Politics weighing on Europe's economic backdrop; oil lifted as Iraqi forces retake Kirkuk

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi SM	4,505	-0.45	-0.90
Bahrain ASI	1,279	0.33	4.79
Dubai FM	3,673	0.34	4.02
Egypt EGX 30	13,714	-1.28	11.09
S&P GCC 40	1,041	-0.28	-9.85
Kuwait SE	6,633	0.07	15.40
KSA Tadawul	7,011	0.34	-2.76
Muscat SM 30	5,067	-1.20	-12.38
Qatar Exchange	8,172	-2.04	-21.70
International			
CSI 300	3,927	0.15	18.64
DAX	12,991	0.00	13.15
DJIA	23,329	2.00	18.04
Eurostoxx 50	3,605	0.01	9.56
FTSE 100	7,523	-0.16	5.33
Nikkei 225	21,458	1.43	12.26
S&P 500	2,575	0.86	15.02

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	57.8	1.01	1.64
KEC	54.0	0.33	3.93
WTI	51.5	0.04	-4.19
Gold	1277.4	-1.85	11.08

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.302	0.23	-1.01
KWD per EUR	0.358	0.00	12.35
USD per EUR	1.178	-0.33	12.08
JPY per USD	113.500	1.48	-2.88
USD per GBP	1.319	-0.72	6.91
EGP per USD	17.635	0.14	-2.03

Interbank rates	%	Change (bps) weekly	YTD
Bhibor - 3 month	2.45	-2.5	35.0
Kibor - 3 month	1.81	6.3	37.5
Qibor - 3 month	2.49	4.6	70.6
Eibor - 3 month	1.57	0.1	9.5
Saibor - 3 month	1.79	0.1	-24.3
Libor - 3 month	1.36	0.3	36.5

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2021	2.35	1.8	-18.2
Dubai 2021	2.98	0.2	-32.1
Qatar 2021	2.96	0.8	2.8
Kuwait 2022	2.54	4.8	n/a
Saudi Arabia 2022	2.84	7.8	n/a
International			
UST 10 Year	2.38	10.1	-5.1
Bunds 10 Year	0.45	5.1	24.6
Gilts 10 Year	1.33	-4.0	9.1
JGB 10 Year	0.07	0.8	2.4

Source: Thomson Reuters Datastream; as of Friday's close 20/10/2017

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Overview

Political developments in Europe were again to the fore at the end of the week, with the Spanish government declaring that it would impose direct rule on Catalonia as the latter pushes for independence – a dramatic ramping up of tensions in the Eurozone's fourth largest economy. But there was a glimmer of progress on the Brexit negotiations, with EU leaders announcing that they may be prepared to start talks on a trade deal in December, though they need to see headway on issues including the UK's 'leaving bill' before then. European stocks were flat on the week.

In the US, equity markets reached fresh highs and both the dollar and bond yields rose on progress on President Trump's tax plan, which could lift economic growth and widen the fiscal deficit. The plan would cut corporate tax to 20%, lower personal tax rates and overhaul the tax code.

Oil was again generally strong, with Brent finishing up 1% w/w despite dropping back towards the end of the week on weaker than expected US inventory data. Market strength was driven by Iraqi government forces advancing on, and subsequently retaking, the Kurdish-held oil city of Kirkuk, following the Kurdish independence referendum last month. Oil exports from the Kurdish region reportedly fell to less than half their normal level of 0.6 mbpd – though government officials said the disruption was likely to be temporary.

In the Gulf, new data show that Bahrain's economy continues to grow at a decent pace – one of the more unsung stories of the past two years. Although the oil sector is struggling against capacity constraints and field maturity issues, non-oil growth stood at 4.3% y/y in Q2 and is now above that in Qatar. The key driver remains project activity financed by the Gulf Development Program – a $10bn, 10-year package of grants from neighboring countries agreed back in 2011, but which kicked in to gear recently.

International macroeconomics

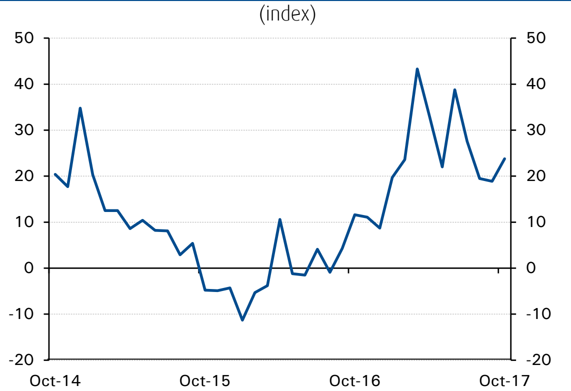
USA: Economic conditions remained broadly positive. The Philadelphia Fed business outlook index continued to register robust levels, coming in at 27.9. (Chart 1.) Other data showed little signs of remarkable strength. Industrial production rose 0.3% m/m in September following two months of soft numbers; the index was up 1.6% y/y. Housing starts were on the weaker side, though some of that was hurricane-related. (Chart 2.)

