Markets enjoy solid week despite prospect of tighter monetary policy; Qatar dispute passes its 100th day

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,481	0.62	-1.43
Bahrain ASI	1,304	-0.89	6.83
Dubai FM	3,657	0.35	3.58
Egypt EGX 30	13,611	1.32	10.25
S&P GCC 40	1,043	0.84	-9.70
Kuwait SE	6,914	0.24	20.28
KSA Tadawul	7,373	0.17	2.26
Muscat SM 30	5,002	-0.88	-13.49
Qatar Exchange	8,409	-3.07	-19.42
International			
CSI 300	3,831	0.14	15.75
DAX	12,519	1.75	9.04
DJIA	22,268	2.16	12.68
Eurostoxx 50	3,516	1.97	6.84
FTSE 100	7,215	-2.20	1.02
Nikkei 225	19,910	3.29	4.16
S&P 500	2,500	1.58	11.68

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	55.6	3.42	-2.11
KEC	52.3	1.79	0.04
WTI	49.9	5.08	-7.13
Gold	1320.4	-1.90	14.82

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.301	0.14	-1.44
KWD per EUR	0.361	0.56	13.39
USD per EUR	1.194	-0.76	13.58
JPY per USD	110.840	2.79	-5.16
GBP per USD	1.359	2.99	10.17
EGP per USD	17.638	0.04	-2.01

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor - 3 month	2.45	0.0	35.0
Kibor - 3 month	1.75	0.0	31.3
Qibor - 3 month	2.43	0.4	64.8
Eibor - 3 month	1.55	0.3	7.5
Saibor - 3 month	1.79	0.0	-24.1
Libor - 3 month	1.32	0.4	32.3

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.14	5.9	-38.7
Dubai 2021	2.90	1.4	-39.5
Qatar 2021	2.71	15.9	-21.7
Kuwait 2022	2.40	-0.1	n/a
Saudi Arabia 2021	2.88	16.9	n/a
International			
UST 10 Year	2.20	14.1	-23.0
Bunds 10 Year	0.44	12.1	23.0
Gilts 10 Year	1.31	30.3	6.9
JGB 10 Year	0.04	4.5	-0.9

Source: Thomson Reuters Datastream; as of Friday's close 15/09/2017

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Overview

The US S&P 500 index broke through the landmark 2,500 level at the end of the week, shrugging off concerns over another North Korean missile launch, a terrorist attack in London and the looming threat of higher interest rates from major central banks across the world.

In the UK, for example, minutes from the Bank of England's latest policy meeting signaled a more hawkish stance, potentially pointing to a rate hike before the end of 2017 and pushing sterling to a high versus the US dollar not seen since the Brexit vote last year. The US Fed's FOMC meets this week, with possible clues on the timing of a future rate hike and the winding down of the Fed's inflated balance sheet.

Oil markets also enjoyed a strong week, with Brent crude finishing up 3.4% to $55.6 – the highest in 5 months – helped by the restarting of US refineries after hurricane Harvey, as well as the passing of hurricane Irma. Prices were also lifted by reports from both the IEA and OPEC that saw global demand forecasts upgraded and assessments that the global oil market is starting to rebalance.

The Qatar crisis passed its 100th day, with Moody's reporting that the 'unprecedented' dispute risks generating further rating downgrades, highlighting both Qatar and more financially-stretched Bahrain. But there was no sign of investor caution on Wednesday with the Bahraini government seeing strong demand for a new $3 billion bond issue – equivalent to nearly 10% of GDP and covering the majority of the government's funding needs for this year – albeit at attractive yields.

International macroeconomics

USA: Core inflation was robust in August, breaking a streak of five weaker months, with a 0.2% monthly gain. Nonetheless, annual growth in core prices was steady at 1.7% y/y. Overall inflation was stronger at 1.9%, but the 0.4% monthly gain was due in large part to higher energy prices from the effects of Hurricane Harvey. (Chart 1.)

