US payroll gains softening at 138K; US & EU stocks advance; Saudi net foreign assets shrink further

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,479	-0.84	-1.49
Bahrain (ASI)	1,325	0.84	8.58
Dubai (DFMGI)	3,352	0.74	-5.07
Egypt (EGX 30)	13,467	2.85	9.09
KSA (TASI)	6,864	-0.12	-4.81
Kuwait (Price Index)	6,813	1.88	18.53
Oman (MSM 30)	5,435	0.60	-5.38
Qatar (QE Index)	9,940	-1.20	-4.76
MSCI GCC	464	-0.22	-2.32
International			
DAX	12,823	1.75	11.69
DJIA	21,206	0.60	7.31
FTSE 100	7,548	0.00	5.67
Nikkei	20,177	2.49	5.56
S&P 500	2,439	0.96	8.94

Commodities	$/bbl	Change (%) weekly	YTD
Brent crude ($/bbl)	49.9	-4.22	-12.09
KEC ($/bbl)	47.8	-1.16	-7.79
WTI ($/bbl)	47.7	-4.30	-11.28
Gold ($/t oz.)	1278.5	1.81	10.56

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.303	-0.13	-0.75
KWD per EUR	0.341	0.74	7.29
USD per EUR	1.128	0.86	7.28
JPY per USD	110.40	-0.82	-5.54

Interbank rates	%	Change (bps) weekly	YTD
Kibor – 3 month	1.63	0.0	18.8
Qibor – 3 month	1.92	-1.9	14.1
Libor – 3 month	1.22	2.1	22.5

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2021	2.29	-1.4	-25.4
Dubai 2021	2.89	-1.0	-43.9
Qatar 2021	2.41	2.6	-54.0
Saudi Arabia 2021	2.62	-1.4	-43.1
International			
UST 10 year	2.16	-9.1	-27.3
Bunds 10 year	0.27	-6.3	6.4
Gilts 10 year	1.04	3.2	-19.8
JGB 10 year	0.05	1.7	0.4

Source: Thomson Reuters Datastream

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Summary

The news cycle is tamer as we approach the summer doldrums, and as the GCC/MENA region settles into the holy month of Ramadan. Equities are either advancing slowly but making new highs (US, EU) or moving sideways (GCC). Oil prices, however, are on the back foot, with Brent closing last week below $50/bbl despite some bullish statements out of the OPEC/non-OPEC camps. Major investment houses have revised their oil forecasts for this year and next (some up, some down). We continue to expect somewhat firmer prices ahead and an average oil price of $55/bbl for this year. Excess global crude inventories should continue to draw down slowly, and the driving/travel season is upon us which should boost crude demand.

US nonfarm payrolls gained 138K new jobs in May, pushing the 3-month average to 121K (Chart 1.), the lowest since 2012 (see USA below). Long-term interest rates came off last week (US 10-year note at 2.16%), while the shorter end has priced in a coming (13-14 June) 25 bps Fed hike, notwithstanding softer US employment. The June Fed hike appears to have been discounted by FX markets as the USD continues to drift lower, in part thanks to firm eurozone economic data, and the expectation that the ECB will have to adjust policy soon, or at the very least signal such. For the Fed, the softer employment report will prompt reassessments for a less aggressive Fed view beyond June and for 2018.

In the GCC, economic activity and volumes are in Ramadan mode, with no catalysts in sight. The regional PMIs, due later this week, continue to signal moderate and steady growth for the countries.

Important elections are in store in the UK (June 8) where Theresa May appears on the rocks, and in France (June 11) where the new president Macron could be on the verge of getting a good working majority in parliament.

International macroeconomics

USA: May nonfarm payrolls were slightly disappointing at 138K, with downward revisions that left the 3-month average at a 5 year low of 121K. (Chart 1.) The unemployment rate, however, fell to a 16-year low of 4.3%, but it did so for the "wrong" reason: a drop in the labor force. Wage inflation remains contained, with y/y wage growth steady at 2.4%.

The May manufacturing PMI points to moderate and steady growth as well, with the index at 54.9. All data appear in line with the latest Fed Beige Book which reported more of the same: modest to moderate growth all over, with tighter labor markets, but no undue wage or price pressure.

The slightly lower-than-expected numbers are not enough to derail the expected 25 bps hike in the federal funds target rate at the 13-14 June FOMC meeting. The numbers do, however, reinforce our view that one or two hikes will do it for this year, no need for more aggressive moves.

