

US-China trade war worries deepen; GCC activity surveys weaker in March

Key market indicators

Stock markets	Index	Change (%)	
		weekly	YTD
Regional			
Abu Dhabi (ADI)	4,689	2.25	6.60
Bahrain (ASI)	1,283	-2.69	-3.67
Dubai (DFMGI)	3,083	-0.81	-8.51
Egypt (EGX 30)	17,411	-0.23	15.92
GCC (S&P GCC 40)	974	2.25	-1.05
Kuwait (All Share Index)	4,821	-3.58	n/a
KSA (TASI)	7,953	1.05	10.06
Oman (MSM 30)	4,799	0.53	-5.89
Qatar (QE Index)	8,793	2.55	3.16
International			
CSI 300	3,855	-1.12	-4.37
DAX	12,241	1.19	-5.24
DJIA	23,933	-0.71	-3.18
Euro Stoxx 50	3,408	1.39	-2.74
FTSE 100	7,184	1.80	-6.56
Nikkei 225	21,568	0.53	-5.26
S&P 500	2,604	-1.38	-2.59
Bond yields			
	%	Change (bps)	
		weekly	YTD
Regional			
Abu Dhabi 2022	3.34	-1.8	39.1
Dubai 2022	3.43	-1.0	28.8
Qatar 2022	3.64	5.2	56.1
Kuwait 2022	3.29	-1.8	48.1
Saudi Arabia 2023	3.69	-0.8	47.1
International			
UST 10 Year	2.78	3.1	36.4
Bunds 10 Year	0.50	0.3	7.3
Gilts 10 Year	1.40	4.4	20.7
JGB 10 Year	0.04	-0.5	-0.9
3m interbank rates			
	%	Change (bps)	
		weekly	YTD
Bhibor	3.06	0.5	33.0
Kibor	2.00	0.0	12.5
Qibor	2.66	3.3	-8.3
Eibor	2.38	5.0	58.5
Saibor	2.28	0.9	38.1
Libor	2.33	1.9	63.6
Exchange rates			
	Rate	Change (%)	
		weekly	YTD
KWD per USD	0.300	0.16	-0.48
KWD per EUR	0.367	-1.00	3.49
USD per EUR	1.228	-0.32	2.38
JPY per USD	106.9	0.61	-5.11
GBP per USD	1.409	0.54	4.28
EGP per USD	17.64	0.34	-0.51
Commodities			
	\$/unit	Change (%)	
		weekly	YTD
Brent crude	67.1	-4.50	0.36
KEC	63.65	-1.16	0.24
WTI	62.1	-4.43	2.71
Gold	1331.9	0.69	1.96

Source: Thomson Reuters Datastream; as of Friday's close 6/4/2018

Overview

Trade war concerns intensified last week, with US President Trump threatening to impose fresh tariffs on \$100 billion of Chinese imports, and China warning that it would fight back. The news sparked further market volatility, with the US S&P 500 down 1.4% w/w on an end-week sell-off, though other global benchmarks did better. Meanwhile, despite further bullish signals on the US economy including strong activity surveys and rising wage growth, a speech by Fed Governor Powell seemed to support the case for two further rate hikes this year, the Fed's current baseline.

Oil prices were weaker, with Brent crude falling nearly 5% w/w to \$67/bbl on trade war rhetoric and a lack of physical demand due to refinery maintenance. Some analysts see oil poised to break out of this year's fairly narrow \$65-70/bbl range, but with risks on either side: continued US supply growth and trade war concerns could push prices back down, while the possible collapse of the Iran nuclear deal and further declines in Venezuelan oil output could pressure them higher.

PMI figures in the GCC point to further evidence of sluggish economic growth against a backdrop of rising interest rates. Headline indices fell in both the UAE and Saudi Arabia, with the latter registering a sharp drop in Q1 from the previous quarter. In Egypt, too, the index dropped further below the 50 'no change' level, though confirmed a further easing in price pressures that should allow the central bank space to cut interest rates again in coming months.

International macroeconomics

USA: Activity surveys signaled very robust conditions and capacity stress. The ISM manufacturing index for March edged back to 59.3 but remained close to February's 14-year high of 60.8, while the non-manufacturing equivalent dipped only slightly to 58.8, including a strong reading for employment. (Chart 1.) PMI results broadly mirrored these trends, easing slightly but still firm. Both measures pointed to rising cost and price pressures: the manufacturing PMI survey for example showed selling prices at a five-year high.

There was also further confirmation of the strong consumer sector, with the ADP employment report showing private payrolls gaining 241,000 in March, beating expectations and the strong February figure. The official government numbers, however, disappointed, with 103,000 jobs added – well below the consensus though coming after a bumper February figure. Meanwhile, the trade deficit widened to \$58 billion in February, its fourth consecutive figure above \$50 billion on strong import growth.

