Equities boosted by Trump tax remark; politics center stage in Europe; oil up as OPEC reaches 90% compliance

Summary

French elections, Greek debt relief, UK parliament’s approval of Brexit and, of course, Donald Trump’s announcements dominated international news last week. The latter’s promise to announce a “phenomenal” tax reform proposal in the next few weeks sent US equities to new highs. Bond yields were not so lucky, however, with the above political uncertainty pressuring 10-year US treasuries and bunds down to a multi-week low last Wednesday.

In Europe, the perennial Greek debt crisis took center stage once again, with the IMF, the EU and the Greek government apparently in disagreement between and amongst themselves over how to handle the country’s bailout. In France, the right’s favored candidate, François Fillon, was mired in a fresh scandal over misappropriating public funds through his wife’s non-employment, while in the UK, MPs voted overwhelmingly on a bill to trigger Article 50 negotiations without any amendments.

In the GCC, the latest Kuwait credit data revealed that growth slowed to 2.9% y/y in December—the slowest pace in nearly five years. This was largely a base effect, growth has slowed considerably in recent months following a large corporate debt repayment in October.

In the UAE, Dubai’s real GDP growth accelerated from 2.2% y/y in 2Q16 to 3.0% y/y in 3Q16. Output in the hospitality, manufacturing and real estate sectors recorded healthy gains.

Meanwhile, the Egyptian central bank saw its reserves increase for the third consecutive month in January, by $2.1 billion to $26.4 billion, following November’s currency float. The narrowing of the country’s budget deficit to -11.5% of GDP (annualized) during the first five months of FY16/17 from -12.2% a year before was another positive for the country last week.

In the oil markets, Brent crude closed up by about a dollar on Friday to $56.7/bbl after the IEA reported that OPEC was 90% of the way to complying with its aggregate output target as per the terms of the 30 November production cut agreement. Total output had declined by 1 mb/d to 32.1 mb/d in January.

International macroeconomics

Eurozone: France’s elections and Greece’s debt relief stood out this week, while in Italy Unicredit initiated its cash call amid the shaky political environment.

Les Républicains’ candidate, François Fillon, is facing fresh accusations of misappropriating public funds. This follows previous allegations of nepotism. The turmoil surrounding the French election has tainted European investor confidence, with markets reacting negatively.

Disagreements over how to handle Greece’s bailout have extended to the IMF and the Greek government, weighing on investor sentiment. Greece and its creditors hope to complete the second review of its €86 billion bailout prior to the onset of election season in the EU. Greece needs funds
released before July 2017, when it has large debt repayments (€6 billion). Creditors have disbursed €31.7 billion so far but are not willing to release further funds unless the IMF participates in the deal. The IMF, however, has conditioned its participation on Greece’s ability to achieve the set targets and on German-led European creditors initiating large-scale debt relief. The latter expect Greece to record a “primary” budget surplus of 3.5% of GDP by 2018. The IMF board seems split between that target and a target of 1.5% of GDP. Meanwhile, Greece’s government is split over the conditions of the second review, which is bound to get more complicated as we approach the French and German elections.

Despite the brewing political unease in the Euro area, Unicredit, Italy’s largest bank, initiated a cash call to raise €13 billion. Unicredit is offering 13 new shares for every 5 ordinary or saving shares. The share offer is expected to end on 10 March 2017. Monte dei Paschi di Siena had attempted but failed to raise €5 billion in December. It now awaits EU approval to finalize its state-led bailout.

UK: MPs voted overwhelmingly, by 494 votes to 122, in favor of triggering Article 50 and the commencement of Britain’s official departure from the EU. Significantly, the bill, which was tabled by the PM, passed without any major amendments; it will now make its way through the House of Lords, where it should similarly pass without much resistance.

China: Capital outflows have been a major concern for policymakers in China, spurring the authorities to increase their efforts to curb capital flight. The IIF released its net capital outflow data which show an increase in resident outflows driven by banking activities and foreign investment. In 2016, FX reserves declined by $320 billion, although China’s reserves of approximately $3 trillion are still the world’s largest. Net capital outflows in 2016 totaled $654 billion, with Chinese companies investing $211 billion abroad and domestic corporates and others lending another $300 billion.

Japan: Real wage growth in Japan rebounded in 2016, reaching a multi-year annual average high of 1.1%. This compares positively with the -0.8% recorded in 2015. Nonetheless, it still remains lackluster. In December, real wage growth came in at a mere 0.4% y/y, as mildly higher inflation more than offset the pick-up in nominal wages. (Chart 1.)

**GCC & regional macroeconomics**

Kuwait: Credit growth slowed in December on account of base effects and despite a healthy gain during the month. Growth came in at 2.9% y/y—it’s slowest pace in nearly five years. (Chart 2.) The pace of growth, which averaged 7% in 2016, slowed considerably in recent months as a result of a large corporate debt repayment in October. We estimate that credit growth, adjusted for that repayment, was 5% y/y.

Consumer spending bounced back during the fourth quarter of 2016, following two quarters of consecutive slowdowns. Credit and debit card point-of-sale spending growth jumped by 9% y/y after sliding into negative territory for the first time on record in 3Q16, when spending shrank by 0.7% y/y. Even total spending including ATM withdrawals showed a comparable increase in growth of 3.9% y/y. Growth in consumer spending has been slowing since 4Q15, in tandem with the significant drop in oil prices, though the slowdown was relatively gradual. As oil prices improved with a more stable and positive outlook for 2017, consumer spending seems to have recovered slightly. (Chart 3.)

