Volatility returns; Yields and USD off; Oil prices firm up; Saudis sign mega deals on Trump's visit

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi (ADI)	4,581	-0.59	0.77
Bahrain (ASI)	1,309	0.13	7.24
Dubai (DFMGI)	3,378	-1.23	-4.33
Egypt (EGX 30)	12,952	0.35	4.92
KSA (TASI)	6,938	0.81	-3.78
Kuwait (Price Index)	6,726	0.83	17.01
Oman (MSM 30)	5,415	-0.31	-5.74
Qatar (QE Index)	10,103	-0.07	-3.19
MSCI GCC	468	0.48	-1.55
International			
DAX	12,639	-1.03	10.08
DJIA	20,805	-0.44	5.27
FTSE 100	7,471	0.48	4.59
Nikkei	19,591	-1.47	2.49
S&P 500	2,382	-0.38	6.38

Commodities	$/bbl	Change (%) weekly	Change (%) YTD
Brent crude ($/bbl)	53.6	5.45	-5.65
KEC ($/bbl)	50.3	5.52	-3.05
WTI ($/bbl)	50.3	5.20	-6.31
Gold ($/t oz.)	1251.7	2.04	8.24

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.303	-0.53	-0.78
KWD per EUR	0.340	2.54	6.73
USD per EUR	1.120	2.54	6.57
JPY per USD	111.26	-1.83	-4.80

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Kibor – 3 month	1.56	-6.3	12.5
Qibor – 3 month	1.93	-3.3	14.4
Libor – 3 month	1.19	0.7	18.9

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.32	-7.1	-23.0
Dubai 2021	2.91	-2.4	-41.8
Qatar 2021	2.43	-7.5	-52.0
Saudi Arabia 2021	2.70	-9.9	-35.5
International			
UST 10 year	2.23	-9.8	-19.7
Bunds 10 year	0.36	-3.1	15.6
Gilts 10 year	1.10	0.9	-14.3
JGB 10 year	0.04	-0.5	-1.0

Source: Thomson Reuters Datastream

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Summary

After weeks of record low market volatility and a plethora of commentators trying to justify it and explicate it, volatility came back with a vengeance. This was bound to happen when Trump-related "scandals" reached fever pitch, which in turn led to serious questions about the administration's ability to function properly and to deliver on its big promises, such as tax reform.

In a torrid two weeks for the President that saw the firing of the FBI director Comey, a mishandled PR aftermath, and a couple of not-so-wise presidential tweets, what finally broke the camel's back was the revelation from a press leak. That leak revealed that Trump may have asked his former FBI director to "let go" of one aspect of the investigation (General Flynn's Russia role). The ensuing political pressure and confusion got to a point where the US Justice Department felt compelled to appoint a special counsel (from outside government) to pursue the investigation. That move seemed to quiet things down, as did the focus on president Trump's first trip overseas, starting with Saudi Arabia. On day-one, the US and Saudi Arabia signed a security and economic agreement, including an arms deal worth $110 billion.

The markets, which had been priced for hunky-dory tax cuts ahead, finally decided the "stories" were too much. The Dow Industrials lost 370 points (1.7%) in one day, while the USD pulled lower, such that the EUR/USD now above 112, its best level in over 8 months. Risk-off moves pushed bond yields lower, with the US 10-year note under 2.25%.

Nonetheless, world growth continues to be well supported: Japan's real GDP grew a better-than-expected 2.2% in 1Q17 (or 1.6% y/y) and US data was firm. Expectations and news of an extension of the current oil production cuts into 1Q18 helped oil prices firm up above $50/bbl and $53/bbl for WTI and Brent, respectively.

International macroeconomics

USA: One of the first economic numbers for May, the Philadelphia Fed index registered a very strong 38.8, with advances across several components. This was the highest level of the index since 1993, save for February, which was even higher at 43.3. Unemployment claims continued their long trend lower (latest week at 232K). All in all, these and other data are in line with further Fed tightening ahead, notwithstanding the day-to-day probabilities of a Fed hike in June. The latter, predictably, declined when stocks got hit by the political scandals swirling around; this lead to an increase in volatility.

For now, regardless of the media noise, there does not appear to be enough to derail the current Fed "plans" or expectations of a fed hike in June.

