Politics provides edgy backdrop for world markets; mixed news for Saudi after landmark reform ruling

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,397	-1.29	-3.28
Bahrain ASI	1,283	-1.87	5.16
Dubai FM	3,564	-1.89	0.94
Egypt EGX 30	13,889	1.41	12.50
S&P GCC 40	1,032	-0.79	-10.69
Kuwait SE	6,680	-2.47	16.21
KSA Tadawul	7,283	-0.59	1.01
Muscat SM 30	5,137	0.72	-11.16
Qatar Exchange	8,312	-0.58	-20.35
International			
CSI 300	3,837	-0.03	15.91
DAX	12,829	1.88	11.74
DJIA	22,405	0.25	13.37
Eurostoxx 50	3,595	1.51	9.25
FTSE 100	7,373	0.85	3.22
Nikkei 225	20,356	0.29	6.50
S&P 500	2,519	0.68	12.53

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	57.5	1.20	1.27
KEC	53.9	0.65	3.00
WTI	51.7	1.99	-3.82
Gold	1281.5	-0.91	11.43

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.302	0.17	-1.22
KWD per EUR	0.361	0.00	13.39
USD per EUR	1.181	-1.17	12.36
JPY per USD	112.470	0.45	-3.76
GBP per USD	1.340	-0.70	8.59
EGP per USD	17.630	0.11	-2.06

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor - 3 month	2.45	0.0	35.0
Kibor - 3 month	1.75	0.0	31.3
Qibor - 3 month	2.40	-9.9	61.8
Eibor - 3 month	1.56	0.1	8.2
Saibor - 3 month	1.79	-0.2	-24.4
Libor - 3 month	1.34	0.7	33.7

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.13	0.3	-40.2
Dubai 2021	2.98	5.6	-31.8
Qatar 2021	2.81	3.3	-12.2
Kuwait 2022	2.54	7.3	n/a
Saudi Arabia 2021	2.85	-9.7	n/a
International			
UST 10 Year	2.33	6.4	-10.6
Bunds 10 Year	0.46	1.0	25.4
Gilts 10 Year	1.37	1.1	12.6
JGB 10 Year	0.06	4.0	1.5

Source: Thomson Reuters Datastream; as of Friday's close 22/09/2017

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Overview

A combination of fallout from the German elections, edginess ahead of the Catalan independence vote today, hawkish comments from Fed Chair Yellen and progress on President Trump's proposed tax overhaul benefitted the US dollar last week, pushing it up 1% on a trade-weighted basis for its best performance of the year. US treasury yields also rose. Meanwhile, reports that the latest Brexit talks between the UK and EU had been 'more constructive' than those before boosted confidence that the two sides would ultimately reach a deal.

It was also another decent week for oil, with the price of Brent crude hitting $59 pb for the first time since 2015; Brent has now risen some 28% since mid-June. One driver was the threat by Turkish President Erdogan to cut off the pipeline carrying crude from northern Iraq, in response to the Kurdish independence referendum. But there is also growing confidence among producers that the market has turned a corner, with some arguing that the 'lower for longer' period for oil is drawing to a close.

In the GCC, there was mixed news for the region's largest economy, Saudi Arabia. The landmark decision by King Salman to grant women the right to drive from June 2018 provided striking evidence of the government's commitment to its reform and modernization program, soon after doubts had been raised over the timing of the Aramco IPO. The move should provide support for key industries including autos, insurance and retail.

Less positively, new figures showed GDP falling for the second successive quarter in Q2. And index provider FTSE Russell opted against – for now – upgrading the kingdom to Emerging Market status, which could have led to a large inflow of capital to the country's stock market. Neighboring Kuwait, however, was upgraded, putting it on a par with the UAE and Qatari markets.

