Central banks hint at policy shift amid weaker growth signals

> Economic Research
+965 2259 5500
econ@nbk.com

Highlights

- **Despite signs of softening economic growth, the rally in global equities extended into February amid optimism on a US-China trade deal and expectations of slower policy tightening by central banks in both the US and Europe.**
- **US growth slowed to 2.6% in 4Q18 and could fall to below 1% in 1Q19 as the impact of last year's fiscal stimulus continues to fade. The Fed has signaled that it plans to end its balance sheet reduction program later this year.**
- **Europe's important manufacturing sector is under pressure from the global slowdown. But relative strength of the services sector and labor market suggest that it can avoid recession.**

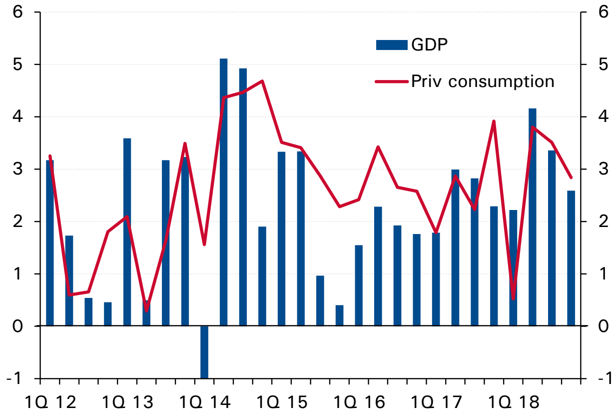
The strong start to the year in financial markets extended into February, with global equities rallying further despite continued signs of slowing growth in major economies including the US, Europe and China. The rise partly reflects a rebound after December's heavy sell-off, but also optimism on an end to the US-China trade dispute after the US agreed to postpone tariff hikes scheduled for March, signaling that a deal was inching closer. There was also growing confidence that policymakers are moving to support growth, with central banks in the US and Europe adopting less hawkish stances and China announcing fresh stimulus measures. And in positive news for the Gulf region, oil prices have hit three-month highs, boosted by signs that OPEC is delivering on output cuts agreed last December.

US growth slows in 4Q18, likely to ease further in Q1

The first estimate of 4Q18 GDP (delayed by a month due to the government shutdown) showed growth at an annualized 2.6% – slightly above the consensus of 2.2% but nevertheless slower than the 3.4% recorded in Q3. (Chart 1.) Consumer spending – worth around 70% of the economy – grew a solid 2.8% though slower than in Q3, while net exports remained a drag on growth due to export softness. The figures meant that growth in 2018 overall reached 2.9%, up from 2.2% in 2017 but slightly below the 3% targeted by President Trump despite a large fiscal stimulus earlier in the year. As this stimulus continues to fade and the lagged impact of earlier interest rate hikes feeds through, growth is seen slowing further going into 2019. 'Nowcasts' by both the Atlanta and New York Federal Reserve banks point to growth of below 1% in 1Q19.

Chart 1: US GDP and private consumption

(% q/q, annualized)



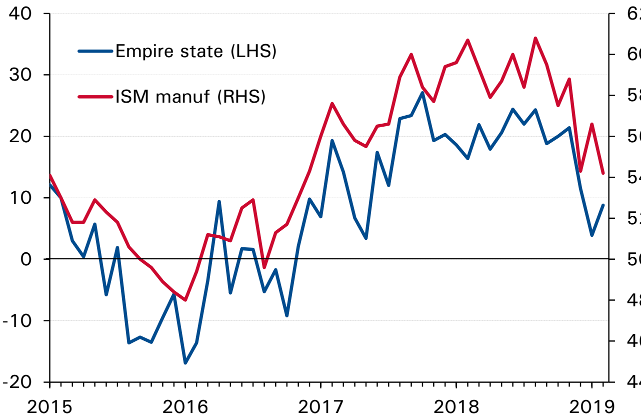
Source: Thomson Reuters Datastream

Indeed as data releases begin to return to normal following delays due to the shutdown, evidence of moderating growth has continued to build. Retail sales growth dropped to a more than two-year low in December as households rebuilt savings, while personal incomes in January fell month-on-month for the first time since late 2015. The housing market also continues to suffer, with home prices rising more slowly in December (4.2%, a six-year low) and existing home sales down 8.5% y/y in January. Consumer confidence bounced back in February following the end of the shutdown, but remains well below its peak of last year. Still, with the labor market in decent shape (unemployment at 4% and wage growth above 3%), any downturn in consumer spending seems unlikely to be severe.

