Politics dent the US markets; Japan grows 4.0% in Q2; Oil prices bounce back above $52/bbl

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,493	-1.28	-1.18
Bahrain ASI	1,299	-1.91	6.43
Dubai FM	3,601	-1.26	1.99
Egypt EGX 30	13,119	-2.55	6.27
S&P GCC 40	1,059	-0.32	-8.29
Kuwait SE	6,886	0.60	19.79
KSA Tadawul	7,179	0.21	-0.43
Muscat SM 30	4,889	-2.05	-15.45
Qatar Exchange	9,106	-1.48	-12.75
International			
CSI 300	3,725	2.12	12.53
DAX	12,165	1.26	5.96
DJIA	21,675	-0.84	9.67
Eurostoxx 50	3,446	1.17	4.73
FTSE 100	7,324	0.19	2.54
Nikkei 225	19,470	-1.31	1.86
S&P 500	2,426	-0.65	8.34

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	52.7	1.19	-7.22
KEC	48.6	-2.17	-7.02
WTI	48.5	-0.63	-9.70
Gold	1285.7	-0.16	11.80

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.302	0.04	-1.25
KWD per EUR	0.354	-0.48	11.35
USD per EUR	1.176	-0.51	11.86
JPY per USD	109.170	0.02	-6.59
GBP per USD	1.287	-1.08	4.34
EGP per USD	17.720	-0.17	-1.56

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor - 3 month	2.40	2.5	30.0
Kibor - 3 month	1.75	0.0	31.3
Qibor - 3 month	2.39	-2.1	60.5
Eibor - 3 month	1.53	0.0	5.1
Saibor - 3 month	1.80	0.0	-23.9
Libor - 3 month	1.32	0.7	31.9

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.24	-0.7	-29.3
Dubai 2021	2.98	-1.2	-32.1
Qatar 2021	2.71	0.9	-21.7
Kuwait 2022	2.53	1.9	n/a
Saudi Arabia 2022	2.84	1.9	n/a
International			
UST 10 Year	2.19	0.7	-23.8
Bunds 10 Year	0.41	2.9	20.6
Gilts 10 Year	1.09	2.7	-15.0
JGB 10 Year	0.04	-2.0	-1.0

Source: Thomson Reuters Datastream; as of Friday's close 18/08/2017

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Summary

For the first time in a long while, equity markets decided to move/correct lower late last week. After ignoring political developments for the longest time (save for North Korea for a couple days the previous week), advanced economies' markets fell in the aftermath of the Barcelona terror attack and amid the political fallout from the violence in the US (Charlottesville).

Recall that president Trump was widely criticized for some of his comments, including by many in his own party and by several business leaders. Some of the latter also pulled out of Mr. Trump's business councils, which were later disbanded by the president. More to the point, the renewed "chaos" was perhaps the straw that broke the markets' back. After ignoring many such flaps with the press and with Mr. Trump's political opponents, the markets finally realized that, besides weakening Mr. Trump, these chaotic developments also led to the 11th removal of a senior White House staffer in the past six months. Senior White House Strategist Steve Bannon was let go—and all this as we go into a difficult "debt ceiling" situation and tax reform period. To be resolved, both will require bipartisan cooperation, something that we have not seen so far; markets are finally, perhaps, fretting that the debt ceiling may lead to a government shutdown (September) and/or that the much-awaited tax reform may just go the way of health care reform, i.e. nowhere.

The Dow lost some 350 points over the last 2 days of the week. The risk-off trade saw some mild flows into safer assets, such as bonds.

The minutes of the July FOMC meeting confirmed that the Fed now was slightly more "dovish" in the near term. The minutes revealed that the Fed "could afford to be patient", primarily in order to assess the lower-than-expected US inflation. On the reduction of the Fed's balance sheet, some members were ready to start the process at the July meeting but it was decided to wait until a later meeting (likely September).

Japan's GDP grew a strong 4.0% in 2Q17 (q/q ann.) and the EU grew 2.5% (q/q ann.) in the same quarter. Both figures provide further evidence that the world economy is growing at a good clip. After slipping mid-week, oil prices rebounded by more than 3% on Friday on signs that the physical market was tightening. US crude stocks had declined for the 7th consecutive week.

