Economic Update

NBK Economic Research Department I 16 July 2019

International Scene

Equities rebound as key central banks mull looser policy

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

Highlights

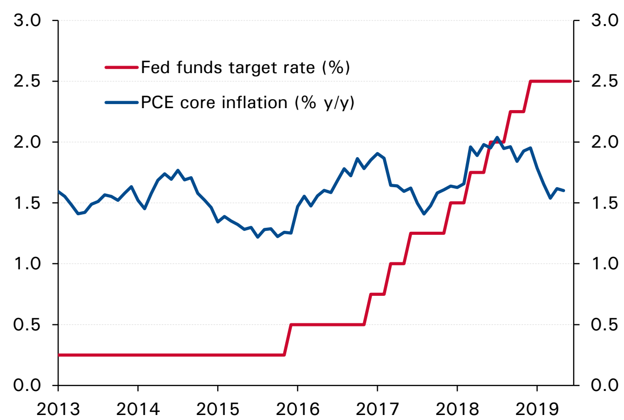
- **Global equities surged in June and bond yields continued to fall as financial markets increasingly anticipated key central banks loosening policy amid signs of slowing global economic growth.**
- **Although economic data in the US is still mixed, the Fed is expected to cut rates in July as insurance against a future slowdown and given that inflation remains below the 2% target.**
- **Weak manufacturing is weighing heavily on the European economy, and the ECB could resume its bond purchase program in September. The Bank of England might also soon cut rates, amid signs that UK growth flat lined in 2Q19.**

Global equities surged in June following a rough May, helped by expectations that key central banks will loosen policy to ward off an economic slowdown. The US S&P rose 6.9% m/m for its biggest June gain since 1955. The prospect of slower growth and monetary stimulus also saw bond yields sink further, with the US 10-year treasury yield below 2.0% in late June and German bunds at a record low of -0.3%. Markets were also boosted by a truce on tariff hikes agreed between the US and China, though a full-scale trade deal still looks some way off. Meanwhile oil prices rose through the month anticipating a decision – subsequently realized – by the OPEC+ group to extend current supply cuts into next year.

Fed paves the way for future rate cuts

The Federal Reserve as expected left interest rates on hold at 2.25-2.50% in June, but paved the way for looser policy by dropping calls for 'patience' in future rate changes and committing to "act as appropriate to sustain the expansion". Although recent economic activity data is by no means all bad, the Fed is mulling a rate cut as 'insurance' against a future slowdown (including as a result of slower global trade), as well as low inflation, which was unchanged at 1.6% y/y in May on the Fed's preferred core PCE measure and well below the 2% target. (Chart 1.) Financial markets – as well as President Trump – are increasingly expectant of looser policy, with futures markets certain of at least a 25 bps cut in July and pricing in a 92% chance of at least 50 bps in cuts by year-end. However, some analysts believe that markets are getting ahead of themselves and the Fed's own 'dot plot' projections still (just about) point to no change in rates this year.