With Fed Chair Janet Yellen's term expiring in February 2018, President Donald Trump mentioned three candidates for the position by name last week, Janet Yellen, Jerome (Jay) Powell and John Taylor, of Taylor rule fame. Taylor is the more hawkish candidate while Powell is seen as close to Yellen's more dovish stance. Other names are still in the mix and the president should make an announcement by early November.

The Senate passed a 2018 budget resolution last week, a move that brought Congress closer to passing the Trump administration's tax reform plans. Markets have risen in anticipation of tax reform, which is expected to provide corporations in particular with a healthy break. The legislation

Chart 1: US Phily Fed index

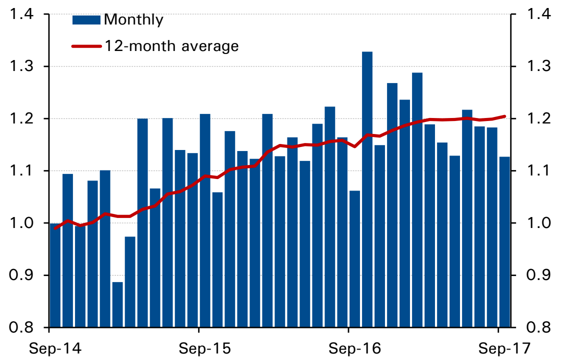
(index)



Source: Federal Reserve Bank of Philadelphia

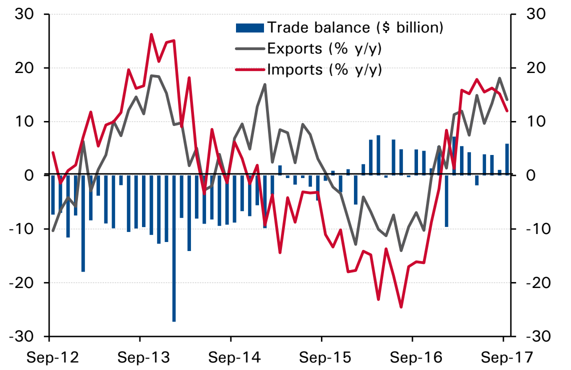
Chart 2: US housing starts

(million units)



Source: U.S. Census Bureau

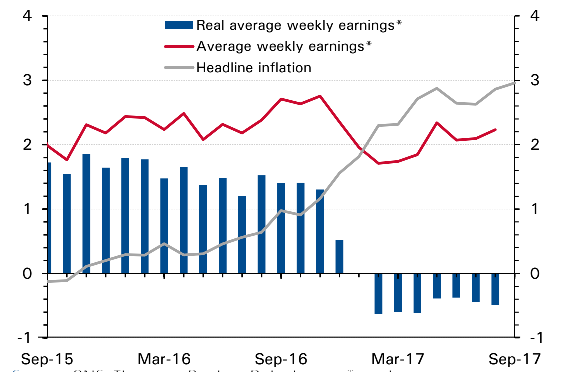
Chart 3: Japan trade



Source: Thomson Reuters Datastream

Chart 4: UK inflation and wage growth

(% y/y)



Source: ONS, Thomson Reuters Datastream; *regular pay

could provide an economic stimulus of around 1% of GDP by some preliminary estimates.

Eurozone: Secession tensions escalated in Spain as Madrid moved to seize control over Catalonia. Spanish PM Rajoy invoked article 155 following increased defiance from Catalan President Puigdemont. Pending Senate approval, governance of regional Catalan institutions would be overtaken quickly by their relevant counterparts in Madrid.

Italy's new electoral law is expected to soon pass in the upper house. This may see national elections pushed forward by 2 months to March 2018. Meanwhile, two of Italy's richest regions (Lombardy and Veneto) will be holding referendums on greater autonomy today.

China: China announced its third quarter GDP figures, growing 6.8% y/y. The growth figure was slightly slower than the 2Q17's 6.9% but was in line with analysts' expectations. The slight slowdown was anticipated given the government's effort to slow the overactive property market and reduce debt risks.