Eurozone: A mixed batch of data released during the week hinted at a continuing positive story for the Eurozone (EZ). The full GDP flash estimate was unchanged (0.5% q/q and 1.7% y/y). The release provided a regional breakdown, with growth driven by healthy performances by Germany

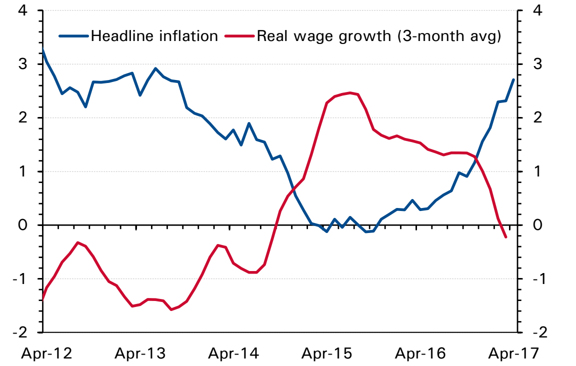
Chart 1: Japan's annualized real GDP

(% y/y)

Source: Japan Cabinet Office

Chart 2: UK inflation and real wage growth*

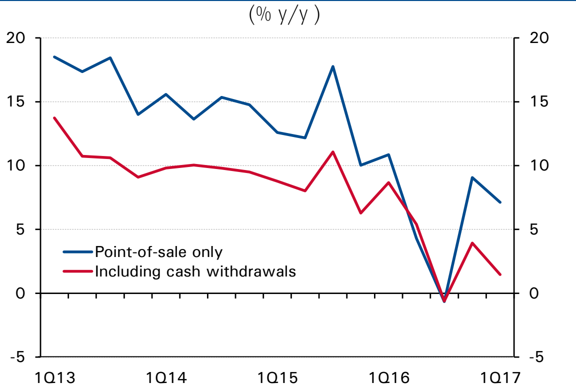
(% y/y)



Source: Thomson Reuters Datastream; *avg. real weekly earnings

Chart 3: Kuwait consumer card transactions

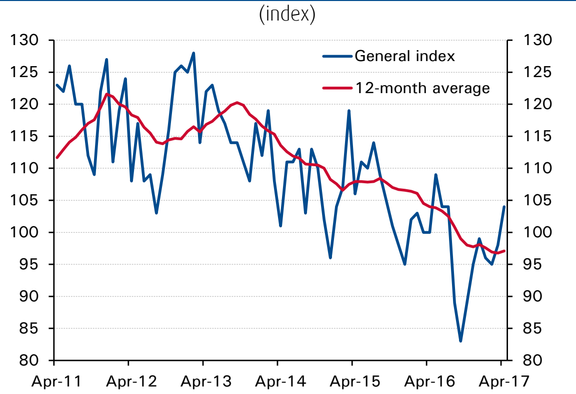
(% y/y)



Source: Central Bank of Kuwait

Chart 4: Kuwait consumer confidence

(index)



Source: ARA Research & Consultancy

(0.6% q/q), Spain (0.8% q/q), and Portugal (1.0% q/q). EZ inflation was also confirmed at 1.9% y/y, in line with expectations, while EZ consumer confidence improved.

Meanwhile, the German May ZEW survey came in at 20.6, the highest reading since September 2015, driven by increased optimism over current conditions.

Greece's parliament has approved pension cuts and tax hikes mandated by its lenders to receive the third tranche of its ongoing bailout. EZ finance ministers will meet on 22 May to approve the release of funds. Greece's 1Q17 GDP growth improved but still shrank by -0.1% q/q, after contracting by -1.2% in 4Q16. This puts Greece in a technical recession. The European commission has revised its 2017 growth estimate down to 2.1% (2.7% prior).

Japan: Japan's real GDP accelerated from an annualized 1.4% in 4Q16 to 2.2% in 1Q17, its highest growth rate in a year according to preliminary estimates. (Chart 1.) The better-than-expected growth rate came on the back of an ongoing recovery in exports and a pickup in private consumption.

UK: Inflation in the UK rose from 2.3% in March to hit a four-year high of 2.7% y/y in April. Core inflation also increased, to 2.4% y/y from 1.8% in March. (Chart 2.) A weaker pound and a rise in transportation costs were behind the rise. The figures were well in line with the Bank of England's (BoE) expectations. A rate rise is unlikely, however, given that real wages have fallen for the first time in two and half years and UK productivity growth continues to disappoint. Average regular weekly earnings growth (adjusted for inflation) slipped to -0.2% y/y in the first quarter.