International macroeconomics

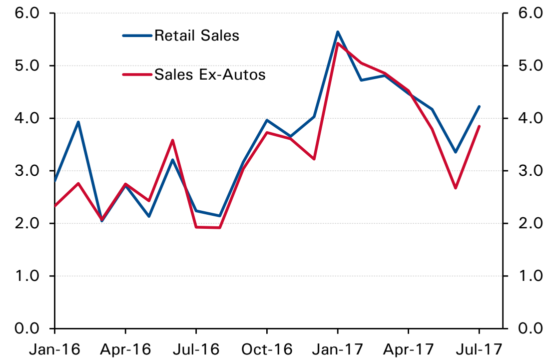
US: Retail sales rose 0.6% m/m in July (0.5% excluding volatile auto sales). The y/y rate recovered as well, posting 4.2%, in line with the average growth rate so far this year. (Chart 1.) The Atlanta Fed's Nowcast estimate for 3Q17 GDP growth was revised a tick up to 3.8% (after 2.6% in 2Q).

Consumer spending and the housing sector are also holding up well. Housing starts fell somewhat in July but their level is still very steady, near 1.2 million units, and up slightly from 2016.

The Philadelphia Fed index of manufacturing activity remained firm at 18.5 (or 56.4 on a 50-basis).

Chart 1: US retail sales

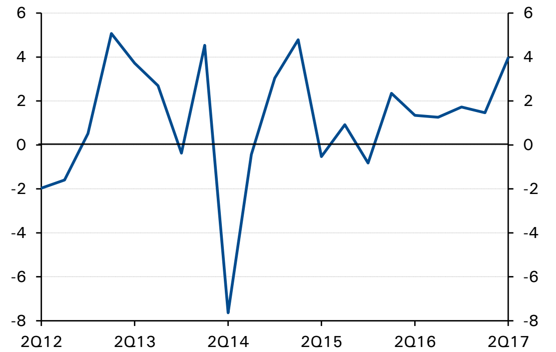
(% ch. y/y)



Source: US Census Bureau

Chart 2: Japan's annualized real GDP

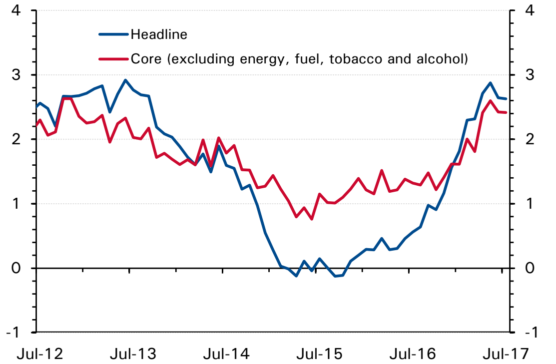
(% y/y)



Source: Japan Cabinet Office

Chart 3: UK inflation

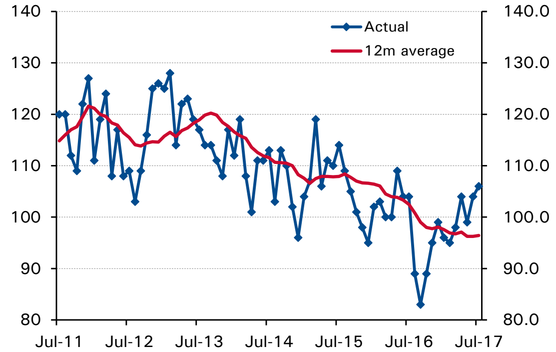
(% y/y)



Source: ONS

Chart 4: Kuwait consumer confidence

(index)



Source: Ara Research & Consultancy

The latest data remain consistent with the Fed's recent assessments of the economy. The minutes from the July meeting also confirmed that we are getting close to a "tapering" of the balance sheet, likely to start in September. Meanwhile, the next Fed hike remains iffy for this year. The Fed wants to review and assess the lower-than-forecast inflation performance and, with tapering pending, could bounce the next hike into 2018.

President Trump was forced to disband two business councils largely made up of business executives. This happened after some CEOs resigned in protest at the president's response to the violence in Virginia last week. This should have little impact on future economic and tax policy, though it does not help the political atmosphere. These councils were consultative and information forums.

