Oil prices edge up ahead of key producer meeting; Saudi budget deficit on track to halve in 2017

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi SM	4,287	-0.94	-5.70
Bahrain ASI	1,277	0.53	4.60
Dubai FM	3,461	0.02	-1.98
Egypt EGX 30	14,106	1.87	14.27
S&P GCC 40	963	-2.74	-16.62
Kuwait SE	6,239	-1.11	8.55
KSA Tadawul	6,878	-0.51	-4.61
Muscat SM 30	5,086	-0.38	-12.04
Qatar Exchange	7,742	-1.06	-25.82
International			
CSI 300	4,104	-0.40	23.99
DAX	13,060	0.51	13.75
DJIA	23,558	0.86	19.20
Eurostoxx 50	3,581	0.95	8.83
FTSE 100	7,410	0.39	3.74
Nikkei 225	22,551	0.69	17.98
S&P 500	2,602	0.91	16.24

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	63.9	1.82	12.39
KEC	60.4	3.29	16.30
WTI	59.0	4.24	9.74
Gold	1286.7	-0.70	11.89

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.302	-0.03	-1.24
KWD per EUR	0.355	1.14	11.53
USD per EUR	1.193	1.16	13.48
JPY per USD	111.530	-0.48	-4.57
GBP per USD	1.334	0.94	8.10
EGP per USD	17.640	0.28	-2.00

Interbank rates	%	Change (bps) weekly	YTD
Bhibor - 3 month	2.55	-1.5	45.0
Kibor - 3 month	1.81	6.3	37.5
Qibor - 3 month	2.42	-1.3	64.3
Eibor - 3 month	1.64	3.0	16.8
Saibor - 3 month	1.82	0.4	-21.8
Libor - 3 month	1.46	2.6	46.4

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	2.75	-5.1	22.3
Dubai 2022	3.00	-3.4	-29.8
Qatar 2022	3.08	-9.1	15.3
Kuwait 2022	2.70	-4.5	n/a
Saudi Arabia 2023	3.13	0.1	n/a
International			
UST 10 Year	2.34	-1.4	-9.2
Bunds 10 Year	0.37	0.6	16.3
Gilts 10 Year	1.25	-4.5	1.1
JGB 10 Year	0.03	-0.6	-1.9

Source: Thomson Reuters Datastream; as of Friday's close 24/11/2017

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Overview

In a holiday-shortened week in the US and Japan, Chinese equities saw their largest daily fall since mid-2016 last Thursday – some 2.9% – triggered by concern over high debt levels and the Chinese authorities' ability to deleverage the economy without causing a financial shock. The Chinese economy accounts for 15% of global GDP. But there was more strong economic data from the Eurozone, with the PMI report showing jobs growth at a 17-year high and potentially pointing to annualized GDP growth of a robust 3%-plus in 4Q.

Crude oil prices recovered from the previous week's losses, with Brent finishing the week up $1 at $64/bbl. Russia announced that it would support an extension to the oil production cut deal with OPEC to beyond March when the producers meet later this week, helping to ease concerns over a disorderly supply surge when the agreement expires. The main US benchmark, WTI, saw still-larger gains and hit a 29-month high of nearly $59, after an oil spill closed a key US-Canada pipeline.

In the Gulf, 3Q fiscal data in Saudi Arabia provided an insight into the government's attempt to balance fiscal consolidation and economic growth. The deficit stood at $13bn (2% of full-year GDP), slightly up from 2Q on weaker revenues and lower spending. Total spending over 1Q-3Q so far is almost flat year-on-year, signaling relative spending restraint, while non-oil revenues were up 6%. The government is broadly on track to hit our deficit forecast of 8% of GDP for 2017 as a whole.

International macroeconomics

US: The minutes of the Fed's last FOMC meeting held no surprises, with members again focused on the softer inflation data and concerns that the 2% inflation target would take longer to achieve. Markets continued to expect a rate hike in December with near-certainty.