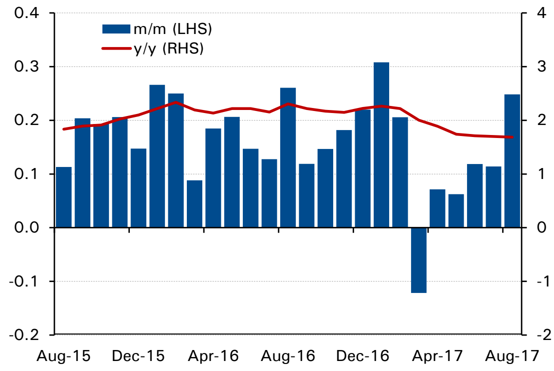
Retail sales were soft in August, contracting by 0.2% during the month. Though some of the softness was due to hurricane Harvey, it went beyond that, with July's growth revised down to just 0.3% m/m from 0.6%. Industrial production was also off by 0.9% during August. Much of this (0.7%), of course, is due to the hurricane weather and further economic reports are due to be distorted near term. Also, and as a result, GDP growth is expected to take a hit in 3Q17, though the impact on the y/y rate, and later on the full-year figures, is likely to be limited.

Eurozone: A relatively quiet week for data, with industrial production coming in as expected at 3.2% y/y, reaffirming the EZ's solid footing. Meanwhile, France is undergoing its first test under Mr. Macron's reform-minded presidency. Protests have sprung across the country, resisting proposed changes to the labor code. Mr. Macron is trying to ease the hiring and dismissal of employees, as well as streamline workplace conflict resolution.

In Italy, the recent uptick in growth (1.5% y/y for 2Q17) has seen

Chart 1: US core CPI inflation

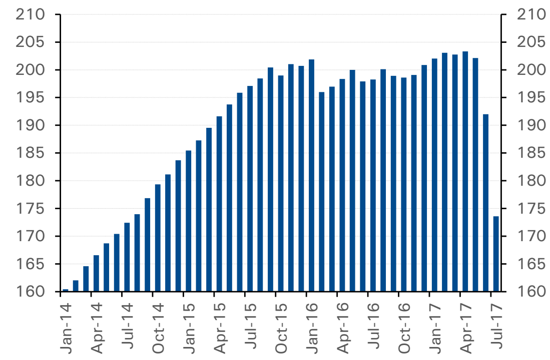
(thousand)



Source: Bureau of Labor Statistics

Chart 2: Non-performing loans at Italian banks

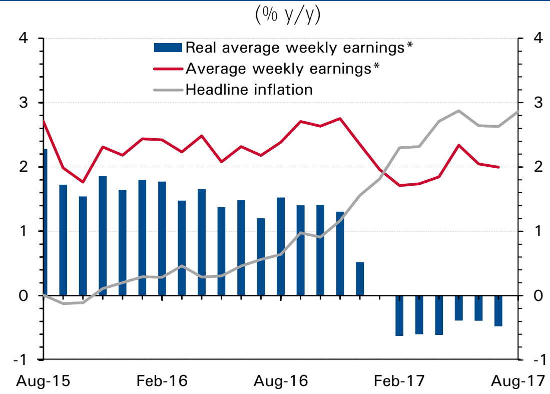
(EUR billion)



Source: Thomson Reuters Datastream

Chart 3: UK inflation & avg. weekly earnings

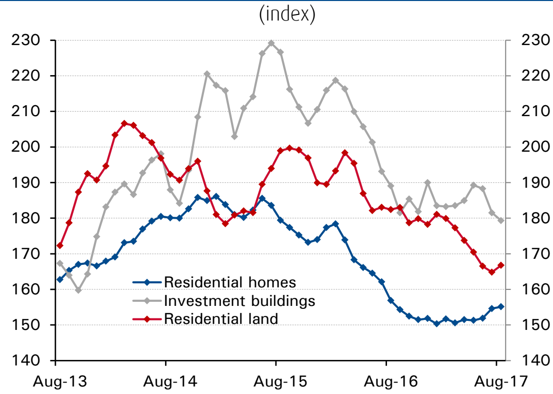
(% y/y)



Source: Office for National Statistics (ONS)

Chart 4: Kuwait real estate prices

(index)



Source: Ministry of Justice, NBK

domestic banks' stock of non-performing loans (NPLs) decrease significantly over the past few months. They now stand at EUR 173 billion in July, down EUR 30 billion from their peak in April 2017. (Chart 2.)