Chart 1: US inflation and policy interest rates*

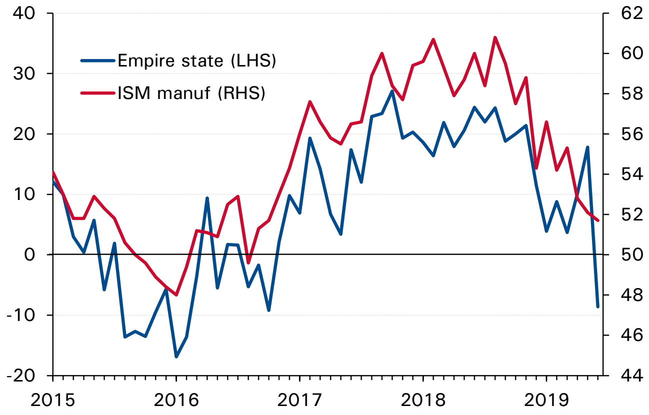


Source: Refinitiv *Upper end of target range for Fed Funds rate

Surveys of manufacturing activity – which is often considered a good lead indicator of the broader economy – have weakened and are among the Fed's key concerns. The Empire State survey for example plunged into contraction territory in June while the closely-watched ISM manufacturing index slipped to just 51.7 having already slowed markedly since last year. (Chart 2.) The hope is that weakness is exaggerated by tariff and trade fears that need not materialize if US-China tensions can be diffused, while the more domestically-oriented service sector remains solid. Consumer spending for example rebounded to 4.4% y/y in April-May and consumer confidence (despite dropping in June) remains at historically high levels backed up by 50-year-low unemployment of 3.6% and 3%+ earnings growth. Even so, with the economic expansion now the longest in US history at 121 months, a sizeable slowdown in GDP growth looks almost certain. 'Nowcast' estimates point to annualized GDP growth of only 1-1.5% in both 2Q19 and 3Q19, less than half of the 3.1% recorded in Q1, which was lifted by a strong rise in inventories.

Chart 2: US manufacturing survey indicators

(indices, 0 or 50 = no change)



Source: Refinitiv

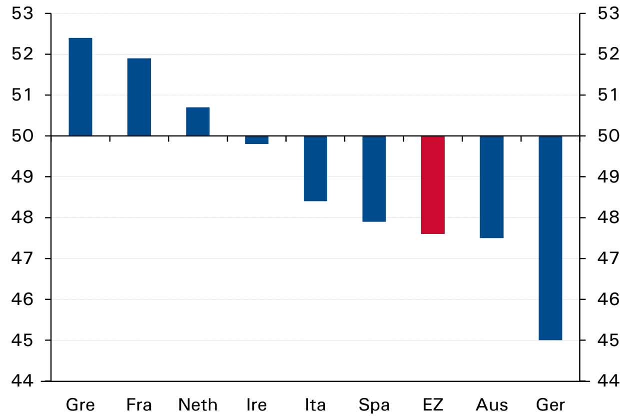
Manufacturing weakness also weighs on Europe

Manufacturing weakness is also weighing on Europe's economy, with the Eurozone manufacturing PMI remaining in contraction territory in June at 47.6 and Germany the worst performer at 45.0 – reflecting the global slowdown, regional political uncertainties and problems in the crucial auto sector. (Chart 3.) The figures suggest that manufacturing output may have fallen 0.7% q/q in 2Q19, perhaps limiting growth in overall GDP to 0.2-0.3% down from 0.4% in Q1. The consensus view is that growth will pick up in H2 if global trade recovers, helped by an improving labor market where wage growth rose to a 10-year high of 2.5% in 1Q19 and unemployment fell to 7.5% in May. However business confidence remains low and there are risks to the outlook from fresh US tariffs (including due to an aircraft subsidy dispute), Brexit (the terms of which are still unresolved) and rising public debt in Italy, despite some recently announced cuts to spending.

Against this backdrop and core inflation that rose but remained well below the 'close to but below 2%' target at 1.1% y/y in June, the European Central Bank (ECB) declared its readiness to implement fresh stimulus. This could be in the form of interest rate cuts, or more likely a resumption of the bond purchase program that it halted last December, combined with stronger forward guidance on policy. Unless the outlook deteriorates further, the ECB may wait until its September policy meeting for any major policy shift. ECB president Mario Draghi leaves his post in October and some analysts hope for a program of long-term quantitative easing to be announced not just as the most effective policy option, but as a way of committing his successor, currently slated to be former IMF chief Christine Lagarde, to future stimulus (though she is already considered a dovish appointment).

Chart 3: Eurozone manufacturing PMIs

(index for June 2019, 50= no change)



Source: IHS Markit

The UK economy is also showing signs of a steeper downturn, with quarterly growth estimated to be close to zero in 2Q19 (0.5% in Q1) and the construction PMI plunging to a decade low of 43.1 in June amid delays to investment caused by Brexit-related uncertainty. Former London Mayor Boris Johnson is currently favorite to replace outgoing prime minister Theresa May when the governing Conservative party elects a new leader on 22nd July and has pledged to seek changes to the negotiated withdrawal agreement with the EU or sanction a 'no deal' exit at the end of October. Neither option will be easy to deliver and given the government's wafer-thin majority in parliament, the chances of a general election are considerable, the outcome of which would be highly unpredictable for Brexit. Bank of England governor Mark Carney hinted recently that interest rates could be cut from their current 0.75% given Brexit and global risks, contrasting earlier official guidance of 'gradual' and 'limited' rate hikes.

