in eight months. While they did partially recover subsequently, the S&P 500 and the DJI were still down 4.1% and 4.2% w/w, respectively. The downturn unsettled other global markets, with the Euro Stoxx 50 and the MSCI EM down 4.5% and 2.4% w/w. (Chart 6.)

**Markets – fixed income**

International benchmark yields dipped from their multi-year highs last week after investors sought safety amid a global stock market sell-off and after US inflation came in slightly short of expectations. The yield on the 10-year US treasuries shed 9 bps to settle at 3.14%. (Chart 8.) A similar trend was seen across other major benchmarks with 10-year bunds and gilts falling by 6-9 bps. Meanwhile, regionally, 4-5 year sovereign yields moved the other way, rising 5-14 bps as worries about a global trade war and a weaker oil demand outlook were compounded by fresh political concerns.

Regionally, markets were mixed but down overall, with the MSCI GCC index falling 4.1% w/w led by Saudi Arabia (-5.8%), on weakness in global equity markets and oil prices. Meanwhile, Kuwait was down 0.9% w/w but held up well, with few upward catalysts at the moment. (Chart 7.)