The build-up to the German elections (24 Sep) has been lackluster, with Angela Merkel and her Christian Democrats still expected to win. With no credible opposition, recent polls have the current Chancellor and her party comfortably grabbing 37% of the vote. The prospect of a smooth election reflects waning anti-establishment sentiment.

China: August retail sales missed estimates, growing 10.1% y/y versus the expected 10.5%, and are down from July's 10.4% y/y. Industrial production growth cooled as well, growing 6.0% y/y against the expected 6.6% for August, and lower than July's 6.4% y/y.

UK: The deliberations of the Bank of England's (BoE) Monetary Policy Committee (MPC) took center stage last week. The release of inflation data which showed retail inflation at 2.9% in August, from 2.6% in July, and unemployment data showing the UK's jobless rate at a 42-year low of 4.3% in the three months to July, weighed heavily in favor of an interest rate rise. (Chart 3.) The 9-member MPC surmised on Thursday that a rate rise might indeed be necessary "over the coming months". Wage pressure continues to be a mitigating factor though. There has been little visible upward pressure on wages despite the positive employment figures. Real annual wage growth has been negative since last February. (See Chart.)

However, public sector workers did have cause to rejoice last week after the government decided to scrap the 1% pay cap it had instituted as part of its post-financial crisis austerity drive. Pressure had been mounting on the government to revise its stance towards public sector pay, especially in the context of rising inflation.

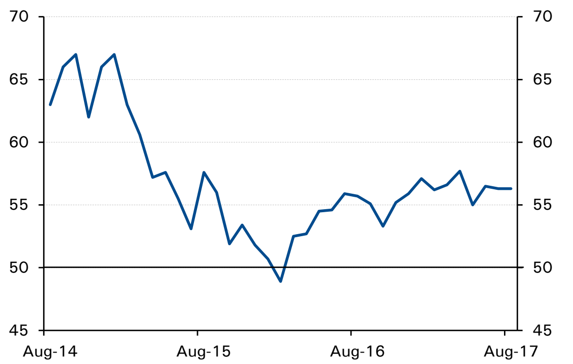
Sterling reacted to the data and the MPC comments, including by one of the most dovish members on the committee, by surging on Friday to a post-Brexit high against the US dollar (USD 1.36 per GBP).

Last week also saw the government secure the second round of parliamentary approval for its European Union Withdrawal Bill. The bill, which aims to incorporate some 12,000 EU regulations into UK law, was passed relatively straightforwardly, by a majority of 36 MPs, and will now progress to the next stage. Already, MPs from all sides have tabled collectively 136 amendments, including a motion to prolong the country's stay in the single market and customs union and a proposal for the final Brexit deal to be approved by parliament. Moreover, MPs are likely to resist the government's intention to unilaterally enact legislative changes without parliamentary approval, the so-called "Henry VIII powers". Parliament took a "historic decision to back the will of the people", was how the Prime Minister summed up the vote. Indeed, with parliamentary backing secured, the government can now press on with the difficult EU negotiations.

On that front, the fourth round of the negotiations are due to resume later this month, having earlier stalled amid disagreements about the UK's financial obligations (EU 'divorce bill'), the rights of EU citizens and the Irish border question. Before then, however, the PM's speech in Florence on 22 September is expected to set out the government's preference for a transition deal based as closely as possible on the UK's current membership and its desire for a longer-term free trade agreement with the EU.