BoJ signals potential easing if downside risks escalate

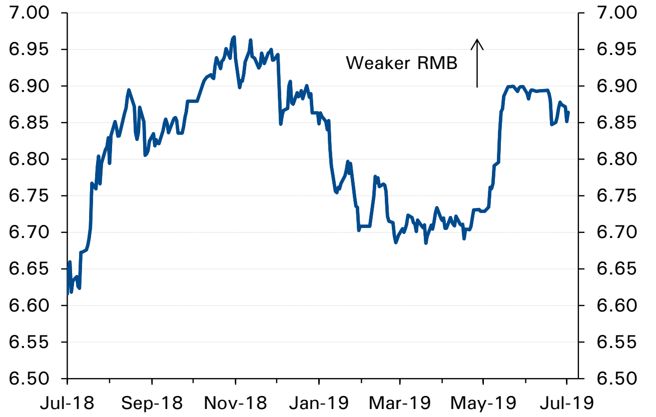
The Bank of Japan left monetary policy on hold last month but, like the Fed and ECB, signaled the potential to adopt further stimulus measures if the global economic outlook continues to worsen. Growth in Japanese exports fell for the sixth consecutive month in May (-7.8% y/y) mainly on the back of weaker Chinese demand for semiconductor manufacturing equipment and car parts, a sign that the ongoing trade war with the US has sapped Chinese manufacturers' appetite for intermediate products. Imports also fell in May (-1.5% y/y) after growing by a decent 6.4% y/y in the previous month, reflecting the underlying softness in domestic consumption.

China looks to boost investment amid growth concerns

The Chinese government announced that it plans to further liberalize key sectors including finance and manufacturing as soon as next year, in a bid to prop up foreign investment inflows. The announcement comes amid signs of continued economic weakness, not least because of trade tensions with the US. Indeed, the latest PMI data came in softer than expected. The private Caixin manufacturing PMI slipped into contraction territory in June for the first time in months. The official manufacturing PMI also pointed to a contraction coming in at 49.4, unchanged from May's reading. On the upside, the official non-manufacturing PMI was broadly unchanged at a decent 54.2. Meanwhile the renminbi, having fallen sharply in May on trade and growth concerns, was more stable through June, amid trade talk progress and US dollar softness. (Chart 4.)

Chart 4: Chinese renminbi exchange rate

(RMB/US$1)



Source: Refinitiv

Growth fears overshadow OPEC+ supply cut extension

Concerns over the weakening global economy have pressured oil prices, even as OPEC+ extended its production cut agreement for nine months to March 2020 (which had been largely priced in before the announcement in early July). In June, oil prices had been whipsawed by opposing, bullish and bearish forces. Brent fell to its lowest level since January in mid-month as US-China trade tensions escalated before geopolitics – the attacks of ships off the Strait of Hormuz and Saudi infrastructure – and the long-awaited drawdown in US crude stocks pushed Brent back up to close the month up 3% at $66.6/bbl. The downing of a US drone by Iran and the subsequent abortive US airstrike and sanctions applied to Iran's Supreme Leader Ali Khamenei only served to further raise oil's geopolitical risk premium. However Brent subsequently eased back to $62.4/bbl in early July as global growth concerns reasserted themselves.

Chart 5: Brent crude oil price

($ per barrel, end of month)

Source: Refinitiv

GCC non-oil growth signals continue to strengthen

Non-oil activity in the GCC continued to gather momentum, with both the Saudi and UAE PMIs comfortably in expansion territory (57.4 and 57.7, respectively) in June, driven by increases in new orders and output. Employment gains, however, were negligible. Official data show Saudi GDP expanded 1.7% y/y in 1Q19, up on the 1.5% recorded a year earlier, led by 2.1% growth in the non-oil sector. Meanwhile growth in Qatar picked up to 0.9% y/y in 1Q19 from 0.3% in 4Q18, with non-hydrocarbon growth at 1.6%.

Finally, according to UNCTAD, foreign direct investment flows to the GCC edged up 0.1% in 2018 to $17.4 billion, with the UAE attracting the lion's share ($10.4 billion). Moves to attract FDI and foreign expertise have accelerated across the GCC. Saudi like the UAE and Qatar is offering skilled expats permanent residency and is relaxing limits on foreign ownership of listed firms in strategic investors.

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