International macroeconomics

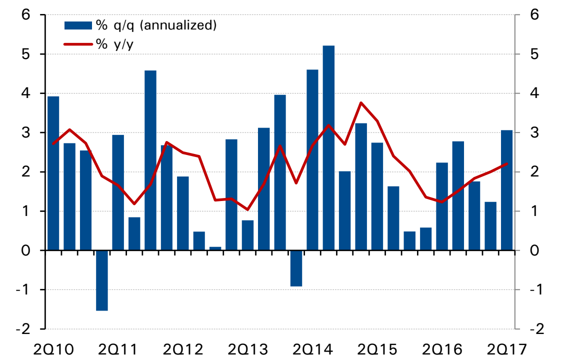
USA: After months of anticipation, the Trump administration outlined its plans for a major tax overhaul which would significantly reduce taxes on businesses and some individuals. The proposal would cut the corporate tax rate to 20% from 35% and reduce the top rate for individuals. Early estimates say the measures could cost the government around $2.2 trillion over ten years, or just under 1% of GDP. More details should be forthcoming and the markets will be focusing on the ability of the Congressional majority to pass anything significant (this year).

GDP growth was revised slightly upward for 2Q17 to an annualized 3.1% q/q, though the y/y pace remains slower at 2.2%. Growth in 3Q17 is expected to come in somewhat lower as well due to the impact from the severe hurricane weather. (Chart 1.)

Eurozone: Chancellor Angela Merkel and her Christian Democrats (CDU) are set to govern for their fourth consecutive term, albeit with reduced support. Markets were alarmed by the unimpressive victory (32%), as voters abandoned center parties in favor of the far-right. Alternative for Germany (AfD), an anti-immigration nationalist party, won an impressive

Chart 1: US GDP growth

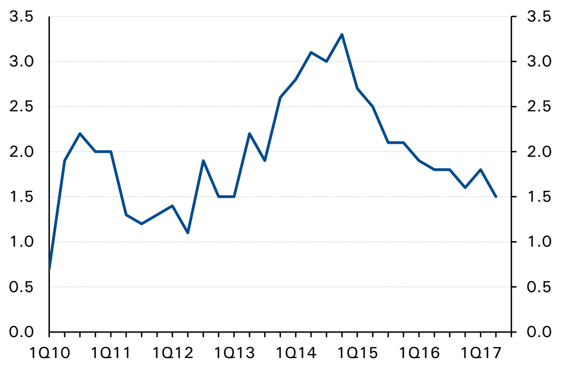
(%)



Source: U.S. Bureau of Economic Analysis

Chart 2: UK real GDP

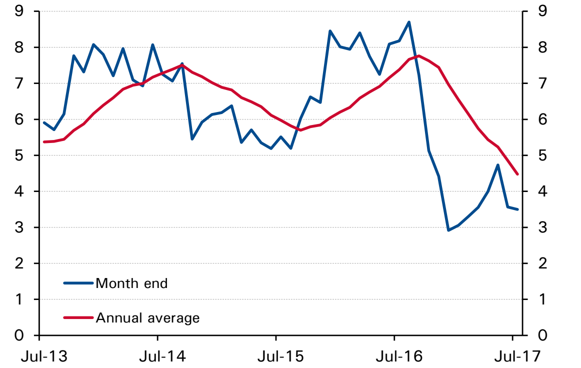
(% y/y)



Source: Office for National Statistics

Chart 3: Kuwait private credit growth

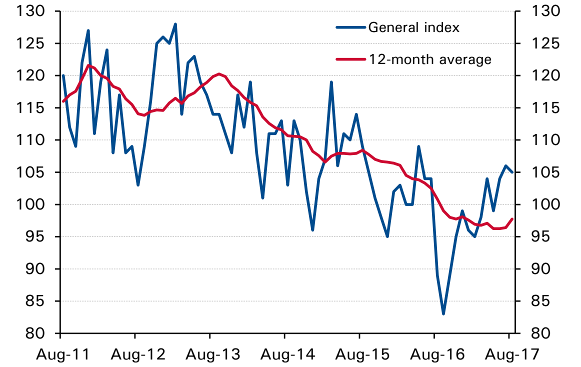
(% y/y)



Source: Central Bank of Kuwait

Chart 4: Kuwait consumer confidence

(index)



Source: ARA Research & Consultancy

13% of the votes and gained 94 seats. With the Social Democrats (21%) clearly opposed to allying again with the CDU, Chancellor Merkel must pursue a first-time and fragile coalition with the Free Democrats (11%) and the Greens (9%). The euro weakened to 1.18 against the US dollar from 1.20 prior to the vote. Stocks, however, took the outcome in stride and were up 1.5% on the week.