In some positive news: retail sales rebounded significantly in April, rising by 2.3% m/m. The increase took the markets entirely by surprise; most analysts had been expecting growth to slow to 1% m/m after March's decline of -1.5% m/m, on the basis that shoppers appeared to be cutting back amid high inflation and falling real wages. But the opposite seemed to happen, with store prices falling, by an average of 0.2% m/m, and shoppers, consequently, taking advantage. A relatively warm month was also suggested as a possible driver of the increase in retail spending. The upbeat assessment was enough to propel Sterling up through its 1.30 ceiling against the US dollar, for the first time since September 2016. The currency is up more than 5% ytd against the USD.

Also helping to round off the week on a positive note, Britain's unemployment rate fell to 4.6% over the same period, which is its lowest level since 1975. 122,000 jobs were created in the 3 months to March.

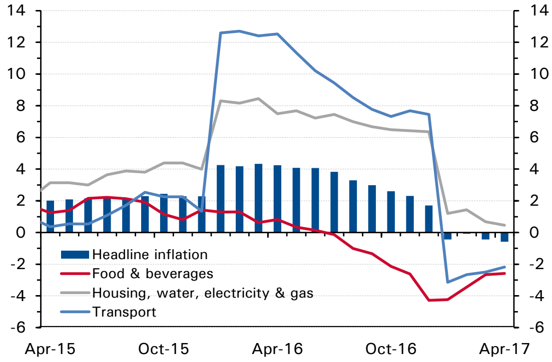
GCC & regional macroeconomics

Kuwait: Activity in the consumer sector continued to moderate in 1Q17, as the value of point-of-sale transactions grew by 7.1% y/y. Growth, while slower than the double-digit growth rates recorded in previous years, has held up relatively well thanks to steady growth in employment and wages. Household borrowing has also moderated in the last year, with growth in consumer debt easing to 6.7% y/y in March. (Chart 3.)

Consumer confidence improved in April, as the Ara index rose to 104, surpassing the 100 mark for the first time in nine months. The index, which has been on a downward trend for four years, fell more rapidly in 2016 after the government hiked fuel prices. It has since recovered somewhat, though the general index's 3-month average in April was still

Chart 5: Saudi inflation

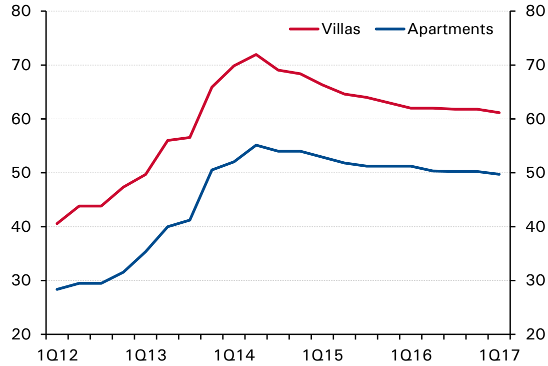
(% y/y)



Source: GASTAT

Chart 6: Dubai residential property sales prices

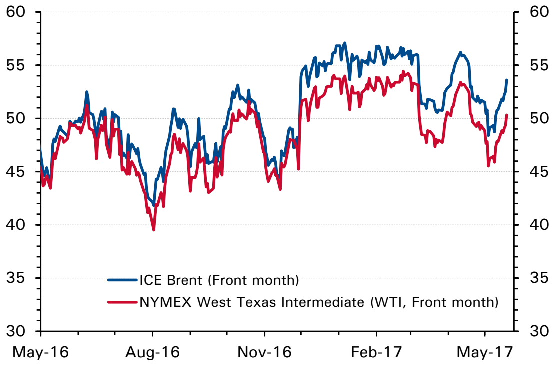
(index)



Source: Asteco

Chart 7: Crude oil prices

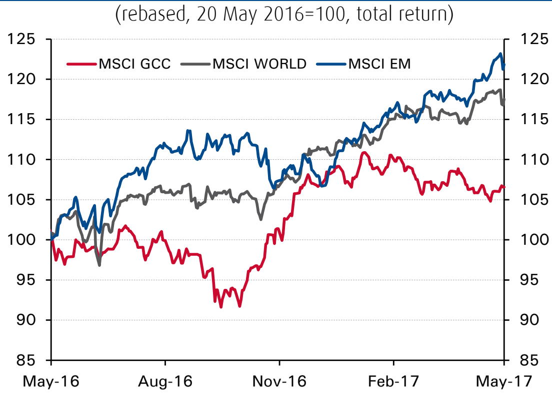
($/bbl)



Source: Thomson Reuters Datastream

Chart 8: Global stock markets

(rebased, 20 May 2016=100, total return)



Source: Thomson Reuters Datastream

down 2% y/y. The durable goods component has remained particularly weak, with the 3-month average down 9% y/y. (Chart 4.)

