Weekly Economic and Markets Review
14 May 2017

Markets steady after Macron victory; Saudi Arabia and Qatar take VAT first step; S&P downgrades Oman debt

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi (ADI)	4,608	-0.19	1.36
Bahrain (ASI)	1,307	-1.81	7.10
Dubai (DFMGI)	3,420	0.01	-3.13
Egypt (EGX 30)	12,907	1.55	4.55
KSA (TASI)	6,883	-0.60	-4.55
Kuwait (Price Index)	6,670	-1.22	16.05
Oman (MSM 30)	5,432	-0.80	-5.44
Qatar (QE Index)	10,111	1.74	-3.12
MSCI GCC	465	0.36	-2.02
International			
DAX	12,770	0.42	11.23
DJIA	20,897	-0.53	5.74
FTSE 100	7,435	1.89	4.10
Nikkei	19,884	2.25	4.03
S&P 500	2,391	-0.35	6.79

Commodities	$/bbl	Change (%) weekly	Change (%) YTD
Brent crude ($/bbl)	50.8	3.54	-10.52
KEC ($/bbl)	47.7	4.63	-8.12
WTI ($/bbl)	47.8	3.50	-10.95
Gold ($/t oz.)	1226.7	0.16	6.08

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.304	0.12	-0.32
KWD per EUR	0.331	-0.81	4.09
USD per EUR	1.093	-0.62	3.94
JPY per USD	113.33	0.55	-3.03

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Kibor – 3 month	1.63	0.0	18.8
Qibor – 3 month	1.94	0.3	15.6
Libor – 3 month	1.18	-0.1	18.2

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.39	-0.5	-15.9
Dubai 2021	2.93	-6.0	-39.4
Qatar 2021	2.51	-6.5	-44.5
Saudi Arabia 2021	2.80	-5.5	-25.6
International			
UST 10 year	2.33	-2.5	-10.6
Bunds 10 year	0.39	-3.2	18.5
Gilts 10 year	1.10	-2.1	-14.4
JGB 10 year	0.04	2.4	-0.6

Source: Thomson Reuters Datastream

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Summary

Brent oil prices managed to move back up above $50 pb, thanks to lower crude inventories, after a few days spent below that level. Oil prices are still being driven primarily by: rising US (shale) production, inventory levels and the likelihood of an extension and possible deepening of the current OPEC/non-OPEC production cut agreement.

The election of centrist and pro-EU Emmanuel Macron to the French presidency soothed markets. However, the result was widely anticipated and the euro rose briefly to 1.10 against the USD, before returning to the 1.09 area. The focus returns to economic fundamentals, and expected rate hikes in the US later this year should limit euro advances. Volatility measures made new lows on the week (both equity and FX).

Saudi Arabia published the GCC VAT (value-added tax) law in its official gazette, marking the first legal step toward introducing a VAT scheme as early as 2018. Other GCC countries are expected to follow suit at their own pace, likely led by Qatar and the UAE.

The IMF provided a positive assessment of the Egyptian economy and progress on reforms, paving the way for a disbursement of another $1.25 billion of a $12 billion loan.

Kuwait saw some solid bank credit growth in March, up KD 488 million. S&P downgraded Oman to BB+ (below investment-grade).

International macroeconomics

USA: April CPI rose 0.2%, 0.1% for the core. The y/y rates are 2.2% and 1.9%, off a bit from recent months, and in line with Fed and market expectations. We are close to target and there are no signs of due pressure, so the Fed remains on track for further "normalization" (two more hikes this year). The next FOMC meeting is on 13-14 June. (Chart 1.)

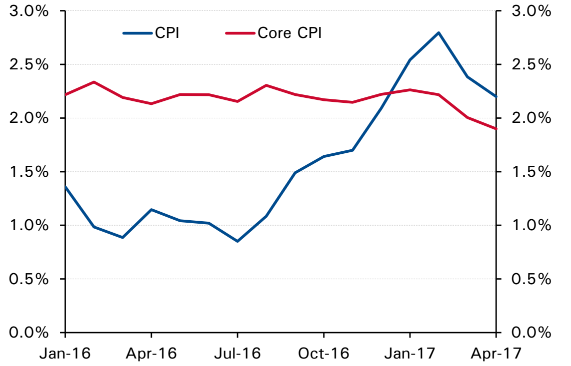
April retail sales rose 0.4%, 0.3% excluding volatile auto sales. Though not stellar, sales remain steady and in line with solid levels of consumer confidence. Y/y April sales are running 4.5%, in line with GDP growth of 2.0%, the expectation for the year.