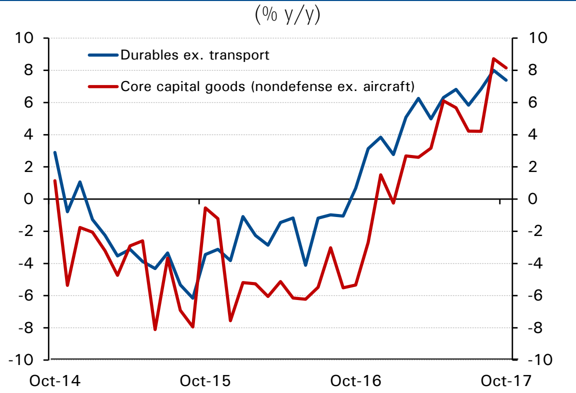
The economic data remained firm. While headline durable goods orders were off m/m in October, the less volatile orders excluding transportation equipment grew 0.4% during the month and 7.4% y/y. (Chart 1.) Core capital goods orders (excluding aircraft) slipped 0.5% m/m, but remained at a robust 8.1% y/y. Existing home sales were also upbeat in October. Consumer sentiment maintained a strong level at 98.5 in November.

Eurozone: Political uncertainty reemerged in the Eurozone. Coalition talks between Angela Merkel's Christian Democrats and 2 other parties failed. Policy differences over immigration and climate protection were behind the breakdown. Chancellor Merkel may pursue one of three options: a grand coalition with the Social Democratic Party (likely); new elections (unlikely and complicated); or a minority government (unusual and unlikely). Markets reacted mildly. The EUR stayed firm at 1.17-1.18 following the news, while 10-year Bunds moved within a tight range.

November's flash PMI came in at 57.5 versus 56 in October, reflecting ongoing momentum in the Eurozone, with multi-year highs in its sub-indices for output, employment and inflation. Meanwhile, Eurozone consumer confidence beat expectations, increasing by 1.1 points to reach

Chart 1: US durable goods orders

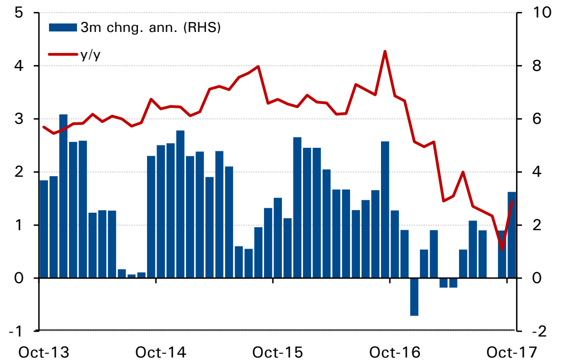
(% y/y)



Source: U.S. Census Bureau

Chart 2: Kuwait inflation

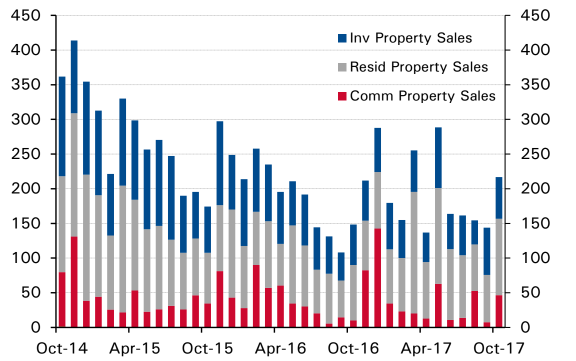
(% y/y)



Source: Central Statistical Bureau

Chart 3: Kuwait real estate

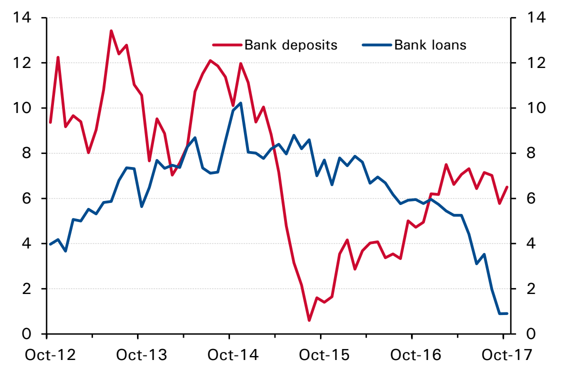
(KD mn)



Source: Ministry of Justice

Chart 4: UAE bank loan and deposit growth

(% y/y)



Source: Central Bank of the UAE

0.1, a post-Great Recession high. This marks its fourth increase in a row, with the indicator up 6.3 points year-on-year.