Eurozone: Eurozone (EZ) data remains positive overall and fundamentals strong, though growth may have peaked. Unemployment edged lower to 8.5%, while headline inflation picked up to 1.4%, with core steady at 1% thanks to French and Italian figures that surprised to the upside.

However, final PMI numbers were lower than initial estimates, with the EZ composite PMI at 55.2 (flash: 55.3). Weakness was driven by moderating growth in services and a larger-than-expected softening in manufacturing,

Chart 1: US ISM activity indices

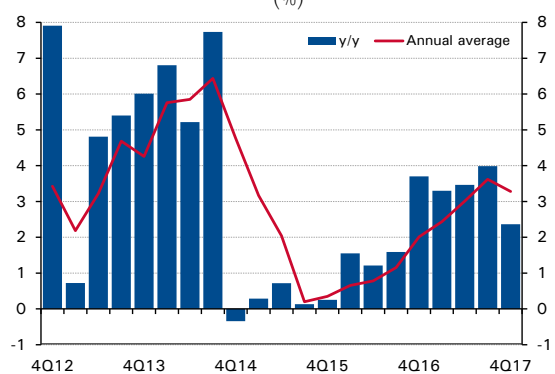
(above 50=expansion, below=contraction)



Source: Thomson Reuters Datastream

Chart 2: Kuwait non-oil GDP

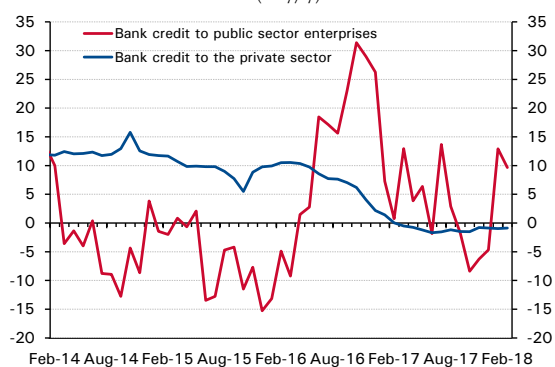
(%)



Source: Central Statistical Bureau

Chart 3: Saudi bank credit growth

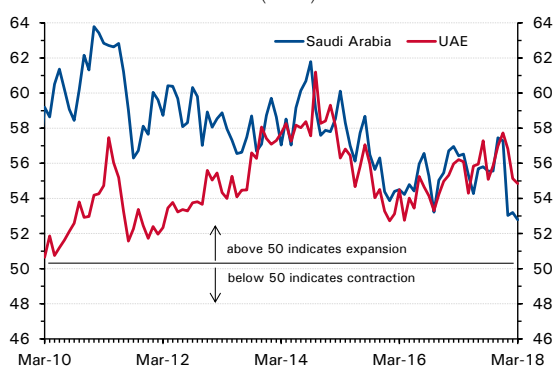
(% y/y)



Source: SAMA

Chart 4: Saudi and UAE PMIs

(index)



Source: IHS Markit, Emirates NBD

particularly in Germany. This was in line with the most recent German industrial production numbers, which recorded their biggest decline since 2015, and German retail sales, which declined for a third month in a row, hinting at a relatively weak first quarter for this core economy. In Italy, formal talks to form a government failed to resolve the current political deadlock. In France, rail union strikes are testing President Macron's resolve for business-friendly reforms.

GCC & regional macroeconomics

Kuwait: Preliminary data on quarterly GDP growth shows the non-oil economy growing by 3.3% in 2017 (chart 2), slightly stronger than our 3% forecast. The pace of growth slowed slightly in 4Q17 to 2.4% y/y, but the performance for 2017 indicates the economy has continued to recover from the sharp slowdown in late-2014 and 2015.

Legislators are considering imposing a 1-5% tax on expatriate remittances, though the law is likely to face considerable obstacles and opposition from the government. The draft law was approved by the National Assembly's finance committee but failed to make it through the legal committee. The proposal would not go well with international organizations and agreements on current account flows.

Saudi Arabia: PMI figures for March revealed ongoing weakness in the non-oil private sector. The headline figure fell from 53.2 in February to 52.8, which was the series' lowest. (Chart 4.) Firms cited weak growth in new orders and exports. The anemic state of bank credit would seem to back up firms' observations: February's 0.9% y/y contraction in private credit was the twelfth consecutive month of negative credit growth. (Chart 3.) Firms' confidence in future output remained strong, however.