Eurozone: Pro-EU candidate Emmanuel Macron won 66% of the vote to become France's next president. The victory reduced fears over the rise of the anti-establishment movement in Europe. As a result, the euro shot to $1.10 shortly after, its highest level since Mr. Trump's election. President Macron and his political party "En Marche!", however, still need to show they are capable of acquiring a majority in June's legislative elections. A failure to do so could see Mr. Macron forced to share power through a coalition government or co-habitation (a form of power-sharing under which a prime minister from the opposition runs the government).

The European Commission released its Spring 2017 economic forecasts with growth seen steady over the next two years. Euro area growth is expected at 1.7% in 2017 and 1.8% in 2018.

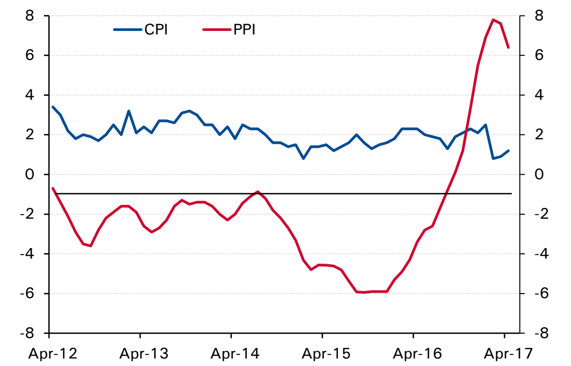
Chart 1: US Consumer price inflation

(% y/y)



Source: BEA

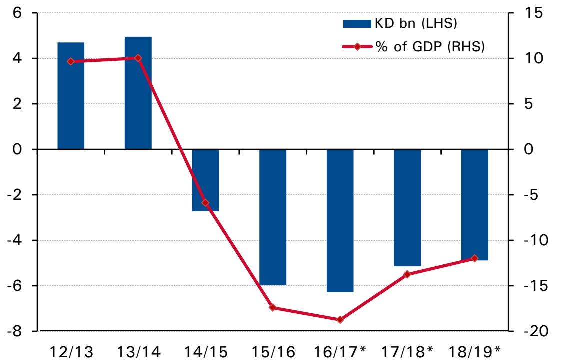
Chart 2: China consumer & producer price inflation



Source: Thomson Reuters Datastream

Chart 3: Kuwait budget balance

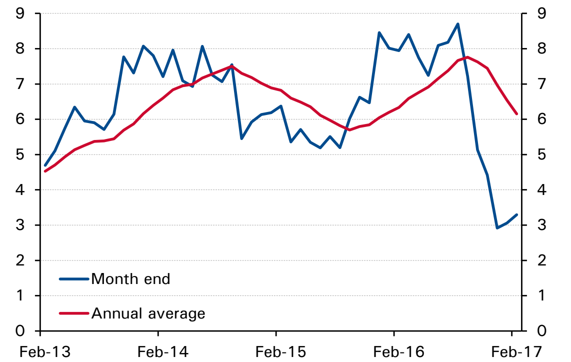
(after Future Generation Fund obligations)



Source: Ministry of Finance, NBK estimates, *estimate/forecast

Chart 4: Kuwait credit growth

(% y/y)



Source: Central Bank of Kuwait

China: Inflation gathered pace in April, but at 1.2% y/y it remained historically low, reflecting weakness in domestic demand. (Chart 2.)

GCC & regional macroeconomics

Kuwait: March credit growth rose to 3.6% y/y, on a monthly gain of KD 488 million (Chart 3). Gains were seen across a number of sectors led by oil & gas. Growth in "productive" sectors (excluding real estate and securities lending) accelerated to a robust 9.6% y/y reflecting progress in Kuwait's projects pipeline. Private deposits saw a large increase, as most banks paid out cash dividends in March.