UAE: After trending lower for two years, Dubai’s real GDP growth appears to have bottomed out in 2Q2016. According to recent data, Dubai’s real...
GDP accelerated from 2.2% y/y in 2Q16 to 3.0% y/y in 3Q16, thanks to a healthy pickup in most sectors, including the hospitality, manufacturing and real estate sectors. (Chart 4.) Indeed, the trend in Dubai’s real GDP growth is in line with the current trend in the Emirates NBD Dubai Economy Tracker (DET) index, a measure of non-oil sector activity in Dubai. The index has also been recovering of late. Thanks to strong gains in output and new orders, the index averaged at a higher 55.6 in 3Q16 versus the 53.9 average in 2Q16; in January it came in at an almost two-year high of 57.1.

Qatar: Finance minister Ali Sherif Al-Emadi, in a recent briefing, assured the markets that the government will be able to manage its public finances in light of the improvement in hydrocarbon prices; oil prices in 2017 are expected to be 22% higher than in 2016, at an average of $55/bbl (Brent).

In December 2016, Qatar announced its 2017 budget, which is based on an oil price of $45. Al-Emadi also mentioned the possibility of another international bond issuance this year depending on whether macro conditions continue to improve or not. Al-Emadi projects that Qatar’s economy will grow in the range of 3.4-3.5% y/y in 2017; growth could be slower, however, after the introduction of the VAT in 2018 or 2019. As for project activity, approximately $500 billion is being spent every week on infrastructure projects and preparations related to the 2022 World Cup.

Egypt: Central bank foreign reserves rose by $2.1 billion in January to $26.4 billion (equivalent to an estimated 5.9 months of imports). (Chart 5.) The increase was the third consecutive monthly rise following the November 2016 float of the currency; over $7.3 billion has been added since. Reserves are expected to see further increases, with $4 billion coming from the recent international bond issuance and another $1.25 billion from the second tranche of the IMF loan.

The budget deficit narrowed to -11.5% of GDP (annualized) during the first five months of FY16/17 through November 2016, down from -12.2% a year before. The primary deficit, which excludes interest payments, improved to -2.2% of GDP from -3.1% a year before. The deficit is likely to narrow further, to -10.5% by the end of FY16/17.

Markets – oil

Oil prices closed last Friday on a relative high, with Brent advancing by about $1 to $56.7/bbl after the International Energy Agency (IEA) said that OPEC members had demonstrated 90% compliance with their production targets as per the terms of the 30 November production cut agreement.

The IEA estimates that OPEC output in January fell by 1 mb/d to 32.1 mb/d, with Saudi Arabia taking the lead and paring back its own production by more than the required 4.5%. (Chart 6.)

Also, in its latest report, the IEA has revised up its forecast for global oil demand growth in 2017 by 100,000 b/d to 1.4 mb/d. At this rate, and assuming OPEC and non-OPEC fully comply with their output quotas, then global crude stocks could see a drawdown of 600,000 b/d during 1H2017. Demand growth in 2016 was also adjusted upwards, to 1.6 mb/d.

The IEA’s latest data comes amid the accumulation of record net-long positions by hedge funds (equivalent to 0.8 billion barrels) as investors and speculators bet on oil prices rising this year.

But markets are tense, however, as they try to reconcile the two opposing supply dynamics. OPEC and its commitment to cut output in 1H17, which is
positive for oil prices, and US shale and its reemergence, which is negative for oil prices. The latest EIA data showed that US crude production increased by another 63,000 b/d last week to 8.98 mb/d—it’s highest level since last April. Also, US drillers added another 17 oil rigs last week, bringing the total up to 729, which is the highest level in 14 months.

**Markets – equities**

World markets were led by US equities that were buoyed by prospective tax cuts and positive earnings; the MSCI World added 0.6%, while US equities reached new highs following remarks by President Trump on a soon-to-be-announced tax plan. This provided a boost to what would otherwise have been a directionless week for US stocks. The S&P 500 and the DJIA were up 0.9% and 1.1%, respectively, on the week. European equities were mixed, with the Euro Stoxx 50 closing the week virtually unchanged. Renewed concerns over Greece’s finances and its debt levels seem to have weighed somewhat on sentiment. Meanwhile, politics and elections take center stage in Europe. Emerging market equities outperformed last week, with the MSCI EM advancing 1.3%.

Regional markets retreated as the heavyweight Saudi Tadawul declined. The MSCI GCC index was down 0.5%, but performance was mixed in the region. Saudi Arabia and Kuwait saw profit-taking, with their general indices down 1.8% and 3.8%, respectively. Despite losses in the Kuwaiti market, volumes held up at healthy levels, close to a daily average of KD 50 million. Meanwhile, Abu Dhabi and Dubai saw good advances, with their indices adding 2.8% and 1.6%, respectively. Banks’ dividend announcements were a main driver for the Emirati markets.

Also, in regional market news, a 20% stake in Jordan’s Arab Bank was bought by a consortium of Arab and Jordanian investors for $1.12 billion.

**Markets – fixed income**

Political risk continued to drive bond markets, with rates down on the week despite a pickup over the last few days. Uncertainties over President Trump’s economic policies, Brexit, France’s elections and related scandals, and Greece’s debt relief saw benchmark yields pressured down for the first half of the week. 10-year US treasuries and bunds hit multi-week lows on Wednesday. Talk of a tax-plan by the Trump administration, coupled with some positive soft data, saw yields increase over the last two days of the week. Nevertheless, the predominantly risk-off tone of the week shaved 8 bps off of 10-year US treasuries yields and 9 bps off of 10-year bunds. (Chart 9.)

Most 2021 GCC paper yields were down on the week, trailing US treasuries, but also benefiting from a steady oil price. Yields dropped between 8 and 16 bps, with Abu Dhabi and Qatar seeing the largest drops. Oman was flat, while Dubai was up 3.7 bps on the week. (Chart 10.)
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