Chart 5: Dubai economy tracker

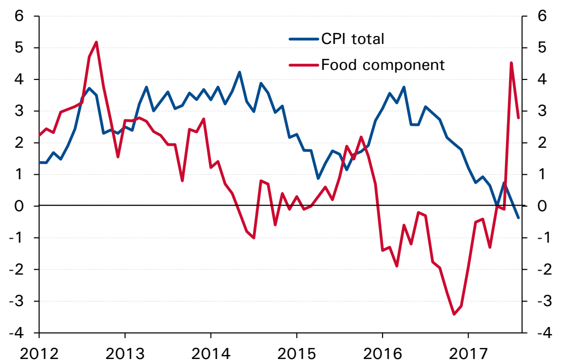
(index)



Source: Emirates NBD

Chart 6: Qatar consumer price inflation

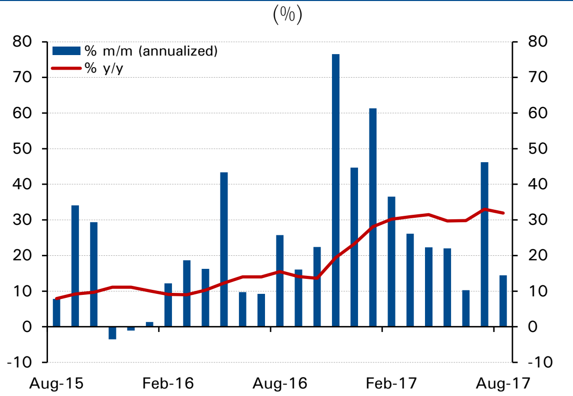
(% y/y)



Source: MDPS

Chart 7: Egypt headline inflation

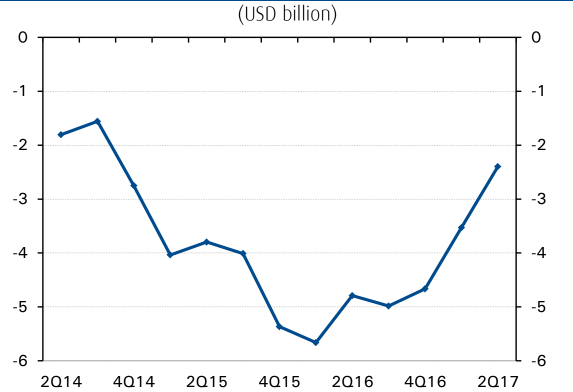
(%)



Source: Central Bank of Egypt

Chart 8: Egypt current account balance

(USD billion)



Source: Central Bank of Egypt

GCC & regional macroeconomics

Kuwait: Real estate activity was healthy in August, with sales up 18% y/y to KD 154.5 million. The commercial sector was particularly strong during the month. Activity in the residential and investment sectors was more subdued. Meanwhile, prices remained relatively stable, with prices of built homes and apartment buildings steady around their levels of the last 12 months. (Chart 4.)

The Kuwait Authority for Partnership Projects (KAPP) has selected an advisor and manager to IPO the first Al-Zour North power and water facility sometime in 1Q18. Expectations are that 50% of Shamal Azzour Al-Oula (the name of the company) will be offered to Kuwaiti citizens at the nominal value of 100 fils per share. The company is expected to be listed on Boursa Kuwait.

Saudi Arabia: Saudi Arabia has indicated its intent to reduce October crude sales to its global customers by 350,000 b/d (-3.5%), as part of its commitment to the OPEC production cut agreement. This is despite increasing demand from refiners.

According to Saudi Arabia's new VAT law, residential property rent and sales will be exempt from the tax. The exemption in the latter only applies if the residential property is intended as a permanent home for the buyer.

UAE: Emirates NBD's Dubai Economy Tracker (a gauge of non-oil activity) held firm at 56.3 in August, as output and new orders remained strong in all sectors, including construction, travel and tourism, and wholesale and retail trade. (Chart 5.) This supports our view of steady, if unspectacular growth in the broader UAE economy this year.

