Weekly Economic and Markets Review

NBK Economic Research Department I 21 October 2018

International & MENA

US rate outlook, European politics weigh on markets; Gulf economies improve competitiveness rankings

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,989	0.42	13.42
Bahrain (ASI)	1,323	0.56	-0.62
Dubai (DFMGI)	2,758	0.09	-18.17
Egypt (EGX 30)	13,644	2.72	-9.15
GCC (S&P GCC 40)	1,101	0.42	11.84
Kuwait (All Share Index)	5,004	-1.22	3.59
KSA (TASI)	7,648	1.56	5.84
Oman (MSM 30)	4,444	-1.01	-12.84
Qatar (QE Index)	10,193	3.36	19.59
International			
CSI 300	3,135	-1.13	-22.23
DAX	11,554	0.26	-10.56
DJIA	25,444	0.41	2.93
Euro Stoxx 50	3,211	0.51	-8.37
FTSE 100	7,050	0.77	-8.30
Nikkei 225	22,532	-0.72	-1.02
S&P 500	2,768	0.02	3.52

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.69	-0.2	74.5
Dubai 2022	4.14	0.9	99.6
Qatar 2022	3.75	-0.2	67.5
Kuwait 2022	3.69	0.8	88.5
Saudi Arabia 2023	4.24	26.8	102.5
International			
UST 10 Year	3.20	6.1	79.1
Bunds 10 Year	0.43	-6.4	1.0
Gilts 10 Year	1.58	-5.5	39.1
JGB 10 Year	0.15	0.0	9.9

3m interbank rates	%	Change (bps) weekly	YTD
Bhibor	3.70	-5.0	97.5
Kibor	2.06	0.0	18.8
Qibor	2.81	3.5	6.5
Eibor	2.65	-4.9	85.4
Saibor	2.74	0.5	83.9
Libor	2.47	3.3	77.5

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.303	0.02	0.59
KWD per EUR	0.348	-1.91	-1.86
USD per EUR	1.151	-0.42	-4.03
JPY per USD	112.5	0.31	-0.12
USD per GBP	1.307	-0.64	-3.27
EGP per USD	17.87	-0.17	0.79

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	79.8	-0.81	19.31
KEC	71.1	-6.27	21.42
WTI	69.1	-3.11	14.40
Gold	1225.3	0.59	-6.20

Source: Thomson Reuters Datastream; as of Friday's close 19/10/2018

Overview

Despite encouraging US corporate earnings and generally strong economic data, financial markets were in cautious mood last week weighed by concerns about tighter US monetary policy, rising fears of a 'no deal' outcome from UK-EU Brexit negotiations and a formal warning for Italy from the European Commission over its 2019 budget plans that could end in financial penalties. The latter saw Italian 10-year government bond yields spike to a four-year high of nearly 3.7% – a development that harms a banking sector heavily exposed to government debt. In Asia meanwhile, Chinese growth slowed to 6.5% in 3Q18, weaker than expected and the slowest since the financial crisis amid the escalating trade war with the US.

Brent crude had an 'up and down' week, first dropping before staging a partial recovery to end a fraction below $80/bbl, down 0.8% w/w. Prices have pulled back from highs of two weeks ago on a combination of US interest rate hike speculation, US-China trade tensions which could slow Chinese oil demand and news of a rise in US crude inventories for the fourth successive week and by more than expected.

There were improvements in the rankings for most Gulf economies in the World Economic Forum's latest Global Competitiveness Report, which grades countries each year on factors key to economic development including the macroeconomic climate, human capital, market structures and innovation potential. The UAE once again came top in the region, ranked 27th out of 140 countries measured, followed by Qatar (30) and Saudi Arabia (39) while there was a small improvement for Kuwait (54 from 56). The biggest improvement however came in Oman, whose rank jumped to 47 from 61 last year helped in particular by better scores on business dynamism and innovation capability.