Chart 1: US Nonfarm payroll gains

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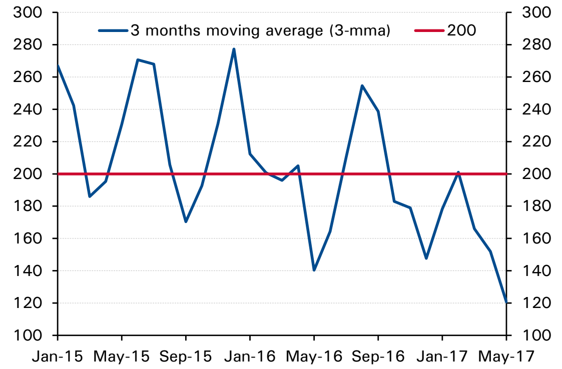
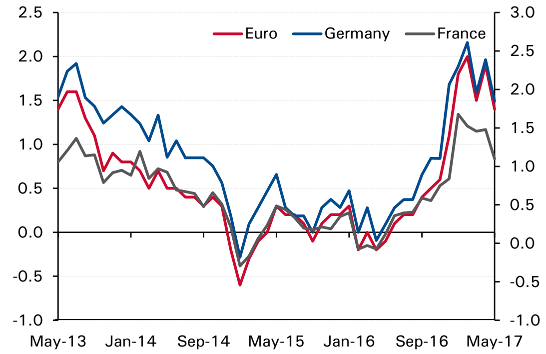


Source: BEA

Chart 2: Eurozone inflation

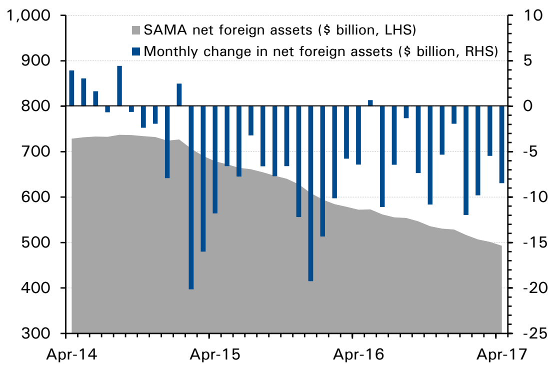
(% y/y)



Source: Eurostat

Chart 3: Saudi net foreign assets

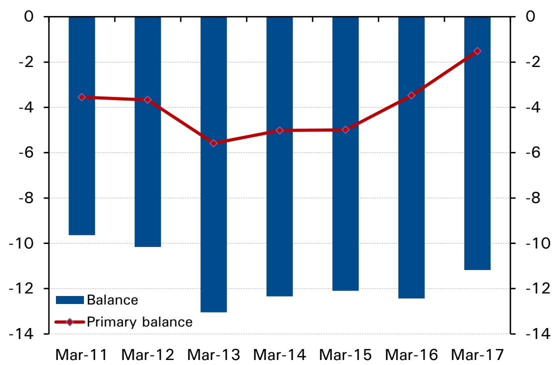
($ billion)



Source: SAMA

Chart 4: Egypt budget balance

(% of GDP, fiscal-year-to-date, excluding grants)



Source: Ministry of Finance, NBK estimates

Eurozone: Eurozone's May flash inflation came in at 1.4%, down from the 1.9% in April, and well below the ECB's 2% target. This modest reading backs ECB President Draghi's dovish views of a subdued inflationary trend and the need for continued stimulus. Nonetheless, markets are expecting the ECB to adjust its language to a more upbeat tone on 8 June, in accordance with the recently observed pick-up in growth indicators. (Chart 2.)

France's legislative elections are expected in two rounds on 11 June and 18 June. French polls are showing President Macron's party, "La République en Marche", in the lead with around 30% of the votes. Marine Le Pen's "Front National" is second, with polls estimating that her party will receive around 18% of the votes. It is difficult to see, however, if these poll results will translate into an outright majority win for Mr. Macron.

The Italian government is close to finalizing its new electoral law, paving the way for earlier-than-expected elections (they were due in May 2018). Former Italian PM and head of the Democratic Party, Matteo Renzi, is among those calling for an early election in September, which may coincide with the German national elections.