Eurozone: EZ 2Q17 growth was confirmed at 2.2% y/y, or 2.5% q/q annualized. Meanwhile, headline inflation was in line with preliminary releases. Core inflation, on the other hand, came in higher at 1.3%. The revisions upwards bolstered investors' confidence in the Euro area's momentum, with European stocks picking up and the EUR holding steady at recent highs.

China: July data showed signs of easing, but steady growth is still expected for the Chinese economy. This would be in line with the government's intention of cooling overheating areas, such as real estate. Factory output slowed in July, growing by 6.4% y/y, but down from June's 7.6% y/y. Fixed asset investment grew by 8.3% y/y for the first seven months of the year, lower than the 8.6% y/y reflected in 1H17. Foreign direct investment for the period from January to July shrunk by 1.2% y/y to CNY 485.4 billion ($72.8 bn). Retail sales beat expectations at 10.4% y/y in July, compared to June's 11% y/y. Finally, new yuan loans were CNY 825.5 billion in July, beating expectations of CNY 800 billion.

Japan: Preliminary estimates showed Japan's real GDP growth surging from an annualized 1.5% in 1Q17 to an impressive, more-than-two-year high of 4.0% in 1Q17. (Chart 2.) The better-than-expected growth rate was mainly driven by stronger growth in private consumption and capital expenditure.

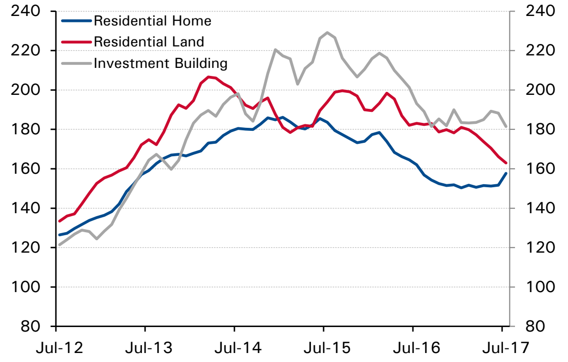
UK: Inflation in July came in below expectations, holding steady at 2.6% y/y. (Chart 3.) While the price of food, clothing and household goods increased (food for the sixth consecutive month), a rise in the headline rate was contained by further declines in the price of fuel. Official figures also showed that in the three months to July, the employment rate hit a record high of 75.1% while the unemployment rate fell to its lowest level since 1975 at 4.4%. Workers' productivity, however, continued to disappoint and lag behind major European countries, falling by 0.1% in 2Q17 after 1Q17's drop of 0.5%. The BoE had remarked earlier in the month that weak productivity growth was holding back wage growth. The employment data was positive for Sterling, which bounced back (+0.2%) from the 7-year low it hit on soft inflation data. Indeed, in the context of anticipating the future trajectory of UK monetary policy, last week's figures might be expected to lend ammunition to the BoE's more hawkish members.

GCC & regional macroeconomics

Kuwait: Consumer confidence improved in July, as the Ara index advanced to 106 points. This is the highest reading in almost two years, backed by a

Chart 5: Kuwait real estate prices

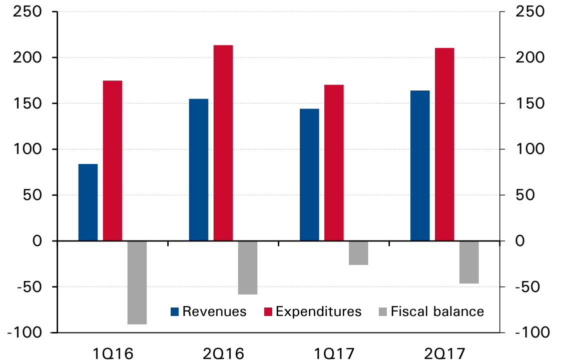
(NBK real estate indices, 2010=100)