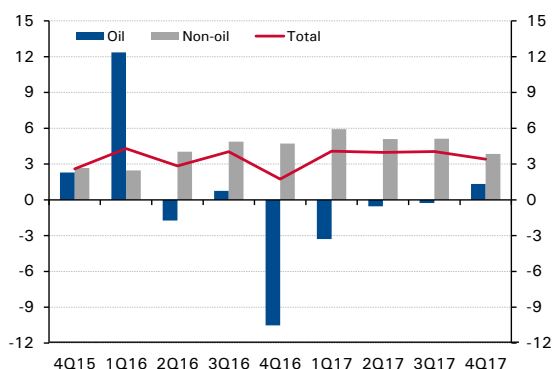
S&P affirmed the kingdom's sovereign credit rating at A-/A-2 with a stable outlook. The rating agency expects economic growth to accelerate to 2% this year from -0.7% in 2017 on the back of the government's trillion-riyal spending package.

UAE: The UAE's headline PMI eased slightly in March to 54.8 from 55.1 in February – the third straight month of softening data. (Chart 4.) The rate of private sector growth was the slowest since May of last year. Firms cited a slowdown in new orders and output growth, while the growth in new export orders slipped back into contractionary territory on the back of more intense foreign competition.

Bahrain: Real GDP growth eased from 4.1% y/y in 3Q17 (revised) to 3.4% y/y in 4Q17, with lower non-oil growth more than offsetting a rebound in the oil sector. (Chart 5.) For 2017 as a whole, growth surprised on the upside, rising from 3.2% y/y in 2016 to 3.9% y/y thanks to robust non-oil growth (+5.0% y/y), led by financial services, transportation other services sectors and underpinned by higher government infrastructure spending (thanks to GCC investments).

Bahrain announced that it discovered up to 80 billion barrels of shale oil and around 20 trillion cubic feet of natural gas in offshore deposits. Bahrain currently produces about 44,000 b/d from its own field and shares the revenue from a 300,000 b/d field owned by Saudi Arabia. It hopes to monetize these reserves within the next five years, with the help of international oil companies. This could ultimately be a major boost to the economy and help restore investor confidence against a backdrop of high debt and large fiscal deficits. Indeed, yields on the kingdom's 2021 government bonds fell by almost 15 bps following the announcement.

Chart 5: Bahrain Quarterly real GDP



Source: Information & Government Authority

Chart 6: Egypt net international reserves

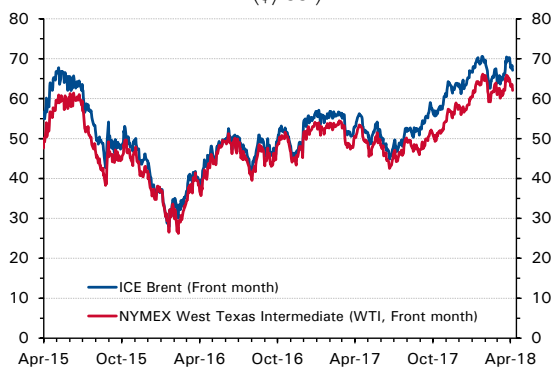
(\$ billion)



Source: Thomson Reuters Datastream / CBE

Chart 7: Oil prices

(\$/bbl)



Source: Thomson Reuters Datastream

Chart 8: Total equity return indices

(rebased, 6 April 2017=100)



Source: Thomson Reuters Datastream

Oman: Following last week's adjustment to the way banks calculate their lending limits, the Central Bank of Oman introduced a slew of regulatory reforms to help boost lending activity, relaxing capital and exposure restrictions. The most prominent measure was the decrease in the capital adequacy ratio to 11% from 12%. This is expected to free up close to OMR 2.6 billion to stimulate credit growth which has been slowing recently, falling to 3.4% y/y in January.

Egypt: Net international reserves were broadly steady in March at \$42.6 billion – though still up \$14 billion on a year ago and \$24 billion from pre-devaluation levels. (Chart 6.) Reserves had jumped a month earlier following a \$4 billion Eurobond sale, and provide a financial cushion as the central bank looks to reduce interest rates further, following the recent 1% cut, to support the economy.

The headline PMI fell slightly to 49.2 in March from 49.7 in February, remaining slightly below the 50 'no change' mark. Although well up from late-2016 levels, the survey continues to point to softer GDP growth than the 5%+ rates reported by official statistics. There was also confirmation of easing price pressures, with both the output prices (52.8) and input costs (61) gauges easing – the latter to its lowest in two-and-a-half years.

Markets – oil

It was a turbulent week for oil prices, with both Brent and WTI closing down by more than 4.4% w/w on Friday at \$67.1/bbl and \$62.1/bbl, respectively. (Chart 7.) Rather than being moved by fundamentals, it was the prospect of a global trade war that pushed oil and commodities lower.