UK: According to the latest PMI, UK manufacturing activity fell slightly in May to 56.7 from a three-year high in April. Based on the evidence of the last few months, the manufacturing PMI has not been a good indicator of actual economic output. While the manufacturing PMI showed constant activity in 1Q17, for example, the official series, published afterwards, reported three consecutive monthly declines.

A series of opinion polls conducted over the last 10 days that alluded to a narrower Conservative majority in this week's general election elicited panic within PM May's government and raised jitters in the currency markets. Last week's YouGov poll showed the Tories' lead over Jeremy Corbyn's Labor Party whittled down to just 3%, with the PM's standing taking a battering over her lackluster election campaign. Sterling was as low as 1.284: USD (+4.3% ytd) and 1.143:EUR (-2.5% ytd) last week. (All before the London terrorist attack of last Saturday)

GCC & regional macroeconomics

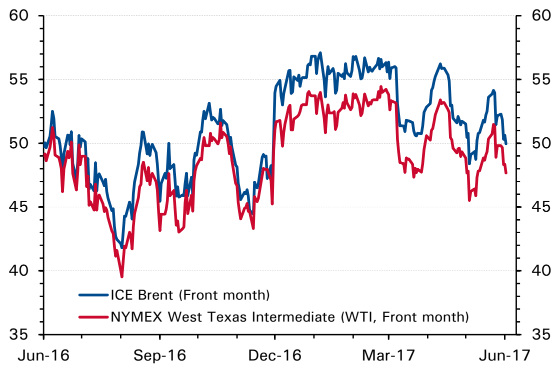
Kuwait: The value of projects awarded during April and May was KD 0.3 billion (vs. KD 1.4 billion in 1Q17). Awards were dominated by three road projects valued at KD 197 million. Another KD 6.6 billion worth of awards are expected this year, led by the construction sector.

Saudi Arabia: SAMA data for April continue to show the kingdom's net foreign assets (NFAs) shrinking. NFAs fell by $8.5 billion to $492 billion, which is the lowest since mid-2011. (Chart 3.) The fall came despite the issuance of $9 billion in sovereign sukuk in March, the proceeds from which have yet to appear on the kingdom's balance sheet. The NFA decline is likely a reflection of BOP-related outflows such as overseas investing by the Public Investment Fund (PIF), imports of goods and services and/or private sector transfers abroad.

Private sector credit growth slowed to -0.8% y/y in April, amid the weakest retail loan growth in years. This is a major concern for policymakers. The value of POS transactions did, however, rise to 11.4% y/y by the end of the month, possibly boosted by the reinstatement of public sector bonuses and allowances; this could signal an uptick in consumer confidence ahead of the historically slow months of Ramadan and the summer.

Chart 5: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

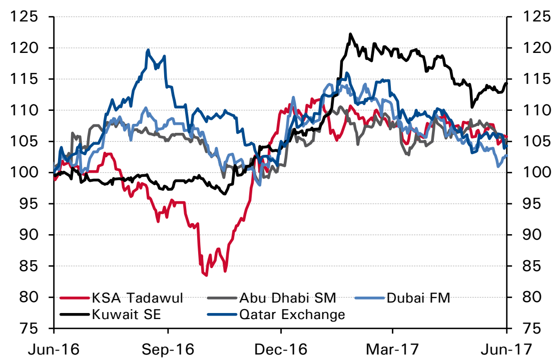
Chart 6: Total return indices

(rebased, 2 June, 2016=100)

Source: Thomson Reuters Datastream

Chart 7: GCC Markets

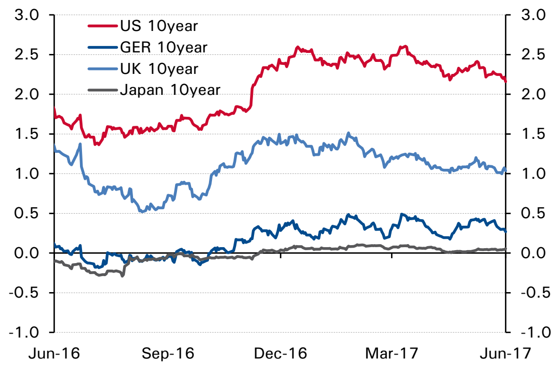
(rebased, 2 June, 2016=100)



Source: Thomson Reuters Datastream

Chart 8: Global bond yields

(%)



Source: Thomson Reuters Datastream

Egypt: The fiscal deficit narrowed during the first nine months of FY16/17 through March 2017 to 11% of GDP. An improvement of 1.1 percentage points came from increased control of the wage bill and healthy tax revenue growth. Revenues benefited from the introduction of a value-added tax which saw tax revenues increase by 27% y/y. The primary deficit (excluding interest payments) more than halved to 1.5% of GDP. (Chart 4.)