Source: Ministry of Justice, NBK estimates

Chart 6: Saudi fiscal balance 2Q17

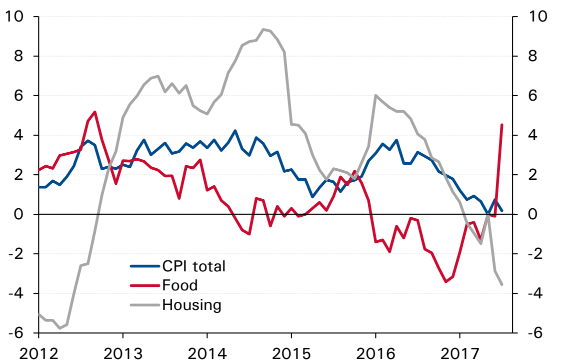
(SR billion)



Source: Ministry of Finance

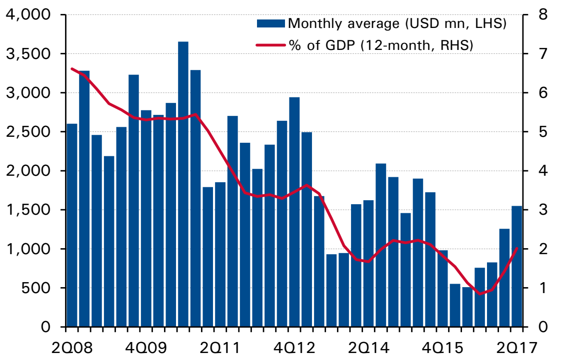
Chart 7: Qatar consumer price inflation

(% y/y)



Source: Thomson Reuters Datastream

Chart 8: Egypt tourism receipts



Source: CBE, Thomson Reuters Datastream, press, NBK estimates

rise in the durable goods component. The index has been trending downward for almost four years, falling below 90 points in mid-2016. The general index's 3-month average in July is still down by 5.9% y/y. The durable goods component soared in July, though the 3-month average remains down 10% y/y. (Chart 4.)

The real estate market appeared more robust in July, with sales up by 12% y/y to KD 161.5 million. The residential sector continued to provide significant support to the sector, with sales increasing by 43% y/y. Real estate prices across most sectors continued to hold steady, although they are still off by 5-10% y/y. (Chart 5.)

Earnings of Kuwaiti listed corporates rose by 16% y/y during the first half of the year, though weak revenue growth continued to indicate softness in business activity. This is despite more robust conditions in the broader economy. The financial sector was the main contributor to growth as investment gains from 1Q17 boosted bottom lines. Results in other sectors, including consumer companies, were more lackluster. Earnings seemed to have a positive impact on the market, with the general index up 6.4% during the reporting period.

Saudi Arabia: According to the MOF's recently-released budget statement for 2Q17, the fiscal deficit narrowed to SR-46.5 billion ($-12.4 bn) from SR-58.4 billion (-$15.6 bn) a year ago. (Chart 6.) The improvement resulted from an increase in government revenues (+6% y/y), thanks to higher oil prices, and a reduction in expenses (-1.0% y/y), due mainly to lower capex spending.

On a q/q basis, however, the deficit widened from 1Q17's SR-26.2 billion (-$7.0 bn). Expenditures increased by 23% q/q after public sector bonus payments were reinstated in April. Other expenses, such as social benefits and infrastructure development, also increased. While on the revenues side, strong non-oil revenues (e.g. investment income, taxes, royalties and fees) helped to offset lower oil revenues.

To finance the deficit, the kingdom announced that it plans to launch the second issue of its local currency sukuk next week. The July sale brought in almost SR 17 billion ($4.5 billion).

According to data published by JODI, Saudi crude exports in June declined by 7.6% y/y to 10.07 mb/d as crude was diverted to domestic power consumption in the hot summer months. However, due to increasing substitution by gas, June's figure of 6.88 mb/d was down by 3.4% y/y.

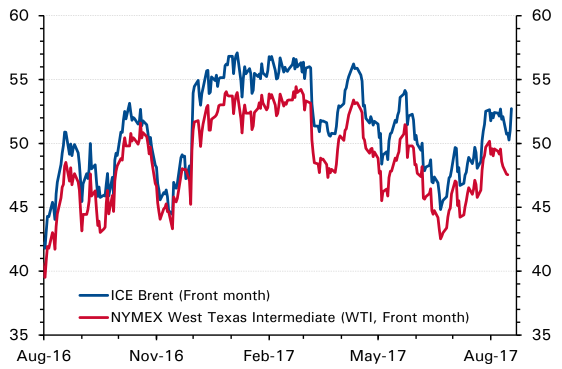
Qatar: Consumer price inflation figures for July show the impact of the trade sanctions on the Gulf state. (Chart 7.) Supply bottlenecks saw food price inflation jump to 4.5% y/y from -0.1% in June. However, inflation in most other segments fell sharply due to weakening demand conditions, meaning overall inflation dropped to just 0.2% y/y from 0.7% in June.

