Economic Update

NBK Economic Research Department I 12 June 2018

International Scene

Global growth at risk as trade tensions escalate following the G7 summit

> Daniel Kaye
Head of Research
+965 2259 3136
danielkaye@nbk.com

Highlights

- **Although the world economy is still set for strong growth this year, concerns over the global trade environment have intensified and political crises in Europe rattled financial markets in May.**
- **US unemployment fell to an 18-year low of 3.8%, supporting the case for more aggressive Fed policy tightening this year, while the negative impact of import tariffs on US industrial activity so far appears modest.**
- **The Japanese economy contracted in 1Q18 for the first time since 2015, potentially undermining the case for an early winding down of the central bank's ultra-accommodative monetary policy.**

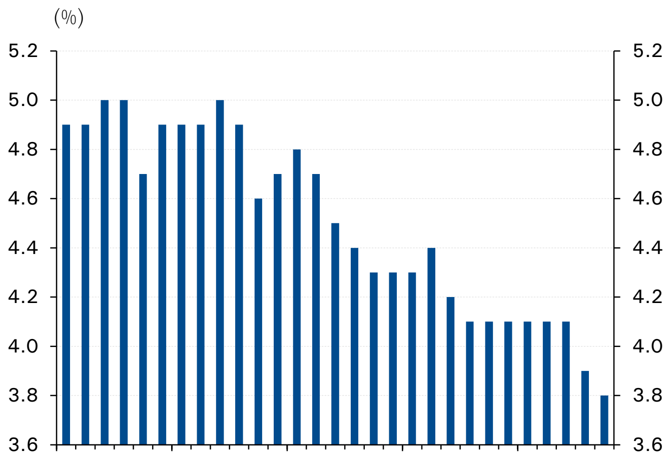
The past month has seen concerns over the global trade environment intensify, with the expiration of US wavers on import tariffs on key allies including Europe and North America prompting a backlash from the EU, which is threatening its own counter measures. This was followed by an acrimonious break-up of the G7 meeting in Canada, which saw US president Trump rail against perceived unfair trade practices and refuse to endorse the usual end-summit written accord. Meanwhile, political crises in both Italy and Spain rattled European bond markets, although tensions somewhat eased in early June. While the world economy is still set to record robust growth of nearly 4% this year, the OECD's latest report said that these and other risks "loom large" on the outlook, with growth still too dependent on government support and the need for structural reform increasingly urgent.

US growth to rebound in Q2, tariff impact so far muted

The US economy continues to perform strongly, despite signs of a moderation in growth early in the year as well as tightening monetary policy. The second release of 1Q18 GDP data saw growth revised down a touch to an annualized 2.2% from 2.3% (2.9% in 4Q17) on the back of slightly softer consumer spending and inventories; growth in the former slipped to just 1.0% from a very robust 4.0% the preceding quarter. But some analysts believe GDP growth could rebound to as high as 4% in 2Q18 helped by the impact of tax cuts, a tightening labor market and a stronger contribution from both inventories and net trade.

High–frequency indicators point to underlying strength in the consumer sector. Jobs growth picked up to 223,000 in May, beating its average for the first four months of 2018, while unemployment fell to 3.8% from 3.9% in April, reaching its lowest in 18 years. (Chart 1.) Consumer confidence, though slightly off its recent highs, remains extremely strong, while home prices are rising at a decent pace despite rising mortgage rates. Having dipped in Q1, data for April show that consumer spending got off to a strong start to Q2, up 0.6% m/m, backed up by solid income growth. The consumer sector accounts for more than two-thirds of the US economy.

Chart 1: US unemployment rate



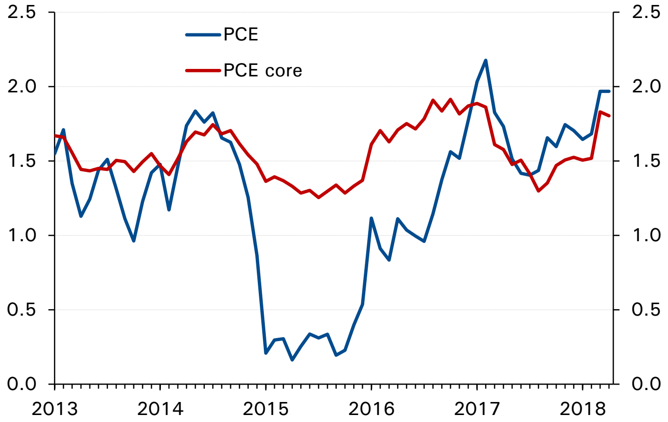
Source: Thomson Reuters Datastream

Although there are concerns among US manufacturers about the impact on costs and prices of recent tariff measures on imports of steel and aluminum, survey evidence suggests that the impact on demand has so far been minimal, with the ISM and PMI manufacturing gauges for May reporting rising orders, work backlogs and lengthening delivery times. Advanced data also show little tariff-related fallout on the merchandise trade deficit, which narrowed to $68 billion in April. But the report could take on greater significance once data on the post-tariff exemption period, starting June, is released later this summer.

The strong jobs figures for May were seen supporting the case for more aggressive Federal Reserve policy tightening this year. This is beyond the almost certain 0.25 bps rate hike expected at its policy meeting in mid-June – the second increase of the year which will take the target rate range to 1.75–2.00%. It also lifted the (futures market) probability of two additional rate hikes in 2018 to 35%, having softened earlier in the month on Italy-related concerns. The Fed's preferred inflation gauge, the PCE measure, hit the 2.0% target in April for only the fourth time in five years, though the less volatile 'core' measure remained at 1.8%. (Chart 2.)