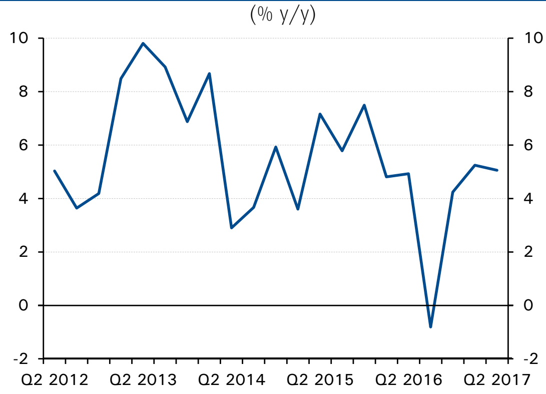
Qatar: Inflation in Qatar continued to decline in August, this time falling into negative territory at -0.4% y/y from +0.2% y/y in July. (Chart 6.) Softness was fairly broad-based, despite fears over the impact on supply chains and import costs from the blockade by other GCC countries. Most notably, after leaping 4.2% m/m in July, the food price segment fell back 0.6% m/m in August, pushing the y/y rate back down to 2.8% from 4.5%. While we would not rule out further upward pressures as the year goes on, this does at least suggest that the spike in food prices and hit to consumer incomes will not be as large as at first feared. Overall inflation was also lowered by a further fall in housing costs (-4.0% y/y) while inflation in all other sectors – 'core' – eased down to just 0.1% y/y. The clothing segment did rise sharply m/m, but after two successive large monthly falls and remains negative in y/y terms.

Bahrain: In an effort to help plug its fiscal gap, the government issued a $3 billion three-tranche bond, with comparatively high premiums. The tranche includes an $850 million 7.5-year maturity sukuk priced at 5.25% and two conventional bonds, one with a 12-year maturity priced at 6.75% and another with a 30-year maturity priced at 7.5%. Although its debt is classified as below investment-grade by the three major rating agencies, investor demand for the multi-tranche bond still topped an impressive $15 billion, thanks in part to its more attractive premiums. The government's budget deficit is forecast at $5 billion this year. With the new issue, government debt stands at around 90% of forecast 2017 GDP.

Egypt: Inflationary pressures eased in August, with prices rising by an annualized 14% as the impact of subsidy cuts and a higher VAT rate in July faded. (Chart 7.) Still, annual inflation remained very high at 32% y/y. Core inflation cooled more noticeably. Core prices (excluding volatile food

Chart 9: Turkey's real GDP

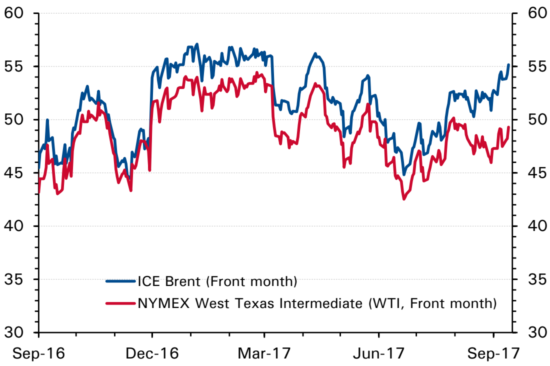
(% y/y)



Source: Thomson Reuters Datastream

Chart 10: Benchmark crude oil prices

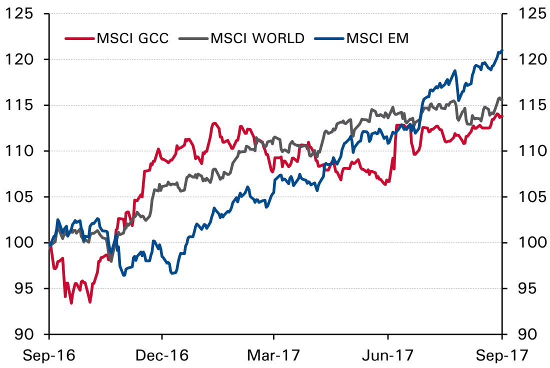
($/bbl)