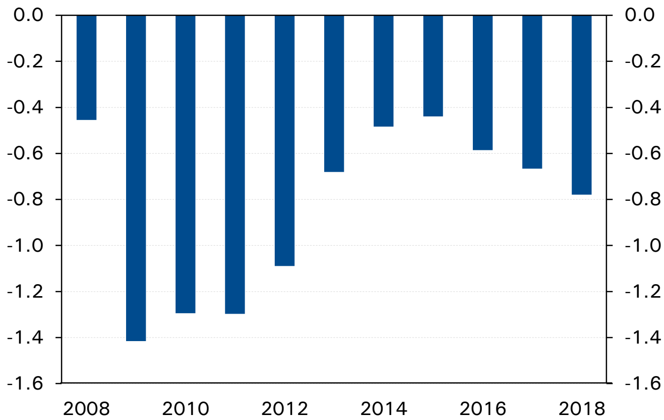
International macroeconomics

USA: Minutes from the Federal Reserve's September policy meeting – at which the Fed funds target rate was increased by 25 bps to 2-2.25% – were bullish with some members suggesting that interest rates may have to become "modestly restrictive" to prevent the economy overheating and inflation rising above target. This appeared to imply greater Fed conviction in its message of further albeit "gradual" rate hikes next year. Fed policy has been the subject of criticism from President Trump, who says the bank is tightening too quickly. Still, futures markets are pricing in an 80% chance of a further rate hike in December.

Meanwhile, the federal government recorded a budget deficit of $779 billion in fiscal year 2017-18 (ending September 2018), or 3.9% of GDP. (Chart 1.) This was slightly below expectations, but still 17% larger than the previous year and the largest since 2012. Despite the strong economy, revenues rose just 0.4% y/y, limited by recent tax cuts for businesses. Spending rose by a stronger 3%, helped by rising debt and interest costs due to higher interest rates. The Congressional Budget Office projects the deficit breaching the $1 trillion mark this year.

Chart 1: US Federal budget balance

($ trillion, fiscal year ending September)



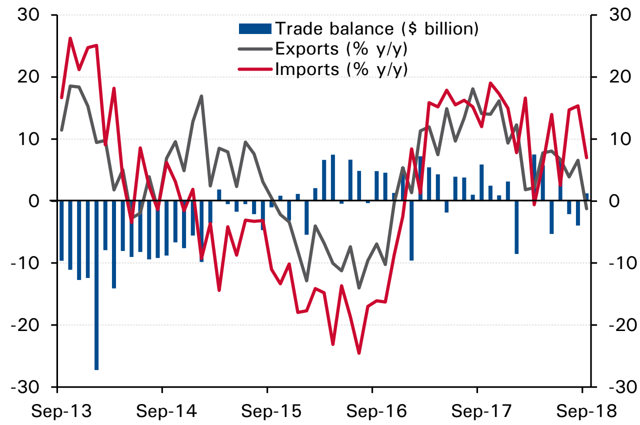
Source: Thomson Reuters Datastream

Data for the real economy was decent overall last week. Retail sales for September disappointed – perhaps affected by hurricane Florence – but growth remains at a robust 5.9% y/y. Industrial production growth accelerated to 5.1% y/y helped by continued strong growth in mining while the Philadelphia Fed survey of manufacturing was solid in October. But weakness in the housing market continues, with existing home sales falling 3.4% m/m in September amid rising mortgage rates and despite price discounting.

Eurozone: Tensions grew between Italy's populist government and the European commission last week. The Italians stuck to their guns on fiscal policy despite clear opposition from the EU governing body, but clarified that they have no intention to leave the union. Alarmed by its strong position, Moody's downgraded the credit worthiness of Italian debt by one notch to Baa2, one rating above non-investment grade. This prompted a sell-off of Italian debt, with yields on 10-year Italian bonds reaching a high of 3.67%, before finishing the week at 3.58%.

Japan: Japan's trade sector continues to struggle, not least because of the ongoing trade war between China and the US. In September, Japanese shipments fell for the first time since 2016, mainly on the back of a fall in demand from both China and the US as well as supply constraints, following a series of natural disasters over the last few months. The continued weakness in domestic demand also weighed on import growth, which slowed from 15.3% y/y in August to 7.0% y/y in September. (Chart 2.) Tepid external and domestic demand as well as disaster-struck production activity are likely to have caused GDP growth to slow in 3Q18.