UK: UK Chancellor Phillip Hammond unveiled his much-awaited Autumn budget. It was a mildly expansionary budget which promised extra government spending on services, including the NHS. The net effect of the additional spending is a near doubling of the UK's budget deficit to 1.3% of GDP in 2021/22. The government intends to front-end the country's borrowing and push back fiscal consolidation.

While the budget's eye-catching items were the removal of stamp duty for first time buyers of homes up to £300,000, the increase in the basic rate income tax threshold, and the £3 billion contingency fund set aside for Brexit preparations, it was the sharply downgraded forecasts for UK GDP growth that really stood out. For this year, the Office for Budget Responsibility, the UK's independent fiscal watchdog, brought growth down to 1.5% from the 2.0% it predicted in March. By 2020, growth could be as low as 1.3% y/y.

China: State-owned enterprises (SOEs) witnessed impressive growth in their profits, according to official data. Combined SOE profits grew 24.6% y/y to CNY 2.39 trillion ($360 billion) in the first ten months of 2017. According to authorities, performance has improved through reforms such as mixed-ownership and market-oriented management. The National People's Congress Standing Committee recently set reporting guidelines on SOE management in order to boost efficiency and transparency.

GCC & regional macroeconomics

Kuwait: Inflation bounced back to 1.4% y/y in October. While this coincided with an increase in upward price pressures during the last two months, a base effect in the housing component also boosted price growth from a year ago. September and October saw some upward pressures in retail goods and services, which coincided with an improving consumer sector. We think inflation will average 1.6% in 2017 and accelerate slightly in 2018 to around 2.2%. (Chart 2.)

The improvement in real estate activity continued apace in October as sales posted strong growth and prices remained relatively stable. Sales grew an impressive 46% y/y, the fastest since June 2014, while the number of transactions was up 23% y/y. Activity was boosted by the commercial and residential sectors. (Chart 3.) Prices continued to broadly indicate stabilization.

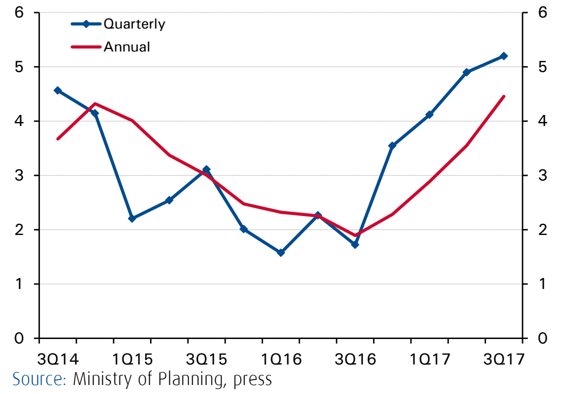
The current account surplus improved to KD 0.6 billion in 2Q17, up from KD 0.4 billion in 1Q17. The improvement was due to lower worker remittances and imports during the quarter and higher investment income. We expect the surplus to improve further during the rest of 2017, helped by higher oil prices, to close 2017 with a surplus of around 5% of GDP.

Saudi Arabia: The kingdom's budget deficit in 3Q17, SR48.7 billion, increased slightly from the SR46.5 billion recorded in 2Q. While spending was down 9.3% q/q – welcomed by the authorities – revenues declined by 13.3% q/q. Surprisingly – given that the average oil price increased in 3Q versus 2Q – oil revenues also declined, by 6.6% q/q. Nevertheless, compared to the government's fiscal position last year, revenues are up almost 23% in Q1-Q3 and spending is largely flat. As a result, the government appears on track to roughly halve last year's budget deficit to 8% of GDP in 2017, in line with our own forecast.