Away from the household sector, business activity is also decelerating, though from levels that pointed to overheating through much of last year. The downturn is most pronounced in manufacturing – often considered a lead indicator of overall economic health – amid softer global growth and concerns over the US-China trade dispute. The ISM manufacturing index, for example, hit a more than two-year low of 54.2 in February, and signaled that cost pressures are easing. (Chart 2.) Service sector growth is also trending lower, though the surprisingly robust ISM non-manufacturing index score of 59.7 in February points to a gentler pace of deceleration than in industry. Optimism in both sectors would be boosted by a US-China trade deal.

Chart 2: Manufacturing activity surveys

(indices, 0/50=no change)



Source: Thomson Reuters Datastream

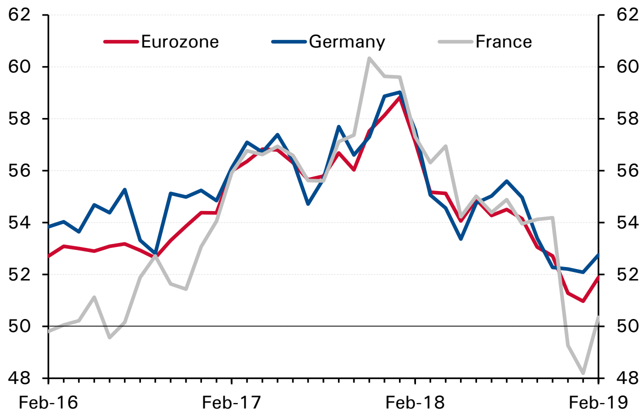
Signs of a slowdown, together with tame inflationary pressures, appear to vindicate the Fed's recent decision to 'pause' further monetary tightening. As well as holding off from hiking the Federal Funds interest rate above its current 2.25-2.50% range, it now plans to end its 'quantitative tightening' or balance sheet reduction program sometime later this year, sooner than previously expected. More details of the plan are expected to be announced following the Fed's meeting on 19-20th March, with markets likely to pay close attention to complex questions over the targeted end-size and structural composition of the Fed's holdings. Once it has finished running down its balance sheet, the central bank may still look, for example, to continue to reduce its $1.6 trillion holdings of mortgage backed debt, thereby implying greater purchases of US treasuries.

Eurozone manufacturing remains under pressure

Concerns over growth in the Eurozone persist, also with particular worry over the region's important manufacturing sector which is exposed to the global slowdown and heightened trade tensions. February's Eurozone composite PMI score of 51.9 points to economic growth of around 0.2% q/q in 1Q19 – unchanged from Q4 – though did at least edge up for the first time in six months suggesting a degree of economic stabilization. (Chart 3.) The manufacturing component fell to below 50, signaling contraction, with new orders declining by their most in six years, and the closely-watched German Ifo index points to a steep decline in business investment ahead. However the relative strength of both the services sector and the labor market – unemployment remained at a decade low of 7.8% in January – provide some grounds for optimism that the region will avoid a recession.

Chart 3: Eurozone PMIs

(index, 50=no change)



Source: IHS Markit

Having ended its asset purchase stimulus program in December and signaled possible rate hikes in 2H19, the European Central Bank, like the Fed, appears to be shifting in a more dovish direction. Its growth forecasts for the region are expected to be revised down at its March meeting, and it looks likely to discuss restarting its program of offering cheap long-term loans to banks ("TLTROs") to support credit growth. Also important is the persistent weakness in inflation: core inflation fell back to 1.0% y/y in February, well below the ECB's "below but close to 2%" target.

Just weeks ahead of its scheduled exit from the EU, the UK has yet to agree the terms of its departure. Prime Minister Theresa May is seeking improved terms with the EU following the overwhelming rejection of her negotiated deal by parliament in January, but the chances of securing satisfactory changes to the contentious 'backstop' component currently look slim. Assuming that any new deal is again voted down, parliament looks likely to press for an extension to the UK's exit date. This would have to be agreed by the EU, and is complicated by the UK's uncertain participation in the EU parliamentary elections in May. It is also unclear what any extension would achieve. Brexit uncertainty is not helping the UK economy, with the PMI index showing growth in the dominant services sector at 51.3 in February, consistent with near stagnation in 1Q19.