Chart 2: Japan international trade



Source: Thomson Reuters Datastream

China: China's economic growth in 3Q18 came in below expectations, as government efforts to shore up the economy were undermined by fresh downward pressures caused by US import tariffs on $250 billion worth of Chinese goods. GDP growth retreated from 6.7% y/y in 2Q18 to 6.5% y/y in 3Q18, its slowest growth rate since the height of the global financial crisis in 1Q09. (Chart 3.) The impact of US tariffs is expected to weigh on growth in the medium-term.

Chart 3: China real GDP

(% y/y)

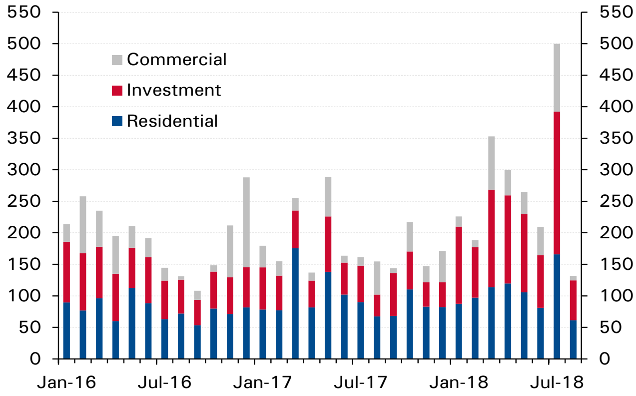
Source: Thomson Reuters Datastream

GCC & regional macroeconomics

Kuwait: Real estate sales in September amounted to KD200 million, up 52% over the previous month and 39% y/y. (Chart 4.) Higher sales were driven mainly by the residential and investment sectors, with transactions increasing by 41% and 71% m/m respectively – though note that August was an exceptionally slow month for sales due to seasonal factors. The September sales figure signals a return to normality, being closer to the monthly average so far this year, after two months of volatility.

Chart 4: Kuwait real estate sales

(KD million per month)



Source: Thomson Reuters Datastream

Saudi Arabia: The IMF, in its recently published World Economic Outlook, reiterated its belief that Saudi growth was finally back on a positive trajectory, following 2017's oil-linked economic contraction of 0.9%. Growth is expected to rebound to 2.2% in 2018 and 2.4% in 2019, while non-oil growth is forecast at 2.3% and 2.1% in 2018 and 2019, respectively.

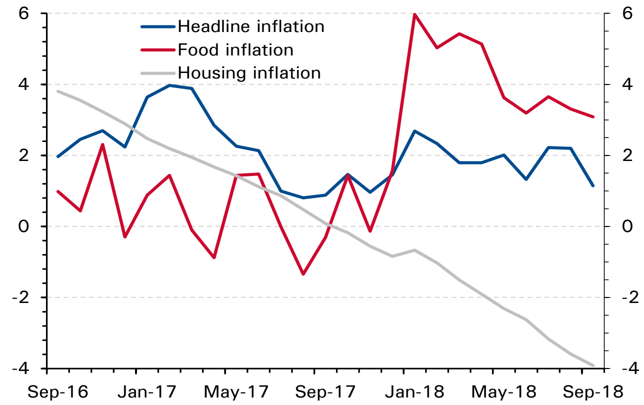
The government has restored the annual allowances for all public sector employees. The new decree will take effect from January 2019 and will no longer be linked to annual appraisals. This was the condition attached to the June 2017 royal decree, which had confirmed the reinstatement of allowances retroactively back to September 2016, when they had been cancelled amid the kingdom's cost-cutting drive in response to the fall in oil prices.

UAE: Inflation in Dubai maintained its downward trend in September, easing to 1.1% y/y from 2.2% in August, thanks to the ongoing decline in residential rents (-3.9% y/y) and falling food costs (3.1% y/y). Food price inflation has been moderating since reaching a peak at the start of the year after an excise tax on selected soft drinks was levied in 4Q17. (Chart 5.)

Meanwhile, activity in Dubai's real estate market continues to slow, as reflected in the latest transactions data. During the first nine months of 2018 there were 39,802 transactions (-24% y/y) worth Dh162 billion (-21% y/y).