Markets – oil

What does OPEC have to do to raise the oil price back above $55/bbl? That is the question currently vexing Saudi Arabia and its counterparts. Oil prices closed down (by more than -4% w/w) for the second consecutive week on Friday, with Brent falling to $49.95/bbl and WTI to $47.66/bbl. (Chart 5.) Markets appear entirely unfazed by the bullish statements coming out of both the OPEC and non-OPEC camps; on Wednesday, Saudi and Russian ministers renewed their pledge to bring global stocks down to 5-year average levels and reiterated their plan to cooperate in managing supply beyond the expiration of the 9-month output cut extension deal in March 2018. Instead of gaining on the news, the oil price dropped by almost 3%.

Over in the US, not even the largest weekly decline in crude stocks since December (6.4 million barrels) or record refinery runs, both of which should have supported prices, could pull sentiment out of the doldrums and shift the market's attention away from rising shale output. Last week US crude production rose by 22,000 b/d to reach 9.34 mb/d after oil drillers added another 9 rigs—the 19th consecutive weekly gain—to more than double (722) the rig count from a year ago.

Markets – equities

Equity markets were lacking direction earlier in the week but eventually gained ground. The MSCI World index advanced 0.8%. US stocks, having started on a weak footing as president Trump concluded his international tour and headed back home, bounced back later in the week to record new highs. The S&P 500 and DJIA closed the week up 1% and 0.6%, respectively and at historic highs. European equities closed the week in positive territory, supported by weaker-than-expected inflation figures and Mario Draghi's comments about the need for continued expansionary monetary policy in the euro area. The Euro Stoxx 50 was up 0.2%. Emerging markets were flat on the week. (Chart 6.)

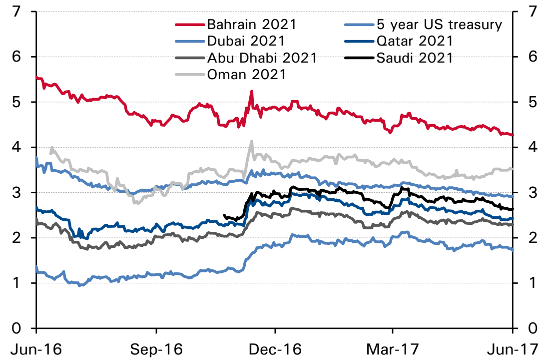
Absent support from oil prices last week, regional markets underperformed; the MSCI GCC index was off 0.2%. Qatari and Abu Dhabi equities took another hit from the MSCI rebalancing, with some of the heavily weighted stocks there seeing big outflows; the two markets' general indexes retreated 1.2% and 0.8%, respectively. (Chart 7.)

Markets – fixed income

Global benchmark bonds continued to trade "risk-off" as old concerns crept back into focus and data releases missed expectations. Investors were worrying last week over early elections in Italy, PM May's call for a Brexit with no deal, and Greece's inability to pay come July. The release of softer-than-expected US housing and employment data and tepid EZ inflation data further supported bond prices. Meanwhile, a dovish speech by ECB president Draghi kept EZ stimulus expectations hinged, with little reaction from fixed-income markets despite a potential change in tone on 8 June. May's lower-than-expected non-farm payroll will most likely not derail the Fed from hiking rates at the 13-14 June meeting; markets are expecting

Chart 9: GCC bond yields

(%)



Source: Thomson Reuters Datastream

the rise with 94.6% certainty. Future rate actions, however, are now seen as relatively less likely. This was reflected in the 9 bps drop over the week in US 10-year yields, which settled at 2.16%. 10-year Bunds were also down 6 bps to 0.27%. (Chart 8.)

GCC sovereign yields on bonds maturing in 2021 for Abu Dhabi, Dubai, and Saudi fell this week, tracking US treasuries and dropping between 1 bp and 2 bps. Qatar's 2021 bond, however, added 3 bps, following its credit rating downgrade, as did Oman's 2021 bond. Meanwhile, Kuwait's 2022 bond saw its yield drop 7 bps, ending the week at 2.49%. (Chart 9.)

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