Listed companies saw strong growth in profits in 1Q17, boosted by the rally in local stocks during the quarter. The earnings of 136 companies rose by 20% y/y to KD 480 million. Continued weakness in non-investment income, particularly for consumer companies, reflected a more lackluster environment. The results appeared to have little impact on stock prices, as equities continued to slip in 2Q17.

The press published details of a proposed law to double Kuwait's sovereign borrowing ceiling to KD 20 billion. The law would also permit the state to issue longer term debt (up to 30 years from the current 10 years). As of the end of April, the public debt stood at KD 6.6 billion, or an estimated 19% of GDP.

Saudi Arabia: President Trump's visit to Saudi saw the signing of more than $300 billion worth of agreements and contracts with the Kingdom. Saudi Aramco alone said it signed 16 accords with 11 companies valued at about $50 billion. The Public Investment Fund (PIF), eager to increase its foreign as well as domestic investments, committed $20 billion in infrastructure investments with the Blackstone Group. Honeywell, Exxon, General Electric and Lockheed Martin were among the most high profile of US companies to have concluded agreements with Saudi entities.

In a move to increase the transparency of fiscal policy, the Saudi Ministry of Finance (MoF) published its first ever set of quarterly fiscal data. The figures in 1Q17 showed the deficit narrowing to SR -26.2 billion ($-7 billion) from SR -90 billion ($-24 billion) a year earlier, thanks to higher revenues (+72% y/y) and lower expenses (-3% y/y). The rise in oil prices was the key factor in the increase in total revenues, with oil revenues jumping by 115% y/y (78% of total revenues), while on the expenditures side, the cancellation of public sector bonuses and allowances as well as wage freezes were largely behind the reduction in expenses. As a result, the deficit was half the 2017 budget's pro-rata quarterly figure of SR 50 billion. It was thanks to these savings, the authorities explained, that the above cancelled bonuses and allowances were reinstated.

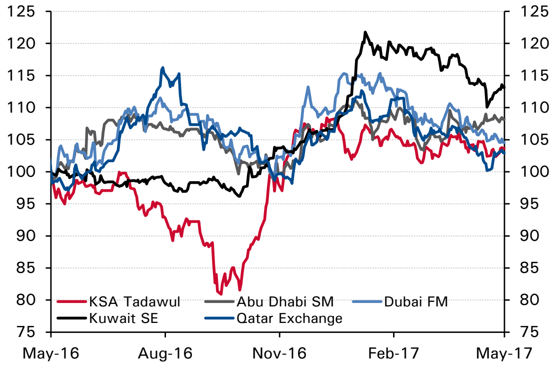
Inflation slowed further to -0.6% y/y in April—the fourth consecutive month that it has been in negative territory. (Chart 5.) Costs in the major CPI categories, such as food, housing and transportation, are either firmly in deflation territory (y/y) or heading that way. The absence of inflationary impulse is a reflection of continued, relatively weak non-oil economic activity.

The IMF, in its Article IV press release, noted the 'good progress' being made by the authorities in their efforts to stimulate the private sector. They also welcomed the improvement in fiscal policy transparency. The IMF believes that so long as the kingdom's fiscal reforms are enacted and directed properly, including subsidy reductions, there is no need for the kingdom to rush to balance its budget by 2019, as it has targeted in its Fiscal balance Program (FBP); after all, it has a 'strong financial asset position and low debt'.

UAE: Dubai's residential property prices continued to stabilize, following almost two years of decline amid tighter regulations, higher housing supply and risk aversion. According to Asteco's quarterly indexes, prices of apartments and villas in 1Q17 appeared steady, though they are down by 3.0% y/y and 1.3% y/y, respectively. (Chart 6.)