Meanwhile, the diplomatic crisis has seen economists surveyed by Bloomberg cut economic growth expectations for this year to 2.5% from 3.1%. Even this may be optimistic. But more encouragingly, news that King Salman of Saudi Arabia has ordered measures to facilitate Qatari citizens wishing to perform the Hajj—including sending aircraft to and from Doha at his own expense—could hint at some thawing of relations in the dispute.

Egypt: The CBE kept policy rates on hold on Thursday, in line with most analysts' expectations. The central bank chose to leave the CBE lending and deposit rates unchanged at 18.75% and 19.75%, respectively, in an effort to counteract persistent inflationary pressures. Inflation in July

Chart 9: Benchmark crude oil prices

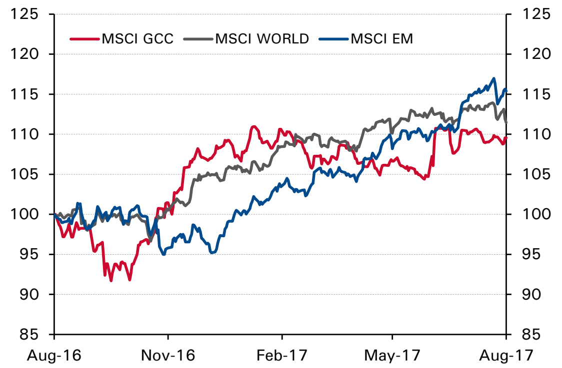
($/bbl)



Source: Thomson Reuters Datastream

Chart 10: Total return indices

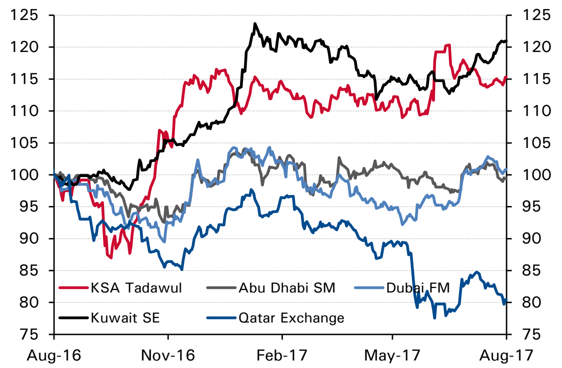
(rebased, 18 August 2016=100)



Source: Thomson Reuters Datastream

Chart 11: GCC markets

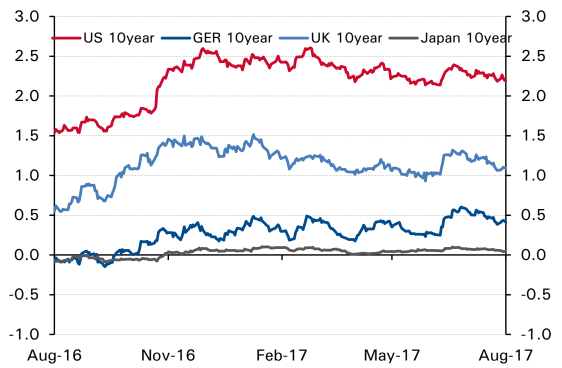
(rebased, 18 August 2016=100)



Source: Thomson Reuters Datastream

Chart 12: Global benchmark yields

(%)



Source: Thomson Reuters Datastream

accelerated to 33% y/y, following hikes in fuel prices and the VAT rate.

Moody's affirmed Egypt's sovereign rating at B3 with a stable outlook despite some expectations that the agency would upgrade the rating given the improving fundamentals. The agency pointed to continued weakness in the country's fiscal position and large financing needs, while noting the "strong" commitment to reform.

