Trade war escalation and growth concerns lead to volatile markets

> Economic Research
+965 2259 5500
econ@nbk.com

Highlights

- **The escalating trade war and concerns over global growth rocked financial markets in August, pushing equities lower and taking the 10-year US treasury yield to below 1.5% for the first time in three years.**
- **US growth signals remain mixed, with weak manufacturing contrasting a still robust consumer sector. However the Fed remains under pressure to lower interest rates and a further cut is expected in September.**
- **The ECB also loosened policy in September, including a rate cut and the restart of its QE program from November. Political turbulence has increased in the UK, but a likely general election may still not yield a decisive move on Brexit.**

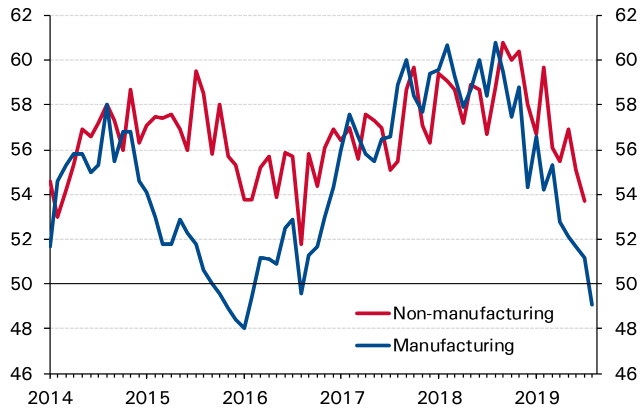
Trade war tensions – with the US and China announcing fresh tit-for-tat tariff hikes – and mounting anxieties over global growth continued to rock financial markets in August. Major equity indices dropped 1-5% on the month amid fierce volatility. Bond markets saw still larger moves, with the US 10-year treasury yield plunging more than 50 bps to below 1.5% on expectations that the US Fed – to be followed by other central banks – will continue to cut interest rates in the face of economic uncertainty. The troubles were also felt in the oil market, where Brent oil prices sank 7% on pessimism over the demand outlook but also the market of excess supply, despite the OPEC+ over-compliance with the production cut target.

US manufacturing activity in contraction territory

The US economy has continued to display mixed signals, with real signs of trouble for manufacturing contrasting a consumer sector still in very good shape. The manufacturing PMI, for example, at 50.3 in August recorded its lowest reading in a decade on deteriorating auto demand and a tariff and trade tension-linked fall in export orders. The equivalent ISM survey was even weaker, pointing to outright contraction in activity. (Chart 1.) However, consumer spending rose a solid 4.1% y/y in July and confidence remains strong, backed up by a tight labor market. There was also upbeat news from the revised national accounts for 2Q19, which saw private consumption upgraded to an annualized 4.7% q/q from 4.3% before, despite a downgrade to GDP growth from 2.1% to 2.0%. Since consumer spending accounts for 70% of the economy and is still doing well, GDP growth is so far not expected to slow much in Q3, at 1.5-2.0%.

Chart 1: ISM business activity surveys

(50=no change)