Source: Thomson Reuters Datastream

Chart 11: Total return indices

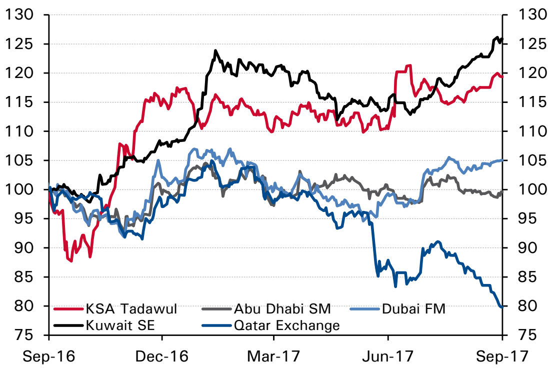
(rebased, 15 August 2016=100)



Source: Thomson Reuters Datastream

Chart 12: GCC markets

(rebased, 15 August 2016=100)



Source: Thomson Reuters Datastream

and regulated items) grew by just 3.8% (annualized).

The current account deficit narrowed further in 2Q17 to $2.4 billion. (Chart 8.) Most of the gain came from continued improvement in tourism receipts, which tripled from a year ago, worker remittances, and reduced imports. Some of this was offset by a rise in the cost of net oil imports due to higher oil prices. Meanwhile, portfolio inflows saw a second exceptionally strong quarter in 2Q17, rising to $8.2 billion.

Turkey: Growth in real GDP eased slightly in 2Q17 but still remained fairly strong at 5.1% y/y. (Chart 9.) The ease came on the back of a drop in government spending, but ongoing gains in consumer spending and exports and a jump in investments, helped offset some of that weakness. Investment growth jumped from 3.0% y/y in 1Q17 to 9.5% y/y in 2Q17, following a pick-up in public-private partnerships.

Markets – oil

It was a good week for oil. Buoyed by an apparent improvement in oil demand and the resumption of previously shuttered refineries in Texas, Brent and WTI closed the week up at $55.6/bbl (+3.4% w/w; -2.1% ytd) and $49.9/bbl (+5.1% w/w; -7.1% ytd), respectively. This was one of the biggest weekly gains since July and left oil at its highest level since April. (Chart 10.)

Both the IEA and OPEC revised upwards their projections for crude oil consumption in 2017. This year, the IEA estimates that demand will grow 1.6 mb/d (1.7% y/y), 100,000 b/d higher than before, thanks to stronger-than-expected demand in Europe and North America. It sees the long-touted rebalancing of supply and demand as well underway.

US crude production rebounded last week, rising by 572,000 b/d to reach 9.3 mb/d, after the previous week's fall caused by Hurricane Harvey. US commercial crude stocks which, along with US crude production, is the most closely tracked petroleum statistic, notched up another increase last week, rising by 5.8 million barrels. In contrast, stocks of motor gasoline recorded their sharpest weekly fall, of 8.4 million barrels, to 218.3 million barrels, as demand recovered. Diesel stocks also withdrew as petroleum product exports out of the US Gulf Coast recovered. Refinery runs, meanwhile, were down for the second consecutive week. This is unsurprising given that at least half of Texas's 30 or so refineries are still either operating at reduced capacity or are offline entirely. The post-Harvey cumulative fall in refinery runs stood at 3.6 million barrels last week, or 21% of the volume processed before the hurricane hit.