Japan: Export growth came under some pressure in September mainly on the back of a stronger yen. However, at 14% y/y it remained fairly solid, thanks to an improvement in global demand. Import growth also slowed, but remained relatively firm at 12% y/y amid a gradual recovery in domestic demand. (Chart 3.) With exports holding strong, the trade surplus expanded from $1.0 billion in August to a multi-month high of $5.9 billion in September.

Voters go to the polls on Sunday, with Prime Minister Shinzo Abe expected to win by a large margin. Abe called for a snap election last month in an effort to capitalize on his recent political strength. He has promised to maintain a tough stance on North Korea. He has also pledged an $18 billion fiscal stimulus package and further structural reforms.

UK: The likelihood of the Bank of England raising interest rates at its next meeting moved a step closer after the UK's headline inflation rate reached a 5-year high of 3% in September. (Chart 4.) Market consensus views the probability of a rate rise at more than 80%, especially given strong employment data. According to the latest, August jobs report, the employment rate, at 75.1%, was close to its highest ever level, while unemployment, at 4.3%, continued to hold steady at its lowest level since 1975. However, with average weekly earnings growth still an anemic 2.1% and the average worker still earning less in real terms in 2017 than in early 2006, a rate rise (to 0.5%) at the next Monetary Policy Committee meeting in November is not a foregone conclusion.

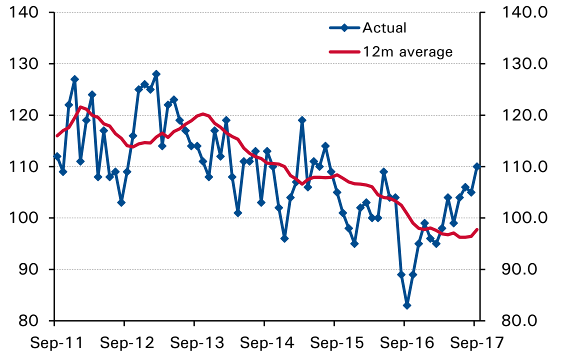
Meanwhile, passage of the UK's key EU withdrawal bill appears to have stalled amid a potential backbench rebellion by pro-EU Conservative and opposition parliamentarians. MPs have tabled hundreds of amendments, many of which are not likely to be accepted by the government, raising the prospect of impasse.

GCC & regional macroeconomics

Kuwait: Consumer confidence continued to improve in September, with the Ara index rising to 110. Confidence has gained as consumers put last year's fuel price hike behind them and focused on higher oil prices and positive economic growth. The rise in the index has also mirrored an improvement in consumer activity over the last several months. (Chart 5.)

Chart 5: Kuwait consumer confidence

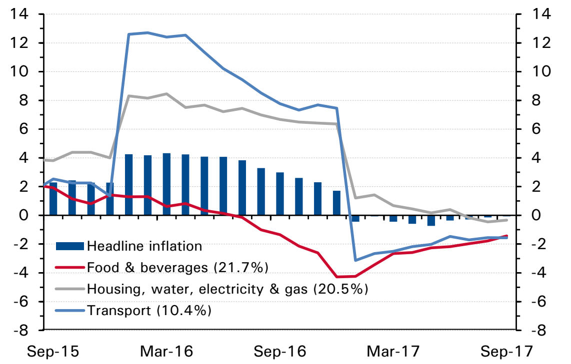
(index)



Source: Ara Research & Consultancy

Chart 6: Saudi inflation

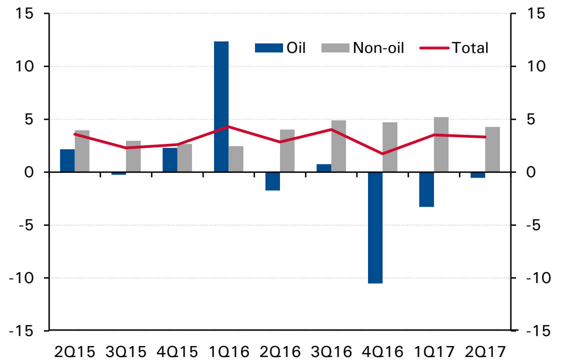
(% y/y)



Source: General Authority for Statistics (GASTAT)