Government spending during the first eight months of FY16/17 (through November 2016) was higher than expectations at 98% of the prorated budget (vs. a 5-year average of 91%). The figure implies annualized spending of KD 18.5 billion in FY16/17 (up 1.5%) and a deficit of KD 6.3 billion, or 19% of GDP (Chart 4). Capital spending was relatively weak; only 22% of the full-year budget was spent on projects, compared to a historic average of 28% and 34% in the prior year.

The current account recorded its first deficit in over two decades in 2016, on the back of a decline in export earnings linked to lower oil prices. The current account balance registered a deficit of 4.5% of GDP compared to a 3.5% surplus in 2015 (Chart 5). To finance the deficit, there was a drawdown of liquid government assets held overseas, which resulted in the first net inflow of assets since the early 1990s. We expect the current account to see a surplus of 1-2% of GDP in 2017.

Saudi Arabia: The VAT Unified Agreement, which provides the framework for the operation of VAT across the GCC, was published in the Saudi official gazette. A standard rate of 5% on goods and services will be implemented across the GCC. Financial services will be exempt and member states can decide whether to exempt other sectors. The VAT will be applied on businesses with annual turnover of SR 375,000 or its equivalent.

In an effort to expand the domestic mortgage market, which has one of the lowest penetration rates in the world, the state-backed Saudi Refinancing Company began approaching banks to purchase their mortgage portfolios, currently valued at SR 116 billion. Once it secures central bank approval, it plans to purchase up to SR 50 billion worth of mortgages. The country's housing shortage is likely to rise to 1.5 million homes within five years.

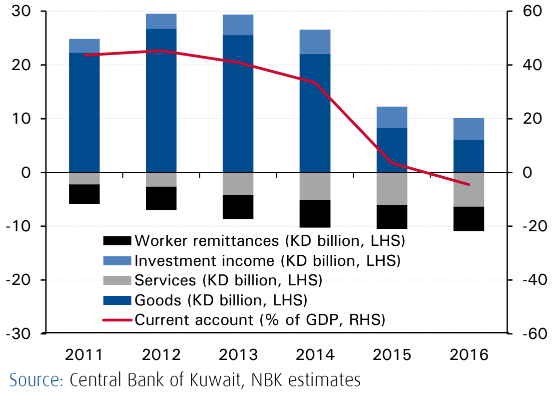
UAE: According to ENBD's Dubai Economy Tracker Index (DETI), Dubai's non-oil economy expanded at its fastest pace in over two years in April. The DETI rose from 56.6 in March to 57.7 in April as output and new order numbers remained robust amid a rise in construction activity (Chart 6).

Oman: S&P lowered Oman's credit rating by one notch to BB+ from BBB-, effectively placing the sovereign at below investment-grade. The downgrade was accompanied by a negative outlook rooted in worries over Oman's net external asset position. We expect the government to register a deficit of 13% of GDP and real growth to slow to 0.1% in 2017.

Qatar: According to S&P Global Ratings, Qatari banks' large external liabilities represent a significant risk for the banking system. Overall gross external funding doubled to QR 441 billion ($121 billion) by the end of 2016. With most of the debt USD-denominated and short-term (<6 months) and with a sizeable portion funding longer-term domestic investments, the currency and maturity mismatches leave banks exposed to shifts in global sentiment and liquidity conditions, the agency noted.

