International scene

International: Tax cuts could boost US growth; Brexit deal marks progress

> Nemr Kanafani
Head of Research
+965 2259 5365, nemrkanafani@nbk.com

An already robust global economic picture improved still further in recent weeks. Data in Europe and Japan firmed noticeably, and continued to come in strong in the US. The outlook in the US also benefited from the Senate's passage of an historic tax reform bill, though a final reconciled measure will require some additional work. Meanwhile, the UK made significant progress on a Brexit agreement with the EU, removing some of the dark clouds on the horizon. With that, equities continued to perform well, hitting fresh highs. Despite the robust outlook for growth, inflation continued to lag behind.

The figures on the US economy continued to come in strong. The latest employment report showed labor conditions continuing to tighten. Nonfarm payrolls rose by 228,000 in November, though the unemployment rate stayed put at the 17-year low of 4.1%. A number of leading indicators have been particularly strong, including capital goods orders and the ISM manufacturing index, showing increased optimism and rising investment. GDP growth also remained solid. 3Q17 GDP growth was revised upward to a solid 3.3% q/q annualized, from 3.0% in 2Q17.

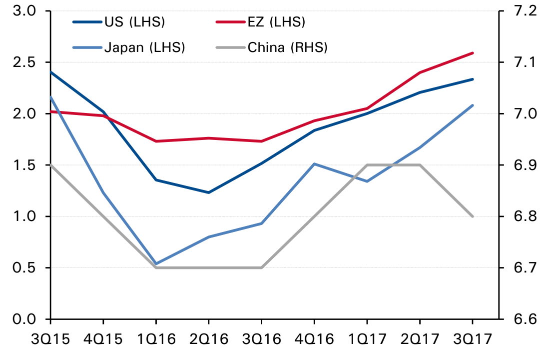
Optimism in a more business friendly White House and a GOP controlled Congress paid off this month, as legislators passed landmark tax cuts. The Senate passed long-awaited tax reform, though it will still need to be reconciled with the House version. While most Republicans believe the cuts, estimated to cost around $1.4 trillion over ten years, will generate enough growth to pay for themselves, many economists do not see them resulting in a large fiscal stimulus. Nonetheless, they are expected to be a boon for corporate earnings and could boost growth in the medium term.

Meanwhile, markets continue to await a budget deal in the US as the government debt, again, approaches the mandated ceiling. In an effort to avert a government shutdown, Congress passed a 2-week stopgap-spending bill, giving legislators more time to agree to new spending levels for the 2018 fiscal year. A broad bipartisan effort is currently underway with hopes an agreement can be reached before Christmas. However, with some expecting agreement on other pending issues, including immigration and healthcare, a deal is unlikely to be straightforward, especially given the need to have something ready before the end of 2017.

Performance in the eurozone has increasingly mirrored the strength seen in the US, with recent data indicating growth picking up pace. The PMI rose to a more than 6-year high of 57.5 in November, showing solid activity across the eurozone. Strength continued to be broad-based, with France (60.3), Ireland (57.7), and Germany (57.3) seeing the best performance. The data pointed to further strengthening in 4Q17 GDP growth. Meanwhile, the final revision to 3Q17 confirmed growth at a robust 2.6% y/y. Consumer confidence for the area also beat expectations, increasing to a post-Great Recession high after its fourth consecutive monthly increase.

Chart 1: GDP growth

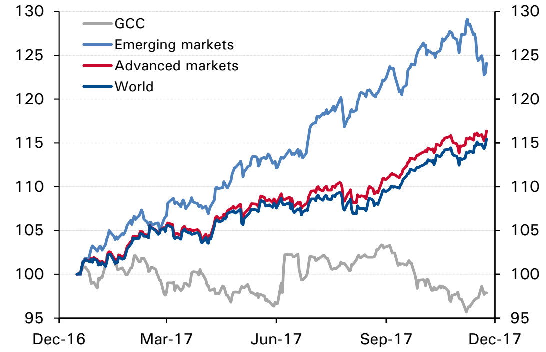
(% y/y)