Chart 9: GCC stock markets

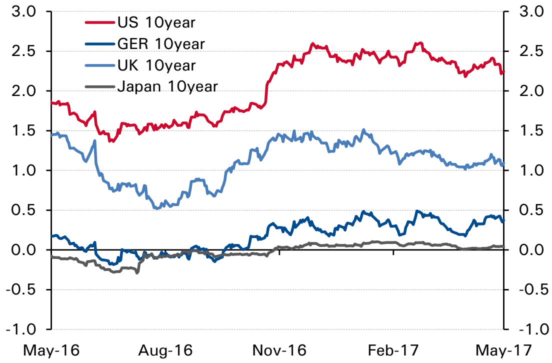
(rebased, 20 May 2016=100)



Source: Thomson Reuters Datastream

Chart 10: Global bond yields

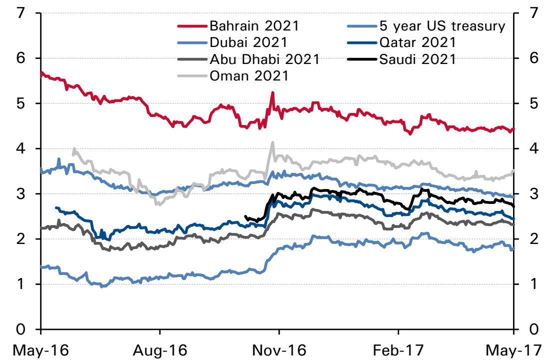
(%)



Source: Thomson Reuters Datastream

Chart 11: GCC bond yields

(%)



Source: Thomson Reuters Datastream

Oman: Oman has mandated banks for a seven-year US dollar sukuk. The sultanate plans to sell $2 billion of Islamic bonds in May. Meanwhile, the IMF recently concluded its Article IV visit. It expects Omani economic growth to be flat in 2017, with its budget deficit coming in at 12% of GDP, which is in line with NBK's expectations.

Markets – oil

Last week oil prices were boosted by pledges from both Saudi Arabia and its non-OPEC counterpart, Russia, to do 'whatever it takes' to reduce global crude stockpiles. Both countries backed prolonging the current 6-month output cut agreement for another 9-months. The extension to March 2018 was received positively by the markets, but much of that had already been factored in. A far bigger boost would have been forthcoming had the oil producers proposed deepening as well as extending the production cuts. There is an outside chance that this could still materialize at the 25 May official OPEC meeting. Brent and WTI closed on Friday more than 5% higher on the week at $53.61/bbl and $50.33/bbl, respectively. (Chart 7.)

Markets – equities

Equity markets saw a worldwide sell-off as White House turmoil hit sentiment, though markets made up some their losses later in the week. The MSCI World retreated 0.6% on the week. Also, market volatility shot up following weeks of historically low levels. US equities retreated, with both the S&P 500 and DJIA dropping 0.4% w/w. European equities underperformed, with the Euro Stoxx 50 down 1.4% w/w. Emerging markets were also off with the MSCI EM down 0.5% w/w. (Chart 8.)

Regional markets held up relatively well, supported by the recovery in oil markets. The MSCI GCC index was up 0.5% w/w, though some markets closed down on the week. With earnings season now behind us, activity in regional markets is likely to slow especially heading towards Ramadan and the summer season. (Chart 9.)

Markets – fixed income

Global government bond markets were rattled out of a period of prolonged calm following growing concern over Mr. Trump's administration. Investors are increasingly pricing-in the probability that in the short term Mr. Trump's pro-growth reform agenda will be hamstrung by various political setbacks. Federal funds futures reflected the latter, with investors now less certain about a rate hike in June. (Probability currently at 74% from a high of 88% 10 days ago.) As such, flight-to-safety trades dominated global bond markets late in the week, with 10-year US treasuries dropping 10 bps to settle at 2.23%, while 10- year Bunds shed 4 bps to reach 0.36%. (Chart 10.)

All GCC sovereign yields on bonds maturing in 2021, except for Oman, tracked US treasuries lower, to finish the week down between 2-10 bps. Oman, however, saw yields on its sovereign bonds increase following its downgrade to junk status by S&P last week. Oman's 2021 yield was up 13 bps to settle at 3.52%. Kuwait's 2022 bond was down on the week by 7 bps to trade at 2.57%. (Chart 11.)

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