UAE: In October, growth in bank lending stood pat at a multi-year low of

Chart 5: Egypt GDP growth

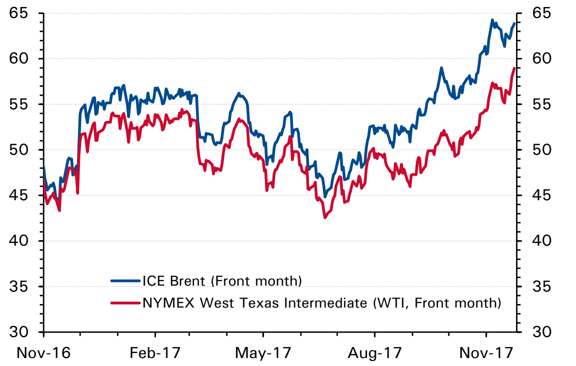
(% y/y)



Source: Ministry of Planning, press

Chart 6: Benchmark crude oil prices

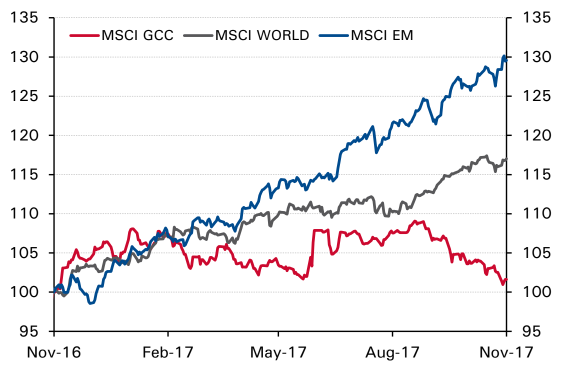
($/bbl)



Source: Thomson Reuters Datastream

Chart 7: Total return indices

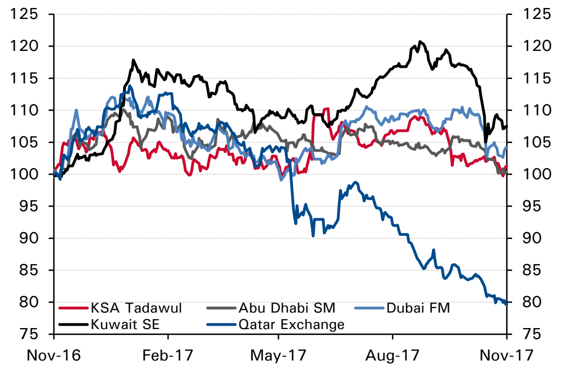
(rebased, 24 November 2016=100)



Source: Thomson Reuters Datastream

Chart 8: GCC markets

(rebased, 24 November 2016=100)



Source: Thomson Reuters Datastream

0.9% y/y (Chart 4), weighed down by ongoing weakness in private sector credit and a continued decline in lending to government-related entities. Deposit growth, in contrast, rose from 5.8% y/y to 6.5% y/y, as higher oil revenues continue to help prop up government deposits. Indeed, government deposits witnessed a 39% y/y jump in October. The loan-to-deposit ratio was stable at a four-month low of 99%.

Egypt: According to a statement by the planning minister, GDP growth continued to show solid improvement, accelerating to 5.2% y/y in 3Q17 (Chart 5). We expect growth to cool slightly in the coming few quarters as some base effects fade, with average growth projected at around 4.5% for the FY17/18 fiscal year ending in June 2018.

Egypt suffered its worst act of terrorism in its modern history when a group affiliated with ISIS killed more than 300 people at a mosque in northern Sinai. Since 2013, the country has battled violent insurgents with little success. More than 570 were killed in attacks during 2016, though the vast majority of those were police and military. Thus far in 2017, nearly 400 civilians have been killed in acts of terrorism.

Turkey: The Turkish lira struck new lows against the US dollar last week, falling by over 1% on Tuesday, even after the central bank implemented new measures to halt the decline. With the central bank under pressure from the government not to raise its key policy rate, it instead reduced banks' borrowing limits which in turn raised the borrowing costs for banks (by an average of 25 basis points). However, the lira recovered only slightly. It is currently trading at 3.94 liras against the USD, almost 12% down year-to-date. The lira continues to be weighed down by geo-political tensions, the renewed upward pressures on inflation and the lingering uncertainty about the central bank's independence.