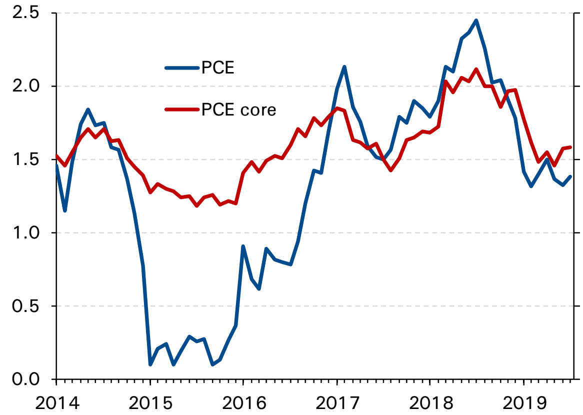


Source: Refinitiv

Nevertheless, the challenge facing the Federal Reserve is becoming ever more acute. Having cut rates by 25 bps in July, the bank is under pressure from both the financial markets and President Trump to loosen policy much further over coming months and "get ahead" of a future downturn as well as tackling low inflation, which was unchanged 1.6% y/y in July on the core PCE measure. (Chart 2.) But minutes of the last Fed meeting show that FOMC members were divided over July's cut, and given the ambiguous data there is a risk that the Fed could dent its credibility and deploy its limited firepower too soon. Futures markets take a dovish view, now pricing in a mid-September rate cut with certainty, and a near-90% chance of another cut by year-end. Fed policy will be influenced by the ability of the US and China to reach an agreement on the trade war, which despite the announcement of a return to official-level talks over coming weeks, still looks some way off.

Chart 2: US inflation

(% y/y, personal consumption expenditures definition)



Source: Refinitiv

European growth falls as ECB mulls inflation target shift

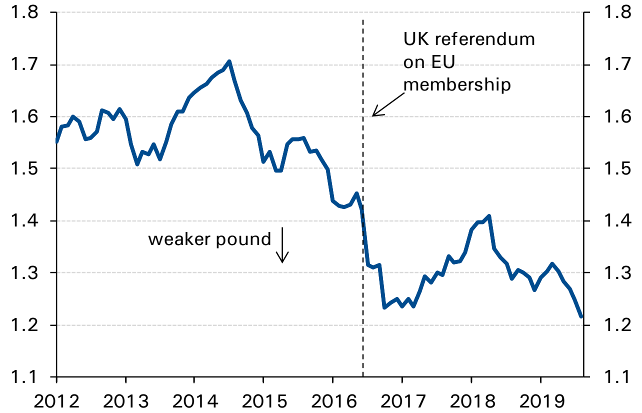
The European economy remains particularly exposed to weaker world growth. Retail sales in the crucial but export-dependent German economy – worth 30% of Eurozone GDP – dropped a larger-than-expected 2.2% m/m in July, while unemployment rose in August, raising fears that external weakness is filtering through to the domestic economy. Indeed, having fallen in Q2, GDP could decline again in Q3, putting Germany officially in recession. Eurozone growth, which slowed to just 0.2% q/q in Q2, could come in at little more than 1% this year overall.

The European Central Bank (ECB) made the shift to looser policy in mid-September, cutting the deposit rate 10bps to -0.5%, issuing stronger forward guidance and restarting the bank's asset purchase program at €20 billion per month from November. But the move was contentious, with some ECB members openly critical of the timing and efficacy of fresh stimulus, including the financial distortions caused by negative interest rates. While likely to support monetary loosening, Christine Lagarde, who will replace current ECB chief Mario Draghi on November 1st, has called for European governments to do more on fiscal policy to promote growth.

In the UK, the Brexit drama took a further turn when the new PM Boris Johnson, looking to reinforce his negotiating hand with the EU, opted to close parliament for five weeks from mid-September and reduce opposition to his threat to take the UK out of the EU without a deal at the end of October. Parliament however looks set to speed through legislation to block a 'no deal' exit, which would force Johnson to ask the EU for a fresh minimum three-month extension. A general election now looks all but inevitable, the result of which may still not be decisive for Brexit if it yields a minority government with a commitment to a second referendum. The uncertainty continues to hurt the UK economy, where construction orders fell the fastest in 10 years in August and the pound hit a 34-year low of $1.21 in August. (Chart 3.)

Chart 3: British pound exchange rate

(US$/GBP1)



