UK and EU agree “divorce terms”; hopes of a diplomatic breakthrough on Qatar rift are disappointed

Overview

The UK and the EU reached an 11th hour agreement over the so-called Brexit “divorce terms”, which will allow them to move on to talks about a future trade arrangement. Initial attention is likely to focus on a possible 2-year transition deal to take effect after the UK’s departure in March 2019, with a full-blown trade agreement set to take longer. The British pound held close to a 5-month high versus the euro, though it is still 10% below its pre-2016 referendum levels.

It was an up-and-down week for oil, with Brent crude prices falling 3% midweek on a large reported rise in US gasoline inventories, before bouncing back on strong Chinese import demand data to stand at $63/bbl, slightly lower on the week. Although the outlook for supply remains solid – US crude production hit another modern-day high the previous week and drilling rigs continued to rise – the feeling is, for now, that the OPEC/non-OPEC output cut extension through 2018 has backstopped prices at around the $60 mark.

Hope of a diplomatic breakthrough on the Qatar rift at the GCC summit in Kuwait last week turned to disappointment as the summit broke up a day early. The Qatari stock market, which had risen more than 2% a day before, had dropped sharply midweek on a large reported rise in US gasoline inventories, before bouncing back on strong Chinese import demand data to stand at $63/bbl, slightly lower on the week. Although the outlook for supply remains solid – US crude production hit another modern-day high the previous week and drilling rig continued to rise - the feeling is, for now, that the OPEC/non-OPEC output cut extension through 2018 has backstopped prices at around the $60 mark.

International macroeconomics

US: November’s employment report continued to show solid labor conditions, with nonfarm payrolls up 228,000. The survey also showed a rise in the average workweek, reflecting increasing tightness in the market. The unemployment rate was unchanged at 4.1%. Despite the strong employment numbers, wage growth remained subdued at 2.5% y/y, disappointing those looking for a pick-up in inflation. (Chart 1.)

Congress passed a 2-week stopgap spending bill last week, averting a government shutdown and giving legislators more time to agree to new spending levels for the 2018 fiscal year. A broad bipartisan effort is currently underway to reach an agreement which could include deals on immigration and healthcare.

Eurozone: The eurozone PMI data confirmed strong flash figures from the week before, with the index hitting a more than 6-year high of 57.5 in November. Strength continued to be broad-based, with France (60.3), Ireland (57.7), and Germany (57.3) seeing the best performance. The data point to further strengthening in Q417 GDP growth. The final revision for Q317 confirmed growth at a robust 2.6% y/y.

Meanwhile, producer price inflation was stronger than expectations in October, rising by 0.4% during the month, though y/y price growth slipped to 2.5%. Inflationary pressures have been building up in recent months,
PM Theresa May finally got the approval from the EU she needed to advance Brexit negotiations to the second stage, which will focus on trade and Britain’s post-Brexit relationship with the EU. Britain’s agreement to pay €40-60 billion as part of the divorce settlement, its acceptance of the residence and social security rights of 3 million EU citizens living in the UK (and 1 million UK citizens living in Europe) and its recognition of Northern Ireland’s wishes for regulatory alignment with the UK appeared to be enough to satisfy the EU’s requirement for evidence of “sufficient progress” before opening trade negotiations. These are slated to commence no earlier than February, however, leaving the UK with just 13 months before the expiry of Article 50. Sterling initially climbed against both the US dollar (to $1.35) and the euro, reaching a 6-month high (£0.87) against the latter, before retreating against both currencies.

**GCC & regional macroeconomics**

**Kuwait:** Credit was weaker than expected in October, though growth rose to 4.6% y/y on base effects. (Chart 2.) The month saw total credit contract by KD 220 million. While some of that was from the usual start-of-quarter drop in securities lending, there was additional weakness in some business sectors. Nonetheless, growth improved as the impact of last year’s Americana-related repayments faded. Private deposits saw a decline on the heels of two strong months.

**Saudi Arabia:** Private sector activity in the kingdom accelerated to a 27-month high in November. (Chart 3.) A sharp rise in the headline PMI from 55.6 to 57.5 signaled a strong improvement in overall business activity, driven by increases in output, new orders and new export orders. Employment growth continued in positive territory as well, with businesses recording the 44th consecutive month of job creation last month.

The Saudi non-oil economy appears to be slowly recovering from more than two years of anemic growth. Retail point-of-sale (POS) activity surged by 15% y/y (by value) in October, helped in large part by the retrospective payment of allowances by the government to public sector employees. In 3Q17, state employees received seven months of back pay for the allowances suspended between October 2016 and April 2017. The kingdom has signed an economic and military partnership with the UAE. The alliance was announced just hours before the start of the recent and prematurely terminated GCC summit held in Kuwait. Sheikh Khalifa bin Zayed Al-Nahyan, the UAE’s president, stated that a “joint cooperation committee” would be set up to coordinate in “all military, political, economic, trade and cultural fields”.