Chart 5: Kuwait current account

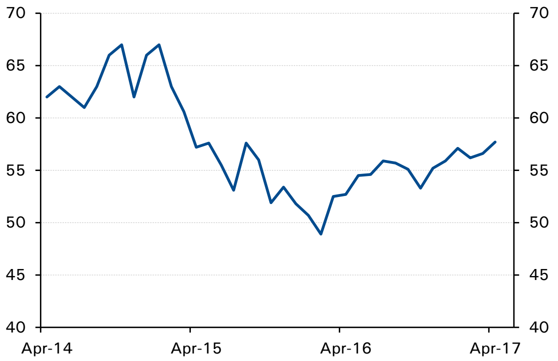
(KD billion)



Source: Central Bank of Kuwait, NBK estimates

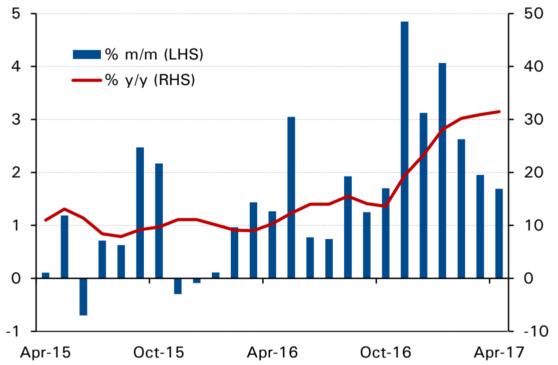
Chart 6: Emirates NBD Dubai Economy Tracker

(index)



Source: Emirates NBD

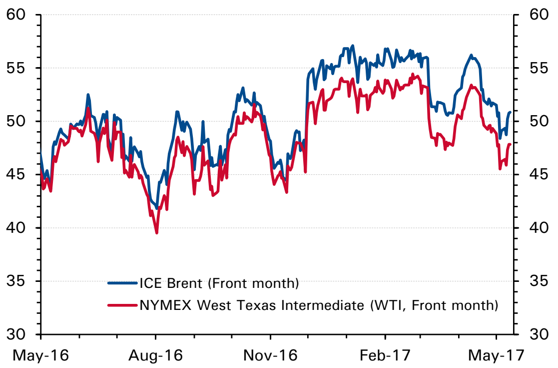
Chart 7: Egypt inflation



Source: Central Bank of Egypt

Chart 8: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

Qatar officially endorsed the GCC VAT framework last week, becoming the second member (after KSA) to formally adopt the GCC-wide agreement.

Egypt: The IMF provided a positive assessment of the Egyptian economy and the progress of reforms, paving the way for disbursing an additional $1.25 billion of a $12 billion loan agreement, pending the approval of the IMF's Executive Board. The IMF sees that good progress on fiscal reforms has been made, with the FY17/18 draft budget to "place public debt on a clearly declining path to sustainable levels". The IMF believes the economy is also seeing "a strong rebound" following the floating of the pound late last year.

The monthly pace of inflation continued to ease in April, though annual inflation remained elevated at over 31% y/y (Chart 7). We expect annual inflation to remain high for most of 2017 as a result of the decision to float the pound in November 2016. Expected hikes in electricity prices in 3Q17 could put some further pressure on prices.

Markets – oil

Oil prices received some positive impetus mid-week by another set of crude stock drawdowns in the US. Prices rose by around 3% on Wednesday after the EIA's weekly petroleum report showed that crude inventories declined for the fifth week in a row. The fall, at 5.2 million barrels, was also the largest this year. By Friday's close, Brent and WTI had increased to $50.80/bbl and $47.80/bbl, respectively. (Chart 8.)

Also contributing to oil's rise was Saudi Arabia's announcement to two of its Asian customers that it would cut their crude deliveries in June by more than expected, and news that the kingdom and Russia appeared amenable to extending the OPEC/non-OPEC production cuts beyond June 2017. Some OPEC members have also discussed the option of deepening the cuts in order to accelerate the drawdown of crude stocks in the face of relentless US shale output growth.

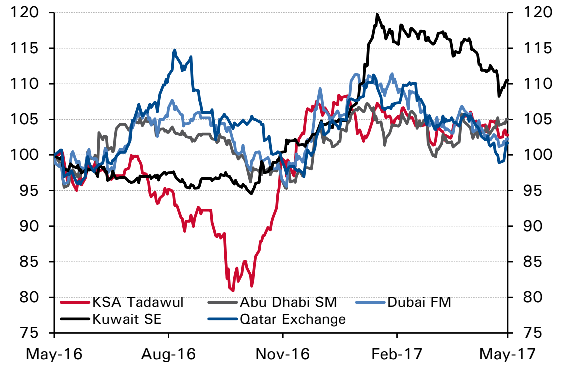
Chart 9: Global stock markets

(rebased, 15 May 2016=100, total return)