In a speech on Tuesday, President Macron pleaded for a more unified European Union, a mainstay of his governing agenda. A call for a centralized EU budget, led by an EU finance minister, was amongst his many proposals, which also covered corporate taxation and border control. Meanwhile, Catalonians will be holding an independence referendum today, despite strong opposition from the Spanish government.

Both September's flash headline and core Eurozone inflation came in steady at 1.5% and 1.3%, respectively, missing expectations. The modest momentum highlights the prevalent sluggishness in consumer prices. This may not deter the ECB from announcing a reduction to its QE program in October.

China: Chinese data showed that the total assets of China's central state-owned enterprises (SOEs) in 2016 grew 80% compared to 2011, reaching 50.5 trillion yuan (about $7.62 trillion). The growth was bolstered by ongoing reforms since 2012; these boosted the efficiency and competitiveness of the SOEs. The number of SOEs declined to 98 from 117 five years ago. The government has also announced that the debt levels are under control and the risk level is "reasonable".

Japan: Prime Minister Shinzo Abe called a snap election for 22 October, in an effort to capitalize on his recent strength politically. In an effort to bolster his support, he has promised to maintain his tough rhetoric against North Korea and pledged an $18 billion fiscal stimulus package that will also facilitate structural reform. The package would be financed by an increase in the consumption tax in October 2019.

UK: Revised data for Q2 confirmed economic growth at 0.3% q/q, on a par with Q1 but leaving the UK at the bottom of G7 growth. The annual growth rate in Q2 was revised down to 1.5% from 1.7%. Weakness was driven by modest growth of 0.2% q/q in household spending. The soft data casts some doubt on the next move for interest rates: many analysts still expect a 0.25% policy rate hike in November in light of recent hawkish comments by BoE governor Mark Carney, but the decision now looks like a closer call than before. (Chart 2.)

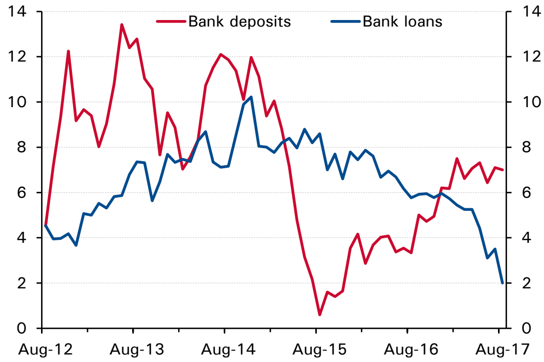
GCC & regional macroeconomics

Kuwait: Credit was down in July, with growth slowing slightly to 3.5% y/y (Chart 3). The month saw a net decline of KD 143 million in credit. Most of the weakness in July was from the regular start-of-quarter drop in securities lending, though there was also some softness in other business sectors. By contrast, lending to the real estate sector and households was robust. Private deposits were down.

Consumer confidence held up in August. Though the Ara index retreated slightly to 105, it remained above 100 points for the third consecutive month. (Chart 4.) All sub-indices improved in the month, with the exception of the current-employment and durables components. Overall, we think the data show continued stabilization in the consumer sector.

