Trump tariff move heightens risk of global trade war; Saudi inflation spikes on VAT implementation

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi (ADI)	4,595	0.28	4.47
Bahrain (ASI)	1,373	0.87	3.13
Dubai (DFMGI)	3,209	-2.95	-4.78
Egypt (EGX 30)	15,443	-0.16	2.82
GCC (S&P GCC 40)	975	0.28	-0.94
Kuwait (Price Index)	6,805	0.72	6.19
KSA (TASI)	7,411	-1.10	2.56
Oman (MSM 30)	5,010	1.04	-1.75
Qatar (QE Index)	8,730	-3.86	2.42
International			
CSI 300	4,016	-1.34	-0.36
DAX	11,914	-4.57	-7.77
DJIA	24,538	-3.05	-0.73
Euro Stoxx 50	3,325	-3.39	-5.11
FTSE 100	7,070	-2.41	-8.04
Nikkei 225	21,182	-3.25	-6.95
S&P 500	2,691	-2.04	0.66

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	64.4	-4.37	-3.74
KEC	59.7	-4.35	-6.05
WTI	61.3	-3.62	1.37
Gold	1321.1	-0.53	1.13

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.300	0.03	-0.53
KWD per EUR	0.371	0.00	4.48
USD per EUR	1.232	0.20	2.68
JPY per USD	105.7	-1.08	-6.16
GBP per USD	1.380	-1.17	2.15
EGP per USD	17.59	-0.28	-0.79

3m interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor	2.83	3.5	10.0
Kibor	1.88	0.0	0.0
Qibor	2.70	0.0	-4.2
Eibor	2.01	5.6	21.3
Saibor	1.92	2.0	2.3
Libor	2.03	6.9	33.1

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2022	3.37	2.8	42.5
Dubai 2022	3.41	0.1	26.7
Qatar 2022	3.67	-1.2	59.5
Kuwait 2022	3.29	-4.2	48.5
Saudi Arabia 2023	3.69	-0.2	47.5
International			
UST 10 Year	2.86	-1.4	44.6
Bunds 10 Year	0.65	-0.9	22.2
Gilts 10 Year	1.48	-4.6	28.7
JGB 10 Year	0.07	2.0	2.1

Source: Thomson Reuters Datastream; as of Friday's close 2/3/2018

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Overview

Equities were dealt an end-week blow after US President Trump announced that he would impose heavy tariffs on imports of steel and aluminum "for a long period of time", raising fears of a global trade war. Major global stock indices fell around 2% on Friday, though US stocks themselves staged a recovery by the close.

The announcement also took steam out of the US dollar, which had earlier in the week risen to a six-week high on a trade-weighted basis after Fed chairman Powell's bullish testimony to Congress hinted at a more rapid pace of monetary tightening. More analysts now believe that four interest rate hikes this year are more likely than three.

Brent crude prices ended February with their first monthly loss in six months, and down 4% w/w at $64/bbl. The fall comes after a strong run which has left Brent still up 44% since last June, helped by improving fundamentals. Last week's dip also reflected the stronger dollar – which raises the price of oil in foreign currency terms – and new data from the Energy Information Administration which showed a larger-than-expected rise in US crude inventories.

In the GCC, the first official data following the implementation of VAT showed inflation in Saudi Arabia spiked to 3% y/y in January from -1.1% in December – a larger impact than expected, but also affected by rises in utility and fuel prices. With the changes in the Saudi CPI composition and weights, it is difficult to disentangle the impact of VAT on prices. By contrast, inflation in Dubai rose by a more moderate 2.7% (1.5% in December). The relative performances might be linked to the scale of exemptions applied to VAT in the UAE, as well ongoing weakness in the key real estate sector in the emirate.

International macroeconomics

USA: In testimony before Congress, Fed chair Jerome Powell suggested that more hikes could be forthcoming this year. Already improving economic conditions in the US and globally will be further bolstered by the US fiscal stimulus. The probability of four 25 bps hikes during 2018 increased, though the market still sees three hikes as the most likely.