Chart 7: Bahrain quarterly real GDP

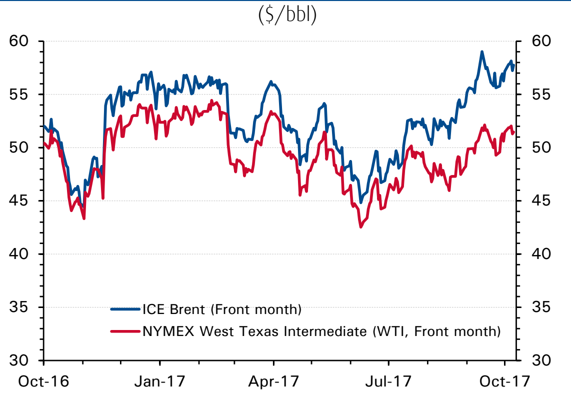
(% y/y)



Source: Information & eGovernment Authority

Chart 8: Benchmark crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

Saudi Arabia: The kingdom has witnessed nine consecutive months of deflation, with prices in the country's cost of living index falling by 0.1% y/y in September. (Chart 6.) The declines, however, are less severe since May's figure of -0.7% y/y.

Saudi Arabia will not rush into reducing energy and other subsidies and risk endangering the nascent economic recovery. The objective of a balanced budget by 2020 may be reconsidered in order to assess the economy's reaction to the changes, the finance minister, Mohammed Al-Jadaan, said last week. In this, the country would appear to be heeding the IMF's concerns that too quick a roll out of austere fiscal reforms could negatively affect demand and consumer confidence.

Responding to recent reports that Saudi Arabia is considering shelving the Aramco IPO in favor of a private placement, possibly to sovereign wealth funds, oil minister Khalid Al-Falih, stated that both local and international listings were still on schedule for 2018. He refused to comment on suggestions that China could be a potential buyer.

SAMA may raise the maximum loan-to-deposit ratio for commercial banks in order to better facilitate the economic recovery, according to central bank governor Ahmed Al-Kholifey. The central bank last raised the rate in February 2016 to 90% from 85%.

Oman: Bidding for Oman's third mobile license has been cancelled and was awarded instead to a consortium of local investment funds and an international operator. Zain, Saudi Telecom, Sudatel, and Etisalat were vying for the license.

Bahrain: The latest official figures show real GDP easing slightly from a revised 3.5% y/y in 1Q17 to 3.3% y/y in 2Q17, as oil sector activity remained in decline. (Chart 7.) However, growth in the non-oil sector remained robust at 4.3% y/y as the transportation & communication, hotel & restaurant and trade segments witnessed strong gains. Strong project-related activity is being financed by grants from other Gulf countries via the $10 billion Gulf Development Program.

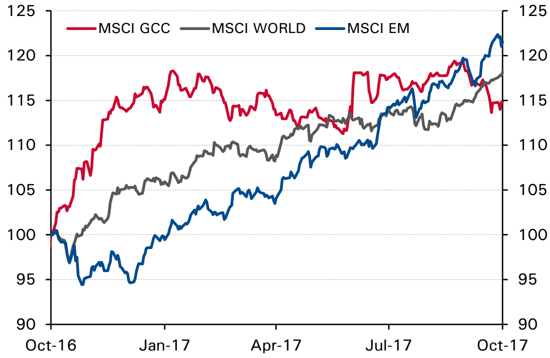
Markets – oil

Oil prices closed on Friday up slightly at $57.8/bbl (Brent) and $51.5/bbl (WTI), after markets took their cue from the end of week rally in equities and the release of US oil rig data that suggested that North American crude production growth was slowing. (Chart 8.) The count of oil rigs fell by seven to 736 last week, which is the third consecutive weekly decline and the lowest number since early June.

Earlier in the week, Brent and WTI climbed to an October high of more than $58 and $52, respectively, before falling slightly after the EIA's weekly petroleum report on US oil revealed an increase in petroleum product stocks and a decrease in crude demand (refinery runs).Oil is in the midst of a 4-month bull run, with Brent crude up 29% from its low of $44.8/bbl on 21 June, boosted by a combination of improving demand/supply fundamentals and heightened geopolitical tensions in the Middle East. And the major catalyst in recent weeks has been geopolitics, with Trump's decertification of the 2015 Iran nuclear deal and the federal government of Iraq's altercation with the Kurdish Regional Government (after the latter held an independence referendum) spurring concerns that oil supplies could be disrupted. There are already reports that pipeline exports from Iraq's northern oil fields to Turkey have fallen by 60%, from an average of 600,000 b/d to 240,000 b/d.