Chart 5: UAE bank loan and deposit growth

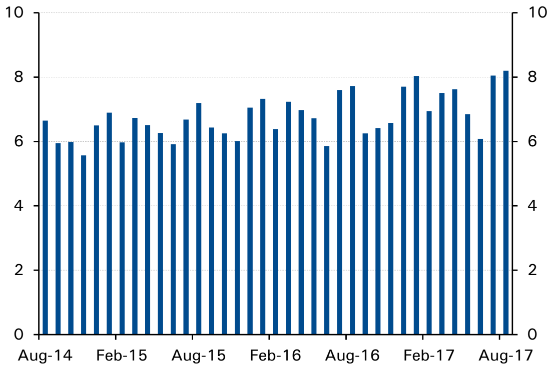
(% y/y)



Source: Central Bank of the UAE

Chart 6: Dubai Int'l Airport passenger traffic

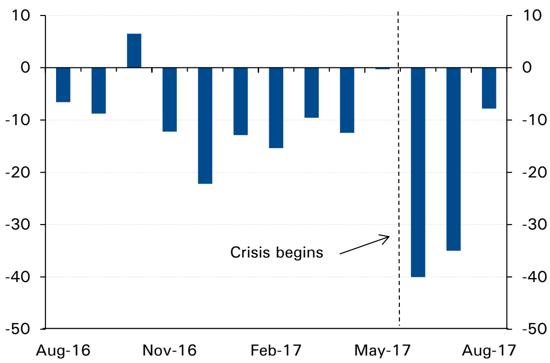
(millions)



Source: Dubai airports

Chart 7: Qatar goods import values

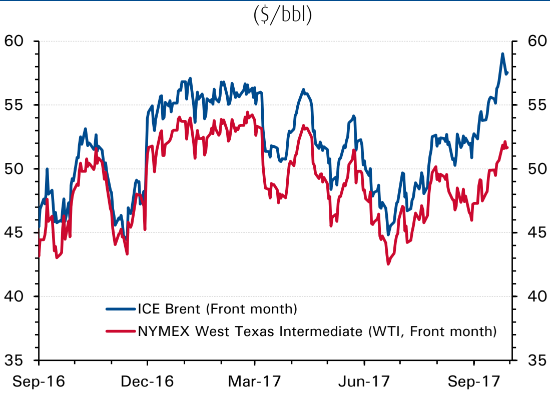
(% y/y)



Source: MDPS / NBK

Chart 8: Benchmark crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

Kuwait's equity market was upgraded to "secondary emerging market" status by FTSE Russell on the back of recent market reforms. The decision, which will take effect in September 2018, is the first time Kuwaiti equities are to be included in an emerging market index and reflects the significant progress that has been made in making the local bourse more liquid and attractive to foreign investors. (See market section for more.)

Saudi Arabia: Through a landmark royal decree issued last week, the Saudi authorities have permitted women to drive for the very first time, starting from June 2018. This is immensely significant for both social and economic development in the kingdom. As well as the gains to the automotive, insurance and consumer industries, there is the much larger productivity dividend that could accrue to the kingdom through higher female workforce participation.

On a more disappointing note, index provider FTSE Russell opted not to upgrade Saudi Arabia to Emerging Market status – though promised to review the decision in March (see the equities section below). The move would likely lead to a fresh inflow of capital to the equity market. Meanwhile, GDP was revealed to have fallen for the second successive quarter in Q2, down 1.0% y/y. Oil sector GDP fell 1.8% y/y on the continuation of OPEC-wide production cuts. Growth in the non-oil sector was slow though unchanged from Q1 at 0.6% y/y, with the private sector softer still at 0.4%.

The kingdom issued $12.5 billion in sovereign bonds last week, bringing its total international issuance (including sukuk) in 2017 to $21.5 billion and coming on top of its emerging market record $17.5 billion issue last October. (See the bond section below.) The amount compares to our forecast of a $55 billion fiscal deficit for this year.

UAE: Higher policy rates and tighter lending rules continue to drag credit growth lower. In August, lending growth dipped to a multi-year low of 2.0% y/y from 3.5% y/y in July, mainly on the back of a drop in private sector credit growth and the continued decline in lending to government-related entities. Deposit growth, by contrast, remained solid, steadying at 7.0% y/y. Growth in deposits has been buoyed over the past year by higher oil export receipts, which have helped replenish government deposits. (Chart 5.) Given that credit growth continued to ease against a backdrop of solid deposit growth, the loan-to-deposit ratio slipped from 100.1% in July to 99.8% in August.