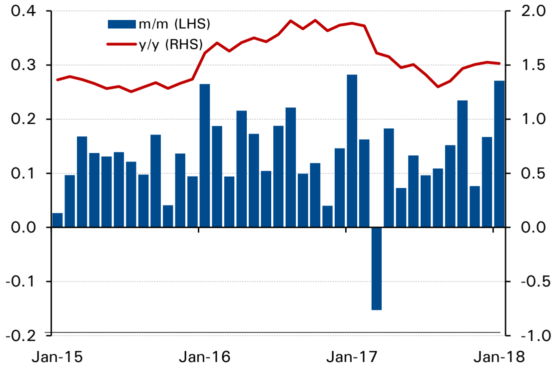
Despite an increasingly bullish tone, recent economic data was mixed. Durable goods orders were soft in January, with total new orders slipping. Meanwhile, January confirmed stronger price growth in the PCE index, but core inflation remained at 1.5% y/y. (Chart 1.) Nonetheless, the ISM manufacturing index rose to 60.8 in February, while consumer sentiment topped expectations despite edging lower to 99.7.

Later in the week, markets reacted to Trump's surprise move announcing tariffs on steel and aluminum imports and indicating he would not shy away from a trade war, drawing condemnation from trading partners and sparking fears of retaliatory action.

The dollar index rose as markets factored a more hawkish Fed but retreated after Trump's comments.

Chart 1: US core PCE index inflation

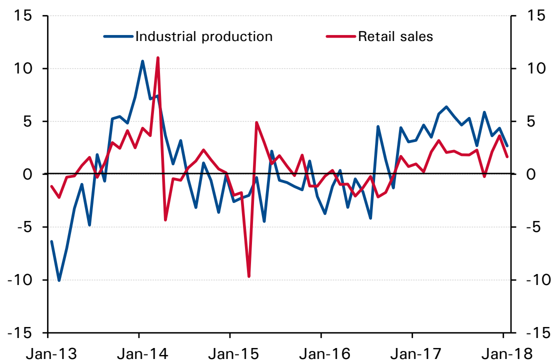
(%)



Source: U.S. Bureau of Labor Statistics

Chart 2: Japan industrial production & retail sales

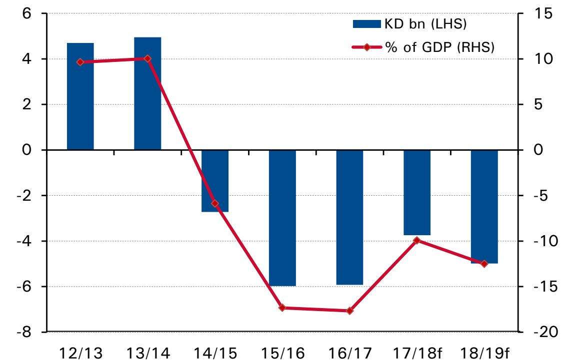
(% y/y)



Source: Thomson Reuters Datastream

Chart 3: Kuwait fiscal balance

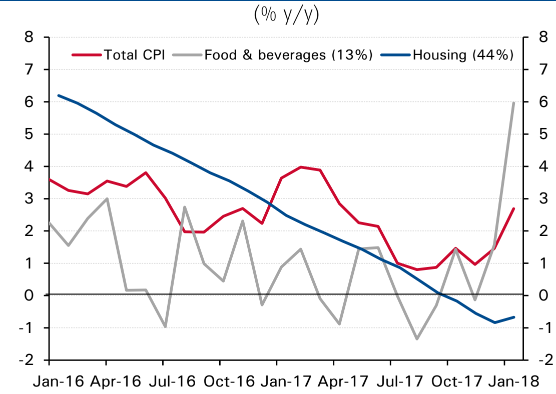
(after FGF transfers)



Source: Ministry of Finance, NBK estimates

Chart 4: Dubai consumer price inflation

(% y/y)



Source: Ministry of Finance, NBK estimates

Eurozone: A slew of European indicators have softened, yet they and others still point to positive momentum. February's Eurozone flash PMI eased to its lowest level in a few months, but still came in strong at 57.5; headline inflation edged lower to 1.2%, but core inflation was encouraging at 1.0%; and economic sentiment dipped to 114.1, but still remained at around 18-year highs. Meanwhile, unemployment remained at a low 8.6% in January.

UK: PM Theresa May acknowledged last Friday that Britain would indeed be quitting both the EU single market and the customs union. Her preference remains for a bespoke and comprehensive free trade agreement with the 27-member bloc and a new customs arrangement. While the speech attempted to pacify both the pro and anti-EU wings of her party – with some degree of success – the EU was less impressed, with the lack of specifics and the UK's continued 'cherry-picking'.