Japanese exports face headwinds from weak demand

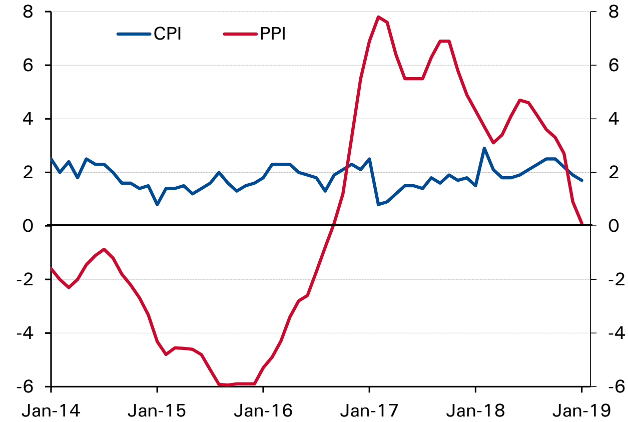
Japan's external sector continues to face headwinds. Exports registered their largest decline, at -8.4% y/y, in over two years in January, mainly on the back of weaker Chinese demand. Imports also fell by 0.8% y/y, reflecting continued softness in domestic demand. Retail sales and industrial production growth also remained subdued during the same period, at 0.6% y/y and 0.0%, respectively. With core inflation, which excludes food costs, holding steady at 0.8% y/y in January, far below the central bank's target of 2%, and economic activity remaining weak, this further reaffirms the Bank of Japan's ultra-loose monetary policy stance.

Chinese government lowers growth 2019 target

In a bid to prop up its slowing economy amid weaker external demand and the ongoing trade dispute with the US, China has vowed to cut taxes and fees, boost infrastructure investment and up its lending efforts to small firms. During its annual Congress meeting, the government announced that it is penciling in a slower growth target range of 6.0-6.5% versus reported growth of 6.6% in 2018. Indeed, factory activity continues to struggle to eke out gains. According to the official PMI, factory activity was at it is weakest in three years in February, and fell for the third consecutive month. Meanwhile, consumer price inflation continued to decelerate, slowing from 1.9% y/y in December to 1.7% in January while producer price inflation slowed to a multi-year low of just 0.1%, paving the way for further government policy stimulus.

Chart 4: Chinese consumer and producer price inflation

(% y/y)



Source: Thomson Reuters Datastream

Oil rally continues amid OPEC+ production cuts

Brent crude oil continued its early year rally last month, closing February up 7% m/m at $66/bbl following a 15% rise in January. The rise has been driven primarily but not exclusively by the efforts of OPEC and its Vienna agreement partners to drain excess supplies from the market by the end of 1H19. OPEC-11 compliance hit 85% in January, thanks to Saudi Arabia and Kuwait, who quickly pared back production to within quota levels. Oil's rise prompted US President Trump to tweet that prices were "getting too high" and that OPEC should "relax and take it easy". The imposition of US sanctions on Venezuela in January, the impending expiry of the 180-day US sanctions waivers on Iran in May and crude rationing in Canada due to pipeline bottlenecks, also supported prices, as has the seemingly improving prospects of a US-China trade deal.

Chart 5: Brent crude oil price

($ per barrel, end of month)

Source: Thomson Reuters Datastream

Mixed news for GCC business activity

It was a mixed bag for GCC private sector activity in February. While the Saudi non-oil economy continued to gain traction, with the PMI rising to a 14-month high of 56.6 on stronger domestic business, the UAE PMI retreated to a more than two-year low of 53.4 on a slowdown in new orders and output. Employment growth, though, was weak across the board. Saudi private sector credit growth also underwhelmed, moderating to 2.4% y/y in January from 2.9% y/y in December. In Dubai, the deflationary trend in residential real estate prices continued into 2019, with price declines accelerating to 9.4% y/y in January due to a combination of more stringent loan-to-value regulations, increased supply and changing demand patterns. In Bahrain, the cabinet approved a draft state budget for the next two years that should see the fiscal deficit shrink from $2.3 billion (6% of GDP) in 2018 to $1.6 billion (4% of GDP) by 2020. Subsidy cuts are on the cards, while revenue-generating measures such as VAT have been introduced.

Outside the GCC, Egypt's PMI fell to 48.2 in February. This was the lowest reading since September 2017 and the sixth consecutive month in contractionary territory. The soft PMI highlights some weakness in the recovery of the non-oil private sector, as Egypt's economic reform program continues.

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 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