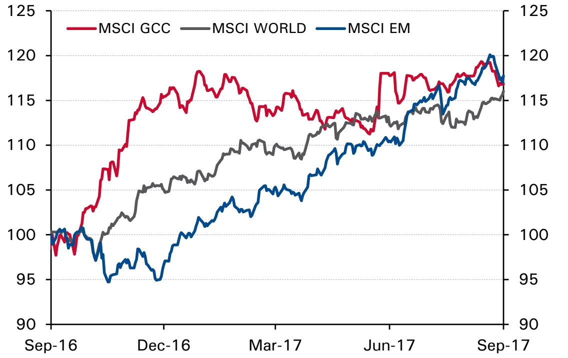
Dubai International Airport witnessed its busiest month on record in August. The number of passengers passing through the airport rose to 8.2 million in August from 8.0 million in July. (Chart 6.) Whilst the latest rise was helped by seasonal factors it also reflects an underlying improvement in tourism. Looking at the average level of passenger traffic, it currently stands at 7.4 million per month thus far in 2017 – higher than the 6.9 million average recorded in 2016.

Qatar: Trade figures show that the Qatari economy has begun to normalize after the initial shock from the embargo imposed by some of its GCC neighbors. After plunging by around one-third in the months following the blockade, the value of Qatari goods imports rebounded by 39% m/m in July (to QAR8.7 billion), taking them back close to pre-crisis levels. Exports also rebounded, albeit after a more modest post-embargo fall.

The recovery likely reflects the authorities determined efforts to find alternative trade routes for goods previously sourced/destined for Saudi Arabia and the UAE. New shipping routes were opened with countries

Chart 9: Total return indices

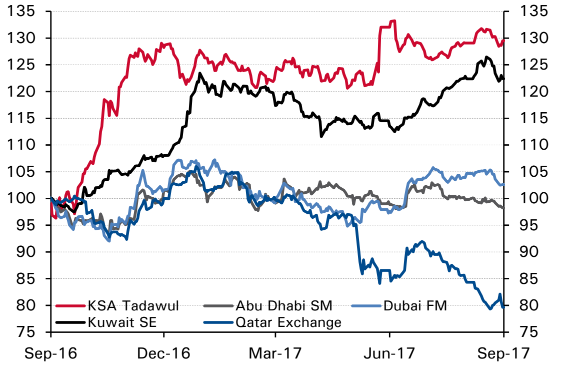
(rebased, 29 September 2016=100)



Source: Thomson Reuters Datastream

Chart 10: GCC markets

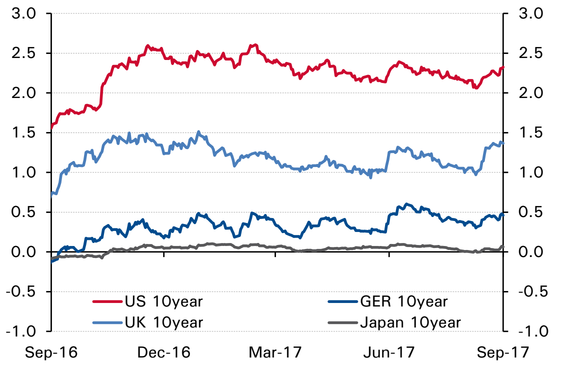
(rebased, 29 September 2016=100)



Source: Thomson Reuters Datastream

Chart 11: Global benchmark yields

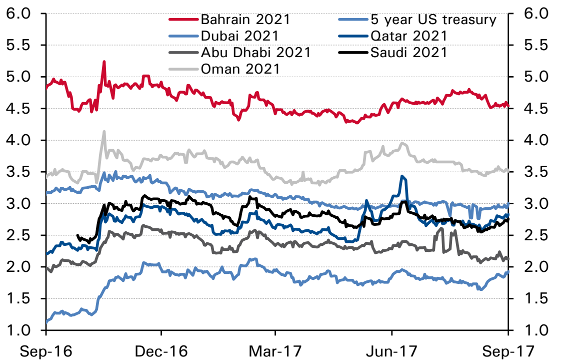
(%)