The PM's speech came more than a week after the EU produced a 120-page draft outline of Britain's withdrawal from the block in which it suggested that Northern Ireland might remain in the EU customs union. Naturally, the British government rejected the proposal.

Japan: Industrial activity surprisingly slowed in January, from 4.4% y/y in December to 2.7% y/y on the back of weaker demand and an inventory build-up. (Chart 2.) Domestic consumption remains subdued. Retail sales growth slowed more than expected, from 3.6% y/y in December to 1.6% y/y In January, as spending on new cars and clothing fell and spending on home electronics slowed.

GCC & regional macroeconomics

Kuwait: The fiscal deficit stood at KD 2.7 billion during the first 10 months of FY17/18. According to the interim Ministry of Finance figures, spending continued to come under budget – by around 14% through January 2018 – though the shortfall has narrowed. By the end of FY17/18, we think the under-spend will narrow to around 8-9%, implying a deficit of KD 3.7 billion or 10% of GDP. (Chart 3.) This is well below last year's 18% shortfall thanks in large part to higher oil prices.

Inflation eased again in January 2018, to 1.0% y/y. Deflation in food & beverage prices and healthcare added to already deflationary prices in housing. Inflation in clothing and in recreation & culture also eased.

February saw the awarding of KD 173 million in project contracts, a 39% decline from the prior month. Awards included infrastructure work for the South Al-Abdullah Al-Mubarak residential area and the southern section of the regional road.

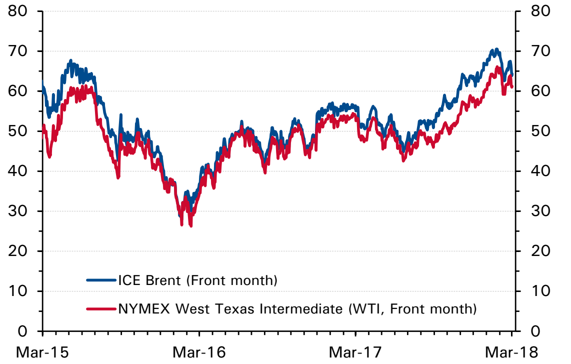
Kuwaiti bank profits saw healthy growth in 2017, increasing by 9.1% to KD 800 million. Rising net interest margins (NIMs) and robust loan growth supported the positive results. The average NIM for the sector rose to 2.4% for the year as a whole, while loan growth topped 7.5%.

Saudi Arabia: Inflation rose significantly in January (+3% y/y; +3.9% m/m), following the introduction of 5% VAT in the kingdom and the hike in fuel and utility prices instigated at the start of the month. Among the subcomponents of the kingdom's CPI, food and beverages, tobacco and transportation were affected to the greatest extent. Both the base year and the weights in the CPI basket were changed, however, making it more difficult to separate the impact of VAT on prices.

Saudi Arabia has extended foreign investment licenses from 1 year to 5

Chart 5: Benchmark crude oil prices

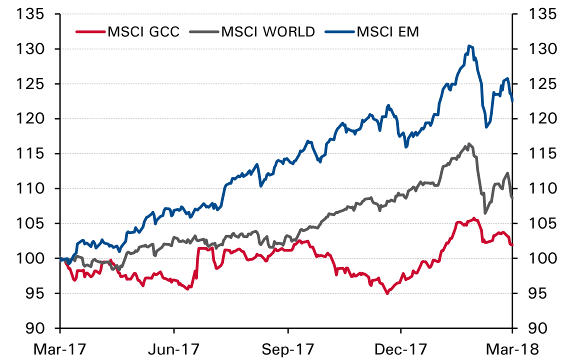
($/bbl)



Source: Thomson Reuters Datastream

Chart 6: Total equity return indices

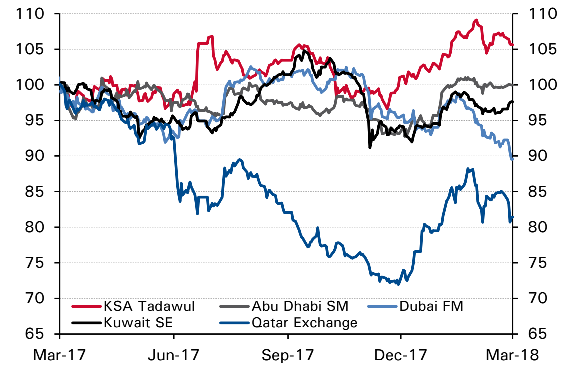
(rebased, 2 March 2017=100)