Markets – oil

Oil prices were back on the march again last week, rising five days in a row to close at $63.9/bbl (Brent) and $59.0/bbl (WTI) after Russia and Saudi Arabia reportedly thrashed out the outline of an OPEC/non-OPEC agreement extension. (Chart 6.) All signatories to the production cut deal are due to meet in Vienna this week, where they are expected to announce the rollover. It is still not certain, though, that the extension will be for nine months; anything less could spark a market sell-off.

Prices were also supported by the shutdown, after an oil leak, of as much as 85% of the Keystone pipeline in the US. The pipeline transports up to 590,000 b/d of Canadian crude to US Gulf Coast refineries. The prospect of reduced crude and refined product supplies finally pushed the WTI forward curve from a contango to a backwardated structure, in which prices in the near term are higher than in the longer term. The last time the WTI futures curve exhibited this pattern was in 2014.

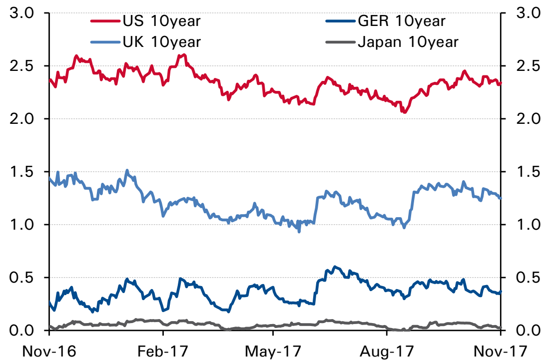
Oil's gains in the US came despite another week – the fifth consecutive – of rising crude production. At 9.66 mb/d, US output reached another shale-era high. The EIA did report, however, a larger-than-expected drawdown in US crude inventories.

Markets – equities

A non-eventful week for the international markets, with the MSCI World All Country index closing up 0.9%. US equities posted their first weekly gain in three weeks and traded near or at record highs, supported by the rally in the oil market and as the retail sector heads into the shopping season. The

Chart 9: Global benchmark yields

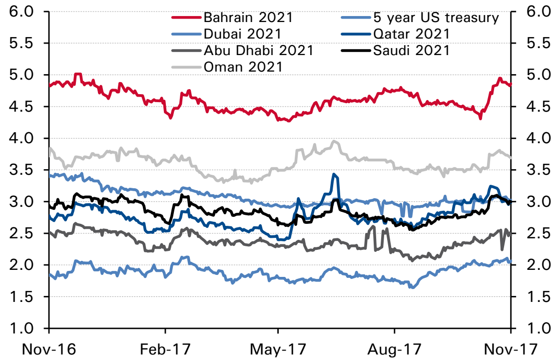
(%)



Source: Thomson Reuters Datastream

Chart 10: GCC yields

(%)



Source: Thomson Reuters Datastream

S&P 500 and DJIA ended the week up 0.9%. Markets also picked up on the positive news from jobless claims and the clearer prospects for an interest rate hike in December. European equities were up 1% on the week on a stronger euro and improving business confidence in Germany as the country moves closer to overcoming a political impasse. Emerging market equities were up 0.9% for the week. (Chart 7.)

GCC markets were mostly in the red last week despite rising oil prices. The MSCI GCC index closed down 0.9%. Kuwait Boursa was down 1.7% on the week, falling back below the 400 point level (KSE weighted index). The Qatari and Abu Dhabi markets continued to trend downwards, falling 1.1% and 0.9%, respectively. The Saudi Tadawul was down 0.5% for the week. (Chart 8.)

Markets – fixed income

The short week saw few major developments in fixed income benchmarks. Long-term US treasury yields fell slightly on Fed inflation concerns, while Bunds were little changed as German political had little impact and the Eurozone's PMI came in strong. 10-year US treasuries ended the week at 2.34%, while 10-year bunds finished at 0.37%. (Chart 9.)

GCC yields declined over the week as regional tensions softened and oil prices strengthened. The return of PM Harriri to Lebanon and news of the release of some anti-corruption suspects in Saudi helped allay investor concerns. (Chart 10.)

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