Chart 5: Dubai inflation

(% y/y)



Source: Thomson Reuters Datastream

Egypt: Egypt has agreed a new $3 billion financing deal with the World Bank to support the budget and the country's economic reform program. Egypt plans also to issue its first international sovereign Sukuk in the fiscal year 2019/20, but the size of the planned offering is still unknown. Issuing Islamic bonds could allow Egypt to attract a new class of investors, improve its debt structure and help reduce borrowing costs. In this context, Egypt's foreign reserves reached $44.5 billion at the end of September, covering nine months of imports versus less than three months in 2012. This improvement was due to 40% growth in exports, a continued recovery in tourism and a 15% increase in the revenues of the Suez Canal, helped by the economic reform program initiated by the government in 2016.

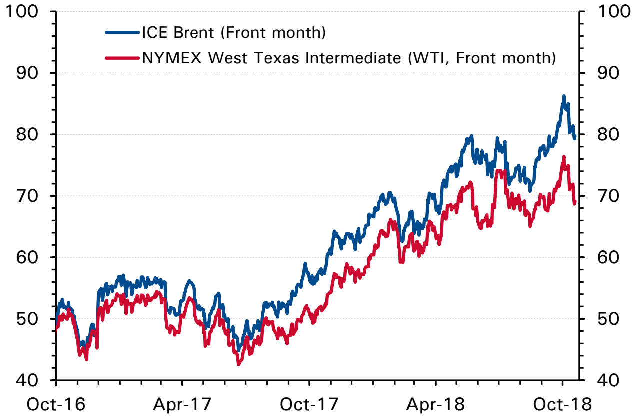
Markets – oil

Oil prices closed lower on Friday for the second consecutive week, with crude benchmarks Brent and WTI settling at $79.8/bbl (-0.8% w/w) and $69.1/bbl (-3.1% w/w), respectively. (Chart 6.) Prices have slipped to their lowest in almost a month, and Brent is down 8% from its near-four-year peak of $86.3 in early October. Further increases in US crude stocks (+6.4 mb to 416.4 mb in the week-ending 12 October) and worries over the outlook for global oil demand amid deteriorating US-China trade relations were the primary drivers of the market's bearish turn.

It remains also unclear, amid various reports, as to when production in the joint Saudi Arabia and Kuwait Neutral Zone will restart. Combined production at the Wafra and Khafji fields had been around 500,000 b/d (0.5% of global oil supply), but the fields have been offline for more than three years now.

Chart 6: Crude oil prices

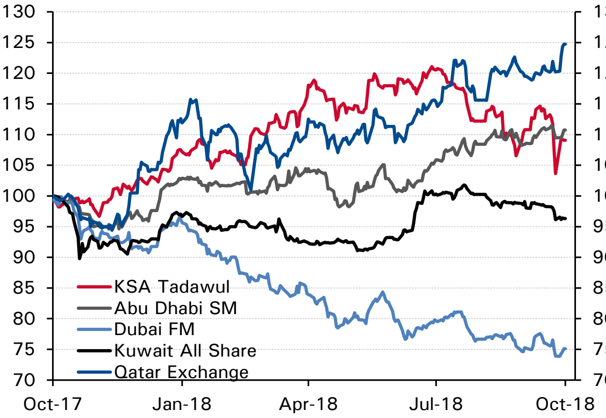
($/bbl)



Source: Thomson Reuters Datastream

Chart 8: GCC equity markets

(rebased, 19 October 2017=100)