Source: Thomson Reuters Datastream

Chart 2: Equity markets

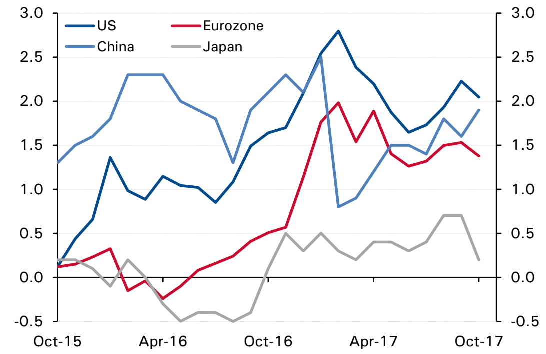
(MSCI, rebased, 30/12/2016 = 100)



Source: MSCI, Thomson Reuters Datastream

Chart 3: Inflation

(% y/y)



Source: Thomson Reuters Datastream

The solid economic recovery took place even as the EU grappled with a series of existential political crises that threatened to upset the status quo; in November, it was Germany's turn. After several EU members survived a wave of anti-EU challengers earlier in 2017, the German national election weakened Angela Merkel, the longest serving EU leader, as the anti-EU far right made marked inroads. With a government yet to be formed, the initial uncertainty subsided after the Social Democrats agreed to talks to form another coalition with Merkel's Christian Democrats.

Brexit-related uncertainty subsided slightly as the UK reached an agreement with the EU over Brexit divorce terms, which should pave the way for negotiations on the trade relationship. The UK agreed to pay €40-60 billion to settle existing commitments to the block. The deal also included a settlement on the rights of EU citizens in the UK post-Brexit and the question of the Irish border. Now the UK and EU will embark on the more important part of the talks, their trade relationship immediately after Brexit and further in the future.

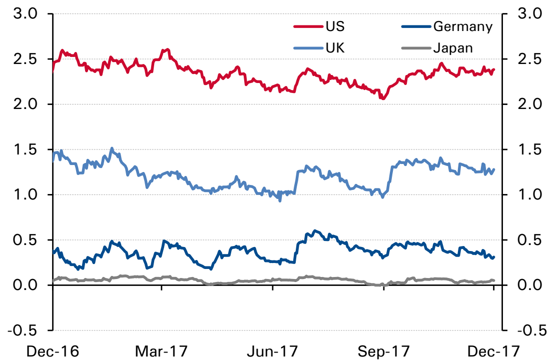
In Japan, a strong showing by Shinzo Abe in the October election now appears to have coincided with an improving economy. Indeed, Japan's economy appears to be seeing its best performance in years, with GDP recording the longest growth streak in decades. GDP growth in 3Q17 was revised upwards to an annualized 2.5%. The question remains whether this pace can be sustained in 2018, something markets will be looking out for.

While advanced economies enjoyed solid economic growth, they continued to see inflation below target and failing to pick up. In the US, core CPI inflation stood at 1.8% but did not appear to be gaining momentum after a bout of soft figures in the summer. This was confirmed once again in November's wage growth, which despite a tight labor market was not gaining pace. The story was similar in the eurozone, where the flash core inflation rate came in at 0.9% for November.

While the Fed has not allowed soft inflation to get in the way of a third hike in 2017, continued softness could begin to weigh on central bank tightening schedules in 2018. Virtually everyone expected the Fed to hike their policy rate by another 25 basis points in December, which they did, especially given the solid economic data and assurances markets received that soft inflation will not hold them back from normalizing. Next year, markets see the Fed moving 2-3 times. In the eurozone, things could be more complicated; given the structural limitations of QE there, the ECB has little credibility continuing with that program past 2018.

Boosted by a solid global economy and the recent OPEC agreement, oil prices climbed for a fifth consecutive month in November, and are holding above $60. Brent rose to $63 per barrel in November, up 32% from where it was six months ago. The recent agreement reached between OPEC and some non-OPEC countries to extend production cuts through the end of 2018 provided additional support to prices, though US production growth from Shale oil will continue to weigh on prices in the medium term.

Chart 4: Benchmark yields
(10-year sovereign bonds)



Source: Thomson Reuters Datastream

Chart 5: US dollar index
(index)

Source: Thomson Reuters Datastream

Chart 6: Brent oil price
(US dollars per barrel)

Source: Thomson Reuters Datastream

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
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
(International) Plc
Paris Branch
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 Representative 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
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
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