Last week's decline was the most pronounced in two months and came amid further gains in US crude production (+27,000 b/d to 10.46 mb/d) and oil rig counts (+11 to 808), with the latter reaching a three-year high. However, US crude inventories did fall (-4.6 mb to 425.3 mb), but neither this statistic nor comments by the Russian energy minister that his country's alliance with OPEC could last "indefinitely", two normally bullish signals for oil, were able to cut through the trade war noise.

Markets – equities

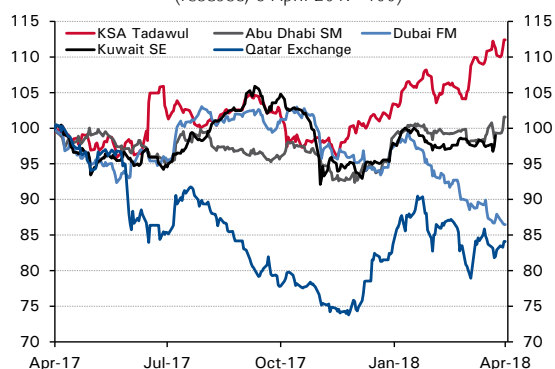
Global equities were volatile, impacted by trade war rhetoric, the tech/online-retailer sell-off, and mixed data in the US and EZ. The MSCI AC World index was 0.6% lower last week.

US equities closed lower with the DJI and the S&P 500 down 0.7% w/w and 1.4% w/w, respectively. Sentiment was initially dragged lower by the sell-off in tech stocks and later intensified by the escalation in US-China trade rhetoric. Meanwhile, Europe diverged from the US with the Euro Stoxx 50 up 1.4% w/w. Emerging markets continued to be affected by trade war concerns, with the MSCI EM index down 0.4% w/w. (Chart 8.)

GCC equities were mixed, but mostly higher, with the MSCI GCC index up 0.6%. Qatar (+2.6% w/w) was lifted by changes to foreign ownership levels in key listed companies. Saudi (+1.0% w/w) rebounded thanks to foreign interest after the sell-off that followed the FTSE upgrade. Oman (+0.5% w/w) was propped up by its banks thanks to the relaxation of capital and exposure regulations. Kuwait wrapped up its first week under the new market structure, with the "All Share" index down 3.6% w/w for unknown reasons. Dubai continued to drag lower, down 0.8% w/w and 8.5% YTD. Sentiment over the next few weeks will be driven by GCC earnings announcements for 1Q18. (Chart 9.)

Chart 9: GCC equity markets

(rebased, 6 April 2017=100)



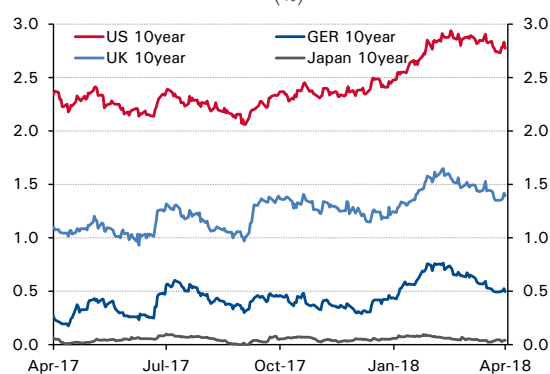
Source: Thomson Reuters Datastream

Markets – fixed income

Faltering US equities, weaker US Jobs data, soft EZ PMIs, and the escalating trade war quarrel saw yields on benchmark bonds tighten further. (Chart 10.) US Treasuries were down 3 basis points w/w to 2.78%, while bunds held steady at 0.50%, despite the stronger EZ inflation reading. Meanwhile, GCC benchmark yields were mostly lower with the exception of Qatar 2022, which increased by 5 bps. (Chart 11.)

Chart 10: Global bond yields

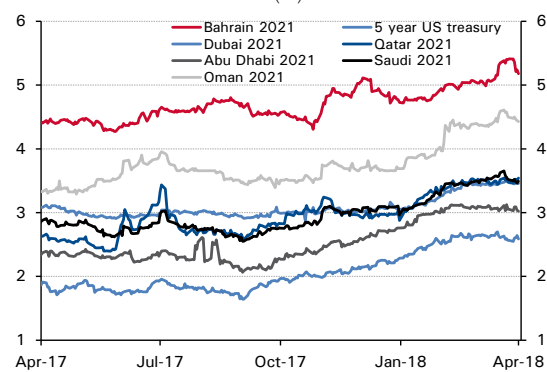
(%)



Source: Thomson Reuters Datastream

Chart 11: GCC bond yields

(%)



Source: Thomson Reuters Datastream

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