Chart 9: Total return indices

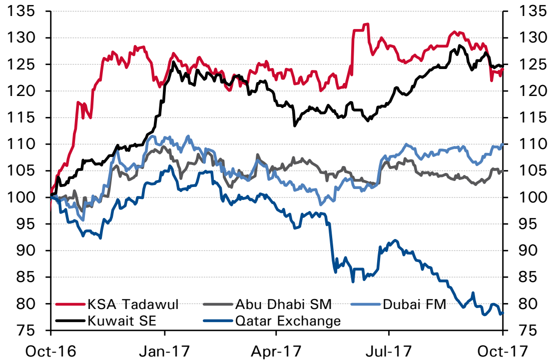
(rebased, 20 October 2016=100)



Source: Thomson Reuters Datastream

Chart 10: GCC markets

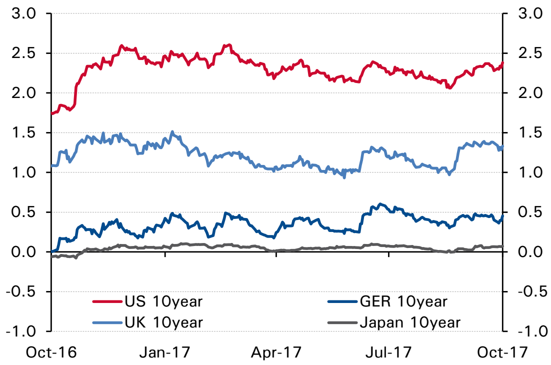
(rebased, 20 October 2016=100)



Source: Thomson Reuters Datastream

Chart 11: Global benchmark yields

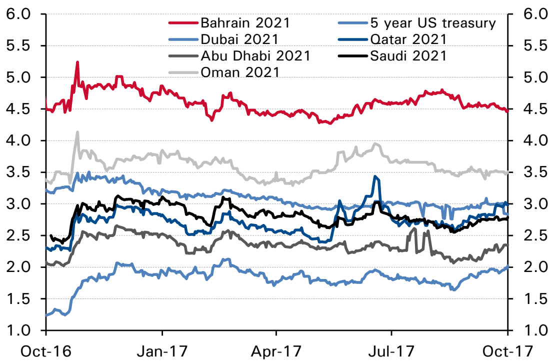
(%)



Source: Thomson Reuters Datastream

Chart 12: GCC yields

(%)



Source: Thomson Reuters Datastream

The announcement on Saturday by OPEC's Joint Ministerial Monitoring Committee (JMMC) that oil producers achieved a record compliance level of 120% in September will undoubtedly fuel further bullish sentiment.

Markets – equities

Equity markets saw no major moves last week. The MSCI World All Country index closed up 0.6%. US equities outperformed, posting record highs, as strong earnings and the passage of a budget blueprint for the next fiscal year, in anticipation of tax cuts, provided further support. The S&P 500 and DJIA closed up 0.9% and 2%, respectively. UK inflation hit a 5-year high, with absent real wage growth remains a concern for the BOE. The Euro Stoxx 50 was flat on the week. Emerging market (EM) equities trailed behind with the MSCI EM retreating 0.1%. (Chart 9.)

Regional markets were flat last week despite the rise in oil prices. Earnings have been mixed so far, with most banks surprising on the upside. The MSCI GCC index closed the week up 0.1%. In other related news, according to the Saudi oil minister, the Aramco's local and international IPO is still on track for 2018. The Abu Dhabi Securities Exchange is introducing technical short-selling, making it the first market in the region to allow short-selling as part of an effort to increase liquidity and attract more foreign investors. (Chart 10.)

Markets – fixed income

Yields finished the week higher as Fed-speak and US politics saw US Treasuries and Bunds sell off. Meanwhile, geo-political risk in the Eurozone saw some risk-off trading. (Chart 11.)

Fed chair Janet Yellen was resolute in pursuing a third rate hike this year, arguing the pick-up in wages as a good enough reason in spite of wavering inflation. Market consensus over the next Fed chair (Powell, least hawkish) and the approval of a budget resolution further supported the Fed's rate hike outlook. Markets now expect a hike in Dec-17 with over 90% probability. As such, US 10-year Treasuries were up 10 bps to 2.38%.

Meanwhile, uncertainty over Catalonia had investors initially favor Bunds, but those were later sold off alongside US Treasuries. Dovish ECB rhetoric, perhaps including an announcement to extend QE and that monetary conditions would remain accommodative for longer, kept the lid on higher rates. German 10-year Bund yields were up 5 bps on the week, to settle at 0.45%.

GCC sovereign yields ended the week higher as oil prices held steady and as they tracked US Treasuries. Yields for most sovereigns maturing in 2021 and 2022 increased by up to 8 bps, with Saudi 2022 yields seeing the largest bump to settle at 2.84%. (Chart 12.)

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