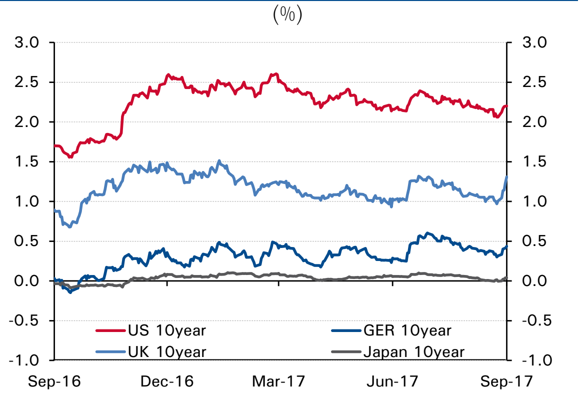
Nevertheless, next week should see further gains in refinery runs and exports.

Markets – equities

Most equity markets rebounded last week as geopolitical and hurricane fears abated and new data continued to signal strength in the major economies. The MSCI World All Country index advanced 1.4% with most world markets ending the week in green. UK equities were one of the few exceptions with the FTSE 100 retreating 2.2% on the week, on signs the Bank of England was getting ready to raise rates. Meanwhile, US equities regained momentum, breaking new highs. The S&P 500 and DJIA closed the week up 1.6% and 2.2%, respectively. European equites also gained with the Euro Stoxx 50 up 2%. Emerging market equities followed suit and the MSCI EM closed the week 1.4% higher. (Chart 11.)

Chart 13: Global benchmark yields

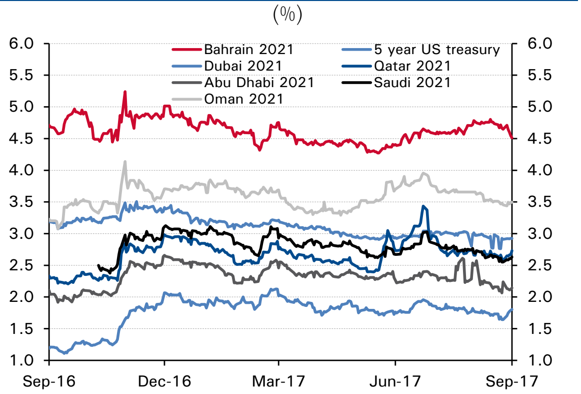
(%)



Source: Thomson Reuters Datastream

Chart 14: GCC yields

(%)



Source: Thomson Reuters Datastream

Regional markets underperformed last week with the MSCI GCC up 0.3%. Kuwait was the only market to register any noteworthy gains on the week with its value-weighted index up 1.5%. Meanwhile, the Qatari market suffered after hopes of a resolution to the diplomatic row were shattered when talks between high level officials ended badly. The general index retreated 3.1%. The market was also weighed down by S&P's outlook change for a couple of heavily-weighted Qatari stocks to "negative" in line with its sovereign outlook revision last month. (Chart 12.)

Markets – fixed income

Benchmark yields reversed the previous week's dip on tempered responses to North Korean aggression, a relatively less severe fallout from hurricane Irma, and hawkish central banks talk, notably from the BOE. An inflow of supply also helped lift yields higher. The sell-off saw US 10-year treasuries and 10-year bunds up 14 bps and 12 bps, respectively, on the week. (Chart 13.)

The Bank of England left its policy rate unchanged (7 for, 2 against) at its latest MPC meeting. Although expected, the hawkish tone of the meeting minutes surprised markets. BOE governor Carney now expects rates to rise faster and sooner than expected. This saw yields on 10-year gilts propelled higher, adding 30 bps and finishing the week at a 2-month high of 1.31%. Markets now expect a November rate hike with 35% probability, up from 22% before.

GCC sovereign yields were mixed over the week. Yields for Dubai 2021 and Kuwait 2022 were little changed, as oil prices held firm. Meanwhile, Abu Dhabi 2021, Qatar 2021, and Saudi 2022 were up between 6-17 bps tracking US Treasuries. Yields on Bahraini debt tightened, however, benefitting from the strong demand for its latest issue (close to 5 times oversubscribed). Bahrain's 2022 shed 12 bps to settle at 4.97%. (Chart 14.)

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