Chart 2: US PCE inflation

(% y/y)



Source: Thomson Reuters Datastream

Eurozone sees mixed data but political uncertainty

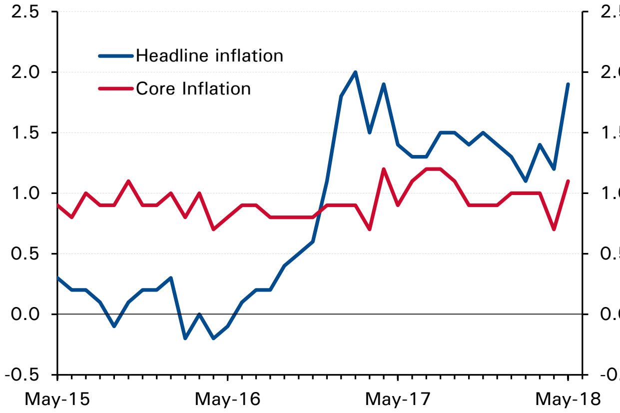
Economic indicators for the Eurozone were mixed but mostly soft in May and hint at a period of lower, if still healthy, growth. The Eurozone composite PMI came in well below expectations at 54.1 and down for a fourth consecutive month while consumer sentiment was little changed. Inflation jumped sharply to 1.9% mainly due to higher commodity prices, but core inflation was still well below the ECB's 2% target, at 1.1%. (Chart 3.)

Political factors were also at the fore across Europe. Following a tumultuous lead up, a populist, anti-establishment coalition government was sworn in in Italy. Its policy agenda includes a flat tax and the rollback of increases in the retirement age – all of which could strain already vulnerable public finances. Meanwhile in Spain, a corruption scandal led to the exit of the prime minister with a minority government led by socialist opposition leader Pedro Sánchez set to take the reins.

These developments may warrant more caution from the ECB. The bank is currently expected to end its QE program by end-2018 and start to hike interest rates by mid-2019. However, further softness in the data and increased political uncertainty could see the latter pushed back. The ECB will meet on 14 June, but no major announcements are expected until July.

Chart 3: Eurozone inflation

(% y/y)



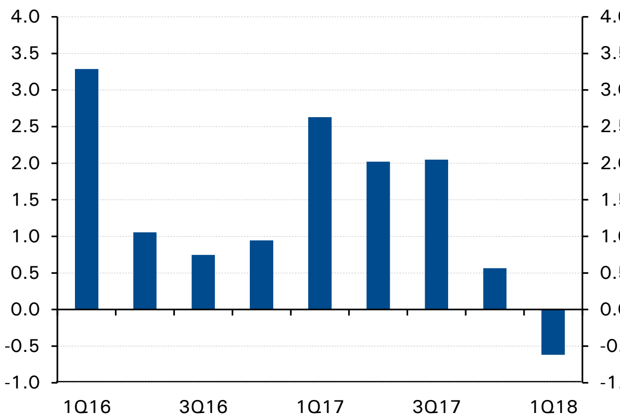
Source: Thomson Reuters Datastream

Japanese economy in first contraction since 2015

GDP fell by an annualized 0.6% in 1Q18, down from growth of 0.6% in 4Q17 and marking the first contraction in activity since 2015. (Chart 4.) Consumption, investment and export growth all came in weaker – the latter reflecting a less favorable external climate. First estimates of growth in Japan can be volatile, and growth is expected to recover in Q2 helped by the weaker yen in relation to the US dollar as well as the tight labor market.

Chart 4: Japanese GDP

(% q/q annualized)



Source: Thomson Reuters Datastream

Latest data, for example, showed export growth accelerating from 2.1% y/y in March to 7.8% y/y in April on the back of higher car and manufacturing equipment shipments, while unemployment stood at 2.5% – still one of the lowest rates in the world. Nevertheless, the weak Q1 GDP data could undermine the case for an early winding down of the Bank of Japan's ultra-loose monetary policy.

Oil prices ease back after touching $80 in May

Having notched up a third consecutive month of gains in May (+3%) and briefly topping a three-and-a-half-year high of $80/bbl, the price of Brent crude oil was on the back foot in early June, pulled down by the possibility of OPEC+ increasing production during the second half of the year. (Chart 5.) The change in strategy could come after the OPEC ministerial meeting on 22 June. However, although it is likely that the production cut agreement will begin to be wound down slowly in July, it is not a foregone conclusion since the majority of producers do not have the capacity to increase production to mitigate the fall in oil revenue resulting from lower prices. Meanwhile, US crude output continues to break records, surging to a high of 10.76 mb/d in the week-ending 25 May.

Chart 5: Brent crude oil price

($per barrel)

Source: Thomson Reuters Datastream

Higher oil prices help replenish GCC FX reserves

With oil prices higher, regional economies continue to improve. Trade surpluses are back, reserves are being replenished – Saudi Arabia's official foreign currency reserves topped $500 billion for the first time in almost a year – and regional non-oil sectors are witnessing increased government spending. Despite ongoing concerns about the fiscal position, the IMF recently revised up its forecast for Bahrain's growth this year to 3.2% from 3.0% on the back of increased infrastructure investment and a recovery in oil production, while S&P reaffirmed Bahrain's long and short-term foreign and local currency ratings at B+/B with a stable outlook based on the kingdom's continued access to foreign capital. Growth in Saudi Arabia, however, remains disappointing, weighed down by barely positive credit growth and contracting bank deposits, even while retail POS activity remains well up on last year at 18% y/y in April. Still, the non-oil PMI managed to improve slightly to 53.2 in May.

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