**UAE:** The non-oil sector continues to steadily strengthen. The headline PMI climbed from 55.9 in October to 57.0 in November, as the ongoing strength in new orders and output data offset weakness in export orders. (Chart 4.) New orders held at a robust 60.2 and output rose to an over two-year high of 64.3, thanks to continued gains in domestic demand. New export orders, however, slipped back into contractionary territory at 47.5, as a stronger dirham continued to weigh on demand.

**Qatar:** The central bank’s international reserves edged up by $0.5 billion in October to $36.1 billion, only the second rise since April. (Chart 5.) This still leaves them nearly $10 billion lower than before the GCC diplomatic dispute began in June, but at least points to some easing of outflow following a few months of softness during the summer.
pressures. Note that the QCB recently updated its calculation methodology, which saw reserves nearly double from previous levels. Overall reserves now stand at 7 months of imports, but this does not include an estimated $300 billion plus in assets held by the Qatar Investment Authority – the sovereign wealth fund.

**Egypt**: The headline PMI rose to 50.7 in November, its highest level in over 2 years, as the recovery appeared to gain momentum. (Chart 6.) Despite the rise, the index continues to come in below levels suggested by GDP growth, which accelerated to 5.2% in 3Q17. Gains in the index were across all components, though exports were particularly strong. Price pressures continued to recede during the month.

CBE foreign reserves remained mostly steady in November at $36.7 billion or an estimated 8.1 months of imports. (Chart 7.) The strong recovery in foreign reserves over the last year has seen the CBE remove restrictions imposed after 2011 on foreign currency activity. Last week, the CBE scrapped caps on deposits and withdrawals by importers. It also imposed a 1% entry charge for use of the CBE repatriation mechanism by foreign investors, presumably in an effort to discourage its use and possibly with an eye toward eventually phasing it out entirely.

**Markets – oil**

Brent and WTI posted two days of gains to close on Friday at $63.4/bbl and $57.36/bbl, respectively. (Chart 8.) The spur was a rebound in crude demand from China, the world’s second largest consumer. Only last month Chinese crude imports had dropped to a one-year low. Oil’s end-of-week rise followed Wednesday’s sharp fall in response to the EIA’s latest petroleum report, which showed US crude production rising to 9.71 mb/d, the highest level in weekly data since 1983. US petroleum product inventory data was also quite bearish for the markets, with gasoline stocks surging by the most in one week (6.78 mb) since January. Stock builds at this time of year are not atypical, however.

**Markets – equities**

International markets advanced during the first week of December, with the MSCI World All Country index closing up 0.5%. US equities logged losses for the first three consecutive days, then reversed those falls towards the end of the week on stronger-than-expected job data and a slight pickup in wages. The S&P 500 and DJIA ended the week up 0.4% each. The prospect of a U.S. government shutdown on Saturday was postponed for two weeks as Congress approved a two-week funding bill, supporting markets further. European markets rallied on a breakthrough in Brexit talks, posting a 1.8% gain for the week. Emerging markets were down 0.2% for the week. (Chart 9.)

GCC markets were mostly down last week, with geopolitics weighing on sentiment. The MSCI GCC index closed up 0.6% on the week, supported by the rally in the Saudi market that ended the week up 1.2%. Other GCC markets witnessed a short-lived spike earlier in the week, hopeful for a breakthrough in the diplomatic dispute ahead of the GCC summit. However, the agreement didn’t materialize, and markets reverted back to pre-summit levels. The Kuwait (weighted) and Dubai indices were down 1.2% and 0.8%, respectively. Qatar’s market was up 0.8% for the week. (Chart 10.)
Markets – fixed income

Yields moved higher internationally as economic data came in mostly positive and the inflation picture was largely unchanged last week. (Chart 11.) In the US, solid economic data and bipartisan efforts to avoid a government shutdown saw Treasury yields continue to move higher. Nonetheless, Congress’s stopgap spending bill still means an agreement needs to be reached before year-end on the budget and the debt ceiling. Yields on German bunds were also up, with eurozone PMIs showing robust growth there. In Japan, yields rose in one of their best weeks in a while, as revised growth data showed the economy enjoying its longest growth streak in decades. Regionally, most benchmark yields moved higher in tandem with global markets, even as a solid rebound in oil prices eased some fiscal concerns. (Chart 12.)