Source: Thomson Reuters Datastream

Chart 7: GCC equity markets

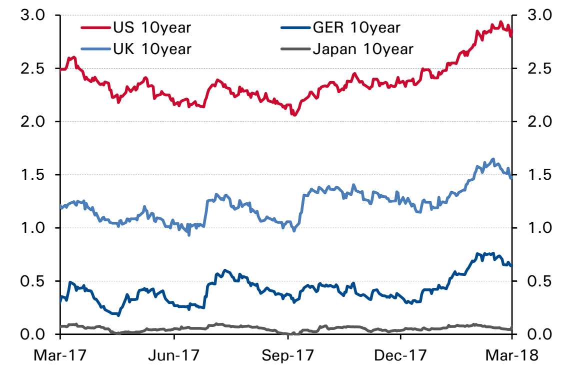
(rebased, 2 March 2017=100)



Source: Thomson Reuters Datastream

Chart 8: Global bond yields

(%)



Source: Thomson Reuters Datastream

years renewable as it bids to entice more foreign investment.

UAE: Consumer price inflation in Dubai leapt from 1.5% y/y in December to 2.7% y/y in January, mainly owing to the introduction of the 5% VAT. (Chart 4.) Housing costs--nearly half of Dubai's consumption basket--remained depressed as the ongoing decline in housing rents more than offset the impact of the VAT on utility prices. In contrast, inflation in the food and beverages segment surged from 1.6% y/y to 6.0% y/y.

The number of passengers passing through Dubai International Airport in January held near a record high, at 8.0 million thanks to seasonal factors as well as a continued improvement in tourism.

Markets – oil

A volatile week saw oil prices pressured by evidence of further US crude inventory and production gains as well as by President Trump's announcement of the imposition of steel and aluminum tariffs. Prices then recovered a little on Friday after some of the tariff-related panic subsided, but not enough to finish week in the black. Brent closed the week down 4.4% w/w at $64.4/bbl and WTI finished 3.7% lower at $61.3/bbl. Brent is down 3.7% in 2018 so far. (Chart 5.)

The IEA, taking its cue from the IMF's more optimistic economic outlook for this year, has revised up its forecast for global oil demand growth in 2018 by 100,000 b/d to 1.4 mb/d. However, thanks to burgeoning US shale output, non-OPEC supply growth is also projected to accelerate by 100,000 b/d this year, to 1.8 mb/d. Therefore, OPEC+, as it attempts to draw down global oil inventories to their 5-year average target, might have to deal with a stock build this year or lower oil price instead.

Markets – equities

Global equities fell last week as investors digested Fed Chair Powell's testimony, new US import tariffs, and mixed data. The MSCI AC index was down 2.3% on the week.

The DJI and the S&P 500 declined 3% and 2%, respectively, with the former heavily impacted by prospective US import tariffs on steel. This weakness comes despite a strong earnings season. Other markets retracted as well, with the Euro Stoxx 50 down 3.4%, with sentiment weighed down by modest Eurozone data and election uncertainty, while the MSCI's emerging markets index was flat. (Chart 6.)

Mixed earnings and softer oil prices saw GCC equities underperform their global peers with the MSCI GCC index down 1.7% w/w (Chart 7). Qatar was the worst hit, experiencing its worst daily performance since the diplomatic crisis began, down 3.9% on the week. Kuwait outperformed, adding 1.0% over the week to become the second best performing bourse in the region, up 3.2% year-to-date, buoyed by positive earnings.

Markets – fixed income

Benchmark yields have edged lower over the past few weeks. (Chart 8.) The threat of new US import tariffs, softening Eurozone data, more dovish than expected ECB minutes, and election uncertainty (Italian and German) saw investors move into bonds. As such, US 10-year treasury yields were down 1 basis point last week, to 2.86%. Bund yields dropped 12 basis points from their high of 0.76% last month and 1 basis point over the week to 0.65%.

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