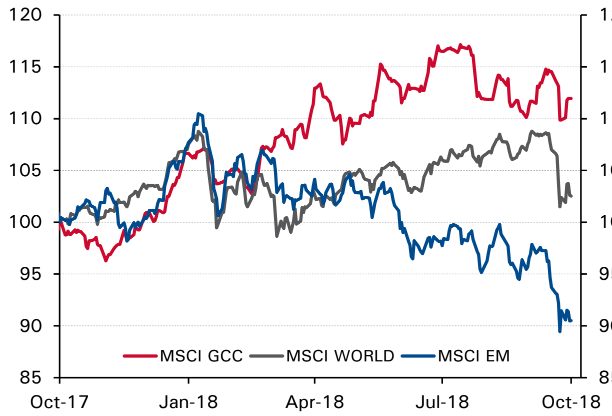
Source: Thomson Reuters Datastream

Markets – equities

Investors balanced bullish Fed meeting minutes, good corporate earnings, and mixed messages from Italy's government last week. The MSCI AC index was flat w/w, with modest gains in developed markets offsetting some emerging market weakness. The S&P was flat, while the DJI gained 0.4% w/w and the Euro Stoxx 50 was up 0.5%. Meanwhile, geopolitical tensions and trade worries saw the MSCI EM index retreat by 1% w/w. (Chart 7.)

Chart 7: International equity indices

(rebased, 19 October 2017=100)



Source: Thomson Reuters Datastream

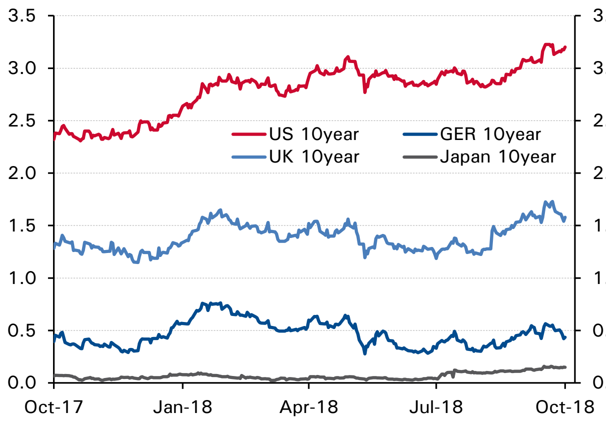
Regional stock markets were mixed, but most ended the week higher, with the MSCI GCC index up 1.9% w/w, partially due to Saudi institutional buying. The TASI was up 1.6% w/w after dipping by almost 6% the previous week on geopolitical factors. Qatar (3.4%), Abu Dhabi (0.6%), and Dubai (0.1%) shook off the Saudi contagion thanks to positive company earnings and despite easing oil prices. However, Kuwait was not able to recover from its 1.4% d/d dip early in the week, as a lack of catalysts saw it move sideways since. (Chart 8.)

Markets – fixed income

International yields were mixed last week, with US rates climbing due to shifting rate hike expectations, German bund yields dropping on Italian fiscal uncertainty, and Saudi rates jumping on geopolitics. The latest Fed meeting minutes revealed bullish views on rate normalization, pushing US yields higher, with the 10-year treasury up 6bps to 3.2%. Meanwhile, uncertainty over Italy's fiscal position, worsened by a credit downgrade, saw Italian 10-year yields reach highs of close to 3.7%. This in turn prompted further buying of German 10-year bunds, pushing their yields lower by 6 bps to 0.43%. (Chart 9.)

Chart 9: Global bond yields

(%)

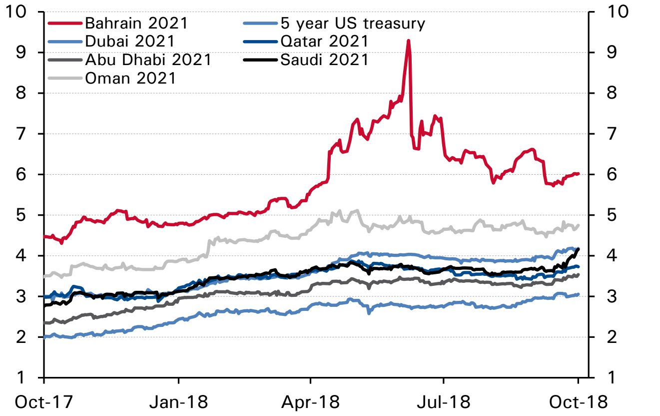


Source: Thomson Reuters Datastream

Regionally, despite weaker oil prices yields on most 4-5 year sovereign bonds were unchanged, with the exception of Saudi, which saw the yield on its 2023 bond increase by 27 bps over the week on geopolitical developments. (Chart 10.)

Chart 10: GCC bond yields

(%)



Source: Thomson Reuters Datastream

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