Source: Thomson Reuters Datastream

Chart 10: GCC stock markets

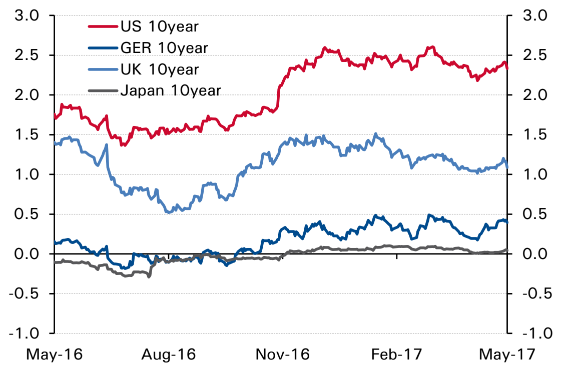
(rebased, 15 May 2016=100)



Source: Thomson Reuters Datastream

Chart 11: Global bond yields

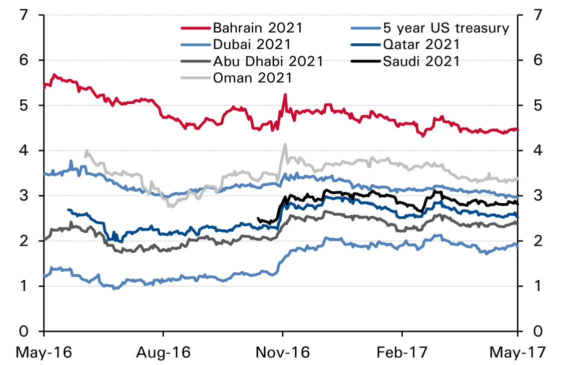
(%)



Source: Thomson Reuters Datastream

Chart 12: GCC bond yields

(%)



Source: Thomson Reuters Datastream

Markets – equities

Equity markets had a mixed performance this week with the MSCI World unchanged amid a notable decline in market volatility. The CBOE Volatility Index (VIX) closed at its lowest levels in 23 years, reflecting a sharp drop in the level of uncertainty in markets. Meanwhile, US equities saw some profit-taking following weeks of gains. The S&P 500 and DJIA were off 0.4% and 0.6%, respectively. European equities also edged lower after a solid performance in the run up to the French election with the Euro Stoxx 50 down 0.1%. Emerging markets outperformed this week, with the MSCI EM advancing 1.4%. (Chart 9.)

The performance of GCC markets was also mixed, with the MSCI GCC index up 0.4%. With only a few days left for earning announcements, profits for 1Q17 have so far failed to create upward momentum, despite beating expectations in most cases. (Chart 10.)

Markets – fixed income

Global government bond market dynamics were driven early on by relief over the French election outcome and US Treasury supply, before reacting to Mr. Trump's latest political moves and weaker than expected April US CPI. Both US government yields and German Bund yields ticked higher early in the week as markets unwound their risk-off positions in response to Mr. Macron's (pro-EU) win. Large bond supply (from the US May quarterly refunding) also pressured US Treasury yields higher.

Global rates moved lower later as investors sought some safe-haven buying following the surprise firing of FBI director Comey and hostile threats from North Korea. Weaker than expected US inflation numbers also pressured global yields lower as US Fed rate hike expectations were revised slightly down. US 10-year Treasuries ended the week at 2.33%, while 10-year Bunds closed at 0.39%. (Chart 11.)

GCC yields on bonds maturing in 2021 were mixed, with Abu Dhabi and Oman finishing the week up by 3 bps each, while Saudi, Qatari, and Dubai yields dropped between 5-7 bps. Kuwait's 2022 bond was down 4 bps on the week, trading at 2.63%. (Chart 12.)

The Bank of England left its monetary policy unchanged, but altered their outlook to account for the ongoing impact of Brexit. The BoE now expects slightly weaker growth for 2017 at 1.9% (2.0% prior) and higher inflation of 2.7% (2.4% prior).

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