Source: Thomson Reuters Datastream

Chart 12: GCC yields

(%)



Source: Thomson Reuters Datastream

including Oman, Pakistan and Turkey. Some of the rise in import values, however, could reflect the higher cost of shipping products from these farther away markets. The recovery in physical trade volumes may not have been as large. (Chart 7.)

Egypt: The Central Bank of Egypt kept its policy rates on hold at its latest meeting, choosing to see inflation decline further before it begins to bring rates lower. Headline inflation remained elevated at 32% y/y in August, though the monthly price gain showed some easing.

Markets – oil

It was another notable week for oil, with Brent crude prices reaching a 2-year high early of $59 pb early in the week, and US-based WTI hitting a slightly less impressive 5-month high of $52. Support came from a combination of solid demand in Asia, tight OPEC supplies and a threat from Turkish President Erdogan to cut off pipeline carrying crude from northern Iraq in response to the Kurdish referendum on independence. Later in the week, however, Brent crude edged back down, undermined by the stronger US dollar. WTI held up better on news that US crude stocks fell as refineries continued to come back online after Hurricane Harvey. Brent ended the week up 1.2%, while WTI rose 2.0%. (Chart 8.)

Markets – equities

Equity markets were mixed last week with the MSCI World All Country index closing up 0.5%. US equities saw some profit-taking before bouncing back as President Trump's pro-business tax plan was unveiled. The S&P 500 and DJIA closed up 0.7% and 0.2%, respectively. European equites were also wobbly earlier in the week as markets tried to interpret the German election results but ended the week on a positive note, as the Euro Stoxx 50 advanced 1.5%. Emerging market equities, on the other hand, were dealt a blow with the MSCI EM retreating 1.2% on the week as the US tax plan sparked dollar repatriation fears. (Chart 9.)

Regional markets were sold off last week in line with emerging markets with the MSCI GCC closing down 1.2%. Dubai, being more susceptible to international markets, was the worst performer with its general index shedding 1.9% on the week. Saudi Arabia and Kuwait also saw some profit-taking ahead of the widely anticipated FTSE upgrade. (Chart 10.)

On Friday, FTSE Russell announced that it is adding Kuwait to its emerging market index while denying Saudi Arabia the inclusion (for now). Both markets have been lauded for implementing reforms and structural changes in recent years but the Tadawul still lags in some criteria. The Saudi market is to be reassessed in March and is expected to have met the requirements for inclusion by then.

Markets – fixed income

Benchmark yields shot up over the week as investors digested the latest iteration of President Trump's tax plan and Fed Chair Janet Yellen's unwavering pursuit of monetary tightening, despite modest inflation. This offset early safe-haven buying spurred by increased North Korean tension and Chancellor Merkel's weaker election win. 10-year US Treasuries settled at 2.33%, up 6 bps, and Bunds at 0.46% bps. (Chart 11.)

Most GCC sovereign yields tracked US Treasuriess higher. Yields for Dubai and Qatar 2021 and Kuwait 2022 were up between 3-7 bps. Meanwhile, Saudi 2022 yields tightened following its third dollar-denominated issuance, dropping 10 bps to settle at 2.85%. (Chart 12.)

Saudi Arabia issued its second international bond, offering $12.5 billion to investors in 3 tranches. It sold $3 billion in 5-year debt at 110 bps over Treasuries, $5 billion in 10-year bonds at 145 bps over Treasuries and $4.5 billion in 30-year debt at 185 bps over Treasuries. The issuance was more than 3-times oversubscribed, garnering $40 billion in bids. The Kingdom has issued a total of $39 billion in international debt since its first foray in 2016. This issue stands as the largest sovereign GCC issue for 2017.

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