Tourism receipts and worker remittances continued to improve in 2Q17, benefiting from the floating of the pound and from improved security conditions. Tourism receipts tripled to $1.5 billion in 2Q17 from a year ago, growing by 17% during the full FY16/17. Despite the improvement, receipts remain well below pre-"Arab Spring" levels. (Chart 8.) Worker remittances were up by 9% y/y in 2Q17 to $4.8 billion.

The government approved new regulations overhauling the investment environment in the country, as part of broader structural reforms. The executive regulations for the new investment law, which provides broad guarantees and incentives to foreign investors and simplifies the investment process, still require a legal review before going into force.

Markets – oil

Oil prices jumped over 3% on Friday—the most in 4 weeks—in response to signs that the physical market was tightening. (Chart 9.) Brent and WTI closed the week at $52.72/bbl and $48.51/bbl, respectively, after traders rushed to cover short positions in the wake of EIA data that showed that US crude inventories had declined for the 7th consecutive week. Amid near-record refinery runs, stocks fell by 8.9 mb to their lowest level (466 mb) since January 2016. Markets remain nervous, however, given that the same data also noted that US crude production was back on its upward trajectory; with the peak summer oil demand season ending soon and refineries scheduled to begin their autumn maintenance period soon, there may be some turbulence ahead for oil prices.

Markets – equities

Equity markets saw a rebound early last week as tensions with North Korea eased, only to be pulled back down by escalating political tensions in the US and the terror attacks which hit Europe. The MSCI All Country World Index was down by 0.1% w/w. The S&P 500 and DJIA retreated 0.6% and 0.8%, respectively. European equities saw their strong gains from earlier in the week trimmed as markets shifted to risk-off mode. The Euro Stoxx 50 closed up 1.2%. Emerging market equities also managed to hold on to some of their gains, with the MSCI EM up 1.4%. (Chart 10.)

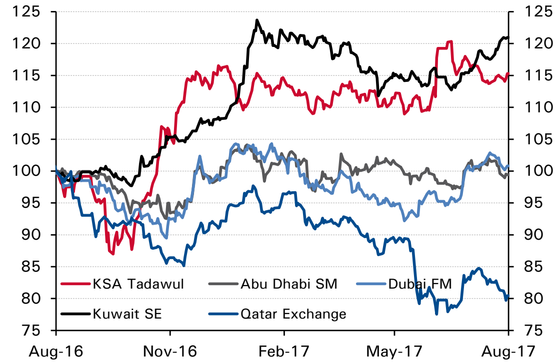
With the exception of Saudi Arabia and Kuwait, all GCC markets retreated last week. The MSCI GCC closed down 0.1% as oil prices dropped. Qatar underperformed, with its general index down 1.5%. Meanwhile, the sale of Zain's treasury shares to Omantel drove the Kuwaiti market, with its value-weighted index up 1.2% on the week and activity picked up noticeably. (Chart 11.)

Markets – fixed income

Though fixed income investors sold off last week's safe-haven purchases as US and North Korean tensions abated, interest rates were kept at bay by central bank "dovish" talk n and the attacks in Europe. US 10-year treasuries were steady at 2.19%. The 10-year bunds added 3 bps to settle at 0.41%.

Chart 13: GCC yields

(%)



Source: Thomson Reuters Datastream

In US markets, rates were pushed higher by strong retail sales and decent housing. Their rise, however, was contained by the release of the Fed's July meeting minutes. Fears of unsustainable inflationary pressures had fed officials split over future monetary policy, with more members favoring a more patient approach. This came in accordance with recent Fed-speak. (Chart 12.)

In the Eurozone, the ECB minutes revealed concern over euro strength. The euro was initially supported by the upwards revision of 2Q17 EZ GDP growth. This had investors expecting the ECB to follow through with tapering. Markets are currently looking for some tapering guidance in September and an announcement in October by the ECB.

GCC sovereign yields were mixed on the week. Dubai 2021 paper edged lower by a mere 1.2 bps. Meanwhile, 2022 bonds for Saudi and Kuwait saw a small bump of 1.9 bps each. Bonds maturing in 2021 for Abu Dhabi and Qatar were steady. (Chart 13.)

Saudi Arabia is planning to issue local currency sovereign sukuk to help finance its deficit, for the second time this year, reflecting the ongoing improvement in domestic liquidity. Last month it sold SAR 17 billion in domestic sukuk.

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