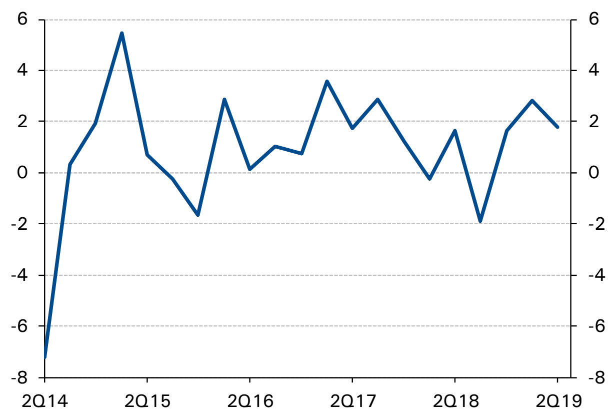
Source: Refinitiv

Japanese growth beats expectations

Japan's economic growth slowed from an annualized 2.2% in 1Q19 to a much better-than-expected 1.8% in 2Q19, as a pick-up in capital spending helped offset some of the ongoing weakness in the external sector. (Chart 4.) The strong growth rate has raised the stakes for a planned increase in the consumption tax from 8% to 10% in October. Analysts are penciling in a GDP contraction for Q3 if the much-delayed tax hike is imposed, as downward pressures from the external sector are compounded by potentially weaker growth in consumption. Meanwhile, the Bank of Japan made its biggest bond purchase cut since it embarked on its yield-curve control policy back in 2016, after a bond rally pushed bond yields near record lows. It now plans to buy between ¥250 and ¥550 billion of 10-year notes at each operation in September, as opposed to between ¥300 and ¥650 billion in August.

Chart 4: Japanese GDP

(% q/q, annualized)



Source: Refinitiv Note: latest figure is for early August

Yuan slides on trade tensions, growth concerns

According to the latest official PMI, Chinese factory activity remained in contractionary territory in August (49.5), consistent with the ongoing softness in domestic conditions and downward pressures on the external sector. While the private manufacturing survey surprised on the upside, pointing to an expansion in activity in August (50.4), export orders continued to fall. Amid signs of ongoing softness in the economy, China's central bank lowered corporate borrowing costs in a bid to prop up investments and ultimately growth. If trade tensions with the US continue to escalate, we are likely to see further pro-growth measures in the months ahead. Meanwhile, the yuan continued to fall further past RMB7/US$1 throughout August for the first time in 11 years, averaging RMB7.02 versus RMB6.88 in July.

Oil prices down again on trade war concerns

Worries over the global economic outlook continue to weigh on oil prices. Brent crude fell 7.3% in August to close at $60.4/bbl, the steepest monthly fall since May's decline of 11.4%. (Chart 5.) Brent, though still returning a robust 12% year-to-date, has lost about 19% of its value since its 2019-peak of $75 in April. The US administration's recourse to trade protectionism, engaging in escalating tit-for-tat rounds of tariffs with China – the latest of which sees China imposing tariffs on a range of US goods including oil – has been significantly bearish for global growth, oil demand and, by extension, oil prices. The weakening economic backdrop has led the IEA to revise down its projection for global oil demand growth in 2019 for a third time this year, by 100 kb/d to 1.1 mb/d. Meanwhile, demand-side worries have, along with surging US crude production (+800 kb/d to 12.5 mb/d in 2019), undermined OPEC+ efforts to limit supplies and eliminate the supply overhang, even while the producers' group serially over-complies (141% in July).

Chart 5: Brent crude oil price

($ per barrel, end of month)

Source: Refinitiv

GCC developments

In Saudi Arabia, indicators of consumer spending improved in July, with POS transactions rising (+18.7% y/y), but private sector credit growth remained low, slowing for a second month in a row in July (+3.4%). Lending growth in the UAE, however, rose to a more-than-two-year high of 5.1% in July, on the back of stronger public sector credit growth. Residential property prices in Dubai, however, continued to decline in July (-8.5%). And in more downbeat news, the UAE PMI fell to a multi-year low of 51.6 in August. In Kuwait, growth in the NBK consumer spending index eased slightly to 2.7% y/y in August but is still up on earlier in the year, backed by last December's easing in lending restrictions by the central bank. Finally, Omani authorities reported the country's budget deficit halving to a five-year low of OMR 661 million in the first half of 2019. Increases in oil, gas and corporate tax earnings boosted revenues (+11.4% y/y) while expenditures were down (-2.8%) due to lower investment; current spending was broadly unchanged.

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 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