Economic Update

NBK Economic Research Department I 20 October 2020

International Scene

Virus 'second wave' casts doubt on global economic recovery, as US election nears

> Economic Research
+965 2259 5500
econ@nbk.com

Highlights

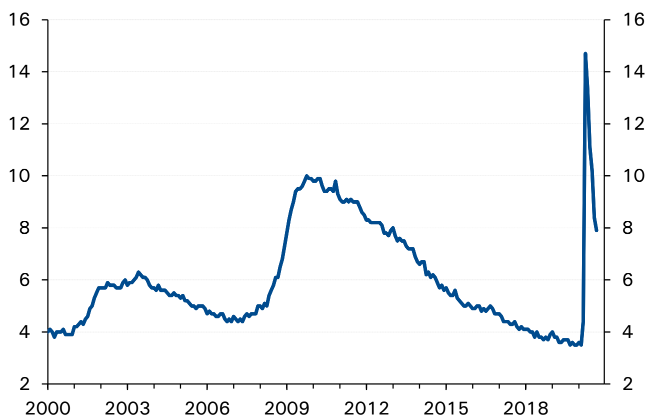
- **A second wave of Covid-19 infections across major advanced economies has triggered a fresh spell of restrictions and curfews and new concerns over the economic outlook. The IMF has also revised down its global growth forecast for 2021 to 5.2%.**
- **US economic data has been broadly positive with the presidential election looming on November 3. A Democratic 'clean sweep' could lead to higher taxes but potentially a larger short-term fiscal stimulus.**
- **New virus cases in Europe have surged and latest restrictions will hit 4Q20 GDP. UK PM Boris Johnson announced that firms should prepare for a 'no deal' Brexit at year-end, though may be looking to force trade deal concessions from the EU.**

The past few weeks have seen a second wave of Covid-19 infections spread across major advanced economies, triggering a fresh spell of restrictions, curfews and business closures and renewed concerns over the economic outlook. The IMF in its latest projections has also downgraded global growth in 2021 to 5.2% (despite signaling that fallout so far has been less severe than expected), while warning that the recovery will be long and uncertain with local virus transmission only brought down everywhere by end-2022. The rally in equity markets stalled in September with US indices down 2-5%, though markets have since been helped by a revival in 'on-off' hopes of another big fiscal stimulus and despite uncertainty related to the looming presidential election. Oil prices however remain broadly steady, still trading in a range of $40-45/bbl, but concerns are rising that OPEC+ may have to rein in future production rises if weakness in the global economy and oil demand intensify.

Election, stimulus generating uncertainty in US

US economic data remains largely positive, though a fresh rise in new Covid-19 cases, pre-election and stimulus uncertainty alongside signs that the labor market rebound may be running out of steam have weighed on recovery hopes. The ISM services activity index rose to a solid 57.8 in September on increasing order books, and despite firms conceding that the outlook is uncertain. But the manufacturing equivalent index edged back to 55.4 from August's recovery peak. Meanwhile, there was a warning signal from a 2.7% m/m drop in personal incomes in August one month after the boost to unemployment benefits expired and the recovery in consumer spending also slowed to 1.0% m/m. Unemployment fell to 7.9% in September from 8.5% in August, but the rise in employment of just 661,000 was less than half that seen a month earlier and still only half of the 22 million jobs lost since the pandemic started have returned. (Chart 1.) The participation rate also dropped back to 61.4, signaling more people leaving the jobs market altogether.

Chart 1: US unemployment rate

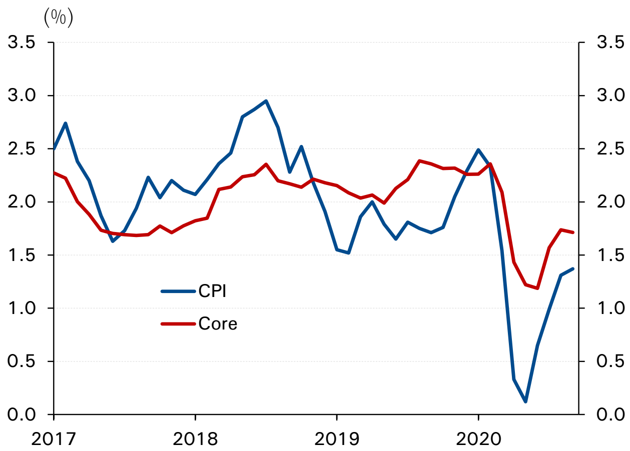


Source: Refinitiv

Ahead of the presidential election on November 3rd, both political parties have so far been unable to agree a fresh stimulus package to support an economic recovery at risk of stalling. President Trump has proposed a $1.8 trillion (9% of GDP) package that includes extended unemployment benefits and checks to individuals, and is closer to the $2.2 trillion sought by Democrats than a previous Republican proposal. The election result could also have major economic implications. Democrat candidate Joe Biden is currently well ahead in the polls and a victory would trigger expectations of higher personal income, corporate and capital gains taxes as well as more environmental regulation, particularly if his party also wins control of the Senate in a 'clean sweep'. But it could also result in a larger short-term fiscal stimulus and potentially a reduction in international trade tensions, both of which would be welcomed by financial markets. Weeks of political uncertainty is also possible if the election result is not clear on the night due to a lag in collecting postal votes, or even legal proceedings.

Following its announcement in August of a move to a more flexible inflation target (still 2%, but on average over time), the Federal Reserve will stick to its ultra-accommodative monetary policy (Fed Funds rate at 0.0-0.25%, bond purchases of $120 billion per month) whatever the election result. Fed officials however continue to push for more aggressive fiscal stimulus and play down the potential risks including larger deficits, with chairman Jay Powell commenting that too little fiscal support is currently worse than too much given the precarious economic climate. Meanwhile core CPI inflation remained modest at 1.7% in September, but has risen quite quickly from a low of 1.2% in June. (Chart 2.) This upward creep, the Fed's looser inflation target and the potential for further fiscal stimulus saw US 10-year treasury yields rise around 10bps to 0.78% in the month to mid-October, but the bank's commitment to keep rates low should keep any further steep moves in check.

Chart 2: US CPI inflation

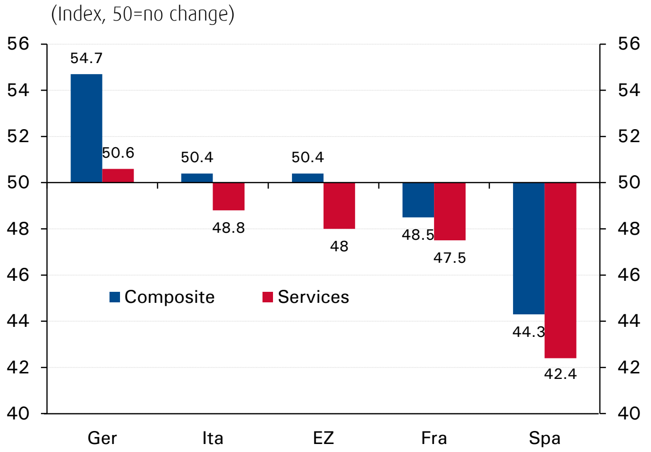


Source: Refinitiv

Virus second wave threatens European economy

A surge in Covid-19 cases across Europe has delivered a heavy blow to hopes of an economic recovery that had been gaining traction. Several large countries including Germany, France, Spain and the UK have introduced fresh lockdown or restriction measures to contain the spread, which will undermine confidence and hit GDP in Q4. The Eurozone PMI fell back towards stagnation territory at 50.4 in September from 51.9 in August, led by a contracting service sector (48.0). (Chart 3.) In France for example, a 9pm to 6am curfew lasting for at least four weeks has been reinstated across major cities and the French statistical agency INSEE projects no growth in 4Q20 with a risk of a contraction after an expected 16% q/q bounce in Q3. This would leave growth at -9% in 2020 overall, slightly better than the IMF's upwardly revised -9.8% in its October WEO. Nevertheless, the consensus view is that the second, larger virus wave across Europe should cause less economic damage than the first, for which national authorities were unprepared.

Chart 3: Eurozone PMIs for September 2020



Source: IHS Markit

On monetary policy, the high degree of uncertainty over the economic outlook due to the latest virus surge (and its effective containment) argues for the European Central Bank to wait and see before any further policy moves. Still, expectations are building that the bank will announce an expansion or extension to its €1.35 trillion PEPP asset purchase scheme in December, while leaving the key deposit rate on hold at -0.5%. Core Eurozone inflation fell further in September to an all-time low of 0.2% y/y – albeit helped by the temporary cut in German VAT – adding fuel to calls for looser policy. In the UK, the Bank of England is also mulling a move into negative interest rates (currently 0.1%). But the economic outlook also hinges on the government's ability to strike a post-Brexit trade deal with the EU ahead of a possible end-October deadline, with negotiations stuck on a few issues including fishing rights and state aid. PM Boris Johnson announced in mid-October that businesses should prepare for 'no deal' at year-end, though this could also be a negotiating ploy to try to gain concessions from the EU. A basic deal might still be agreed over coming weeks.

Japanese households more confident but still saving

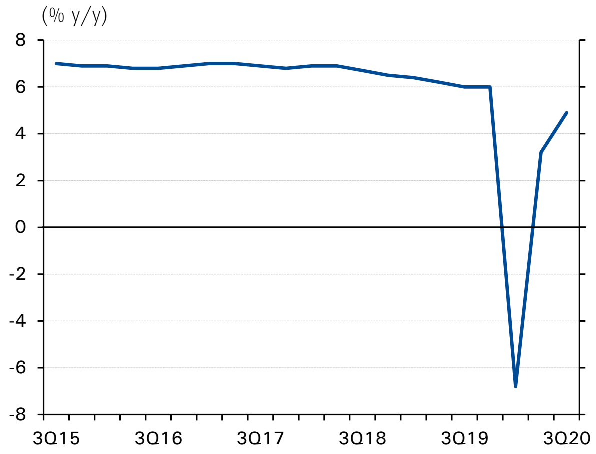
Japanese consumer confidence improved in September, rising to 32.7 from 29.3 in August for the general household index. The index was as low as 21.6 at the height of the coronavirus pandemic in April. Moreover, the index of coincident indicators, which looks at a range of metrics such as factory output, employment and retail sales, rose 1.1 points to 79.4 in August. The index of leading economic indicators, meanwhile, grew 2.1 points to 88.8 from July. The data led the Japanese government to upgrade its assessment of the outlook and state that the Japanese economy had stopped contracting after hitting rock bottom in May. The new assessment follows last month's more upbeat outlook from the Bank of Japan, in which the bank reasoned that no further coronavirus stimulus was necessary.

The authorities still, however, have the work cut out reversing Japanese customers' high propensity to save in favor of higher private consumption. The household savings rate hit a 20-year high of 44% in the five months to August, higher than last year's rate of 33% over the same period, official data showed. Cash and deposits held by Japanese households rose to ¥1.03 quadrillion ($9.7 trillion) in the April to June period. A major contributing factor were the government's cash handouts during the pandemic, which due to mobility restrictions and general spending restraint, were banked rather than spent by households.

Services and manufacturing support China's recovery

China's economic recovery continues to proceed. GDP growth picked up to 4.9% y/y in 3Q20 from 3.2% in Q2 and -6.8% in Q1, while the IMF expects growth of 1.9% this year, leaving China the only major economy escaping a recession. (Chart 4.) The official manufacturing PMI activity measure for September rose to 51.5 from 50.0 the previous month and bettering analysts' expectations of 51.2. Services also expanded, with the official PMI coming in at 55.9 compared to 55.2 in August. Activity was also higher due to the arrival of the Golden Week holidays in early October, which helped spur manufacturers to quicken production before the break.

Chart 4: China GDP



Source: Refinitiv

Moreover, improved credit conditions on the back of government stimulus was helping to facilitate the uptick. The People's Bank of China reported that aggregate financing reached 3.48 trillion ($517 billion) in September, 38.6% higher than September 2019, and driven by government bond issuance. The improvement in activity is yet to be reflected in consumer prices, however, with September's inflation rate moderating to 1.7% y/y from 2.4% in August. This was mainly due to slowing food price gains. Core inflation was steady at 0.5% for the third month running, indicating that underlying household spending activity has yet to fully rebound, post-pandemic.

India's business activity improves

Following a massive contraction in India's GDP in 2Q20 (1Q of FY 2020/21) by 24% y/y due to the adverse effects of the pandemic, there were signs of a slow recovery in the economy during Q3. Business activity has been gradually improving since July, with the services PMI rising to 49.8 in September though remained in contraction territory, while the manufacturing PMI rose to an eight-year high of 56.8 on a pick-up in new orders and exports. Both PMI readings easily beat market expectations. On the policy front, the Reserve bank of India held the key policy (repo) rate at 4% in its previous policy meeting amid higher inflation after two consecutive emergency rate cuts in 2020 in a bid to curb the severe pandemic-induced economic slowdown.

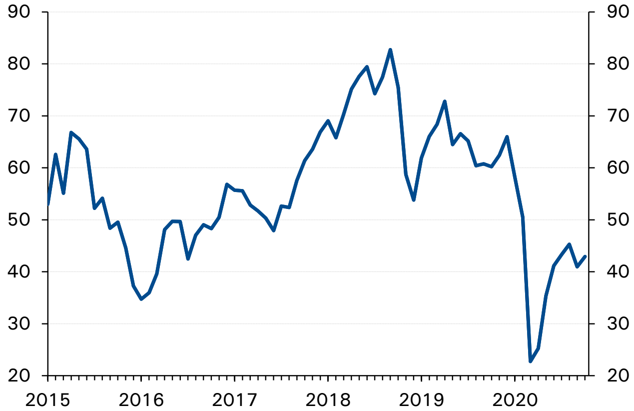
Despite the recent rise in business activity, the potential recovery seems fragile given that hiring remains subdued as social distancing requirements are met. Lower hiring may curb a potential rise in demand. Further headwinds are present in the form of still relatively high inflation (6.7% in August), which may limit the room for further policy rate cuts, while previously strong government spending – which has helped soften the impact on the economy from the pandemic – may also be limited due to a widening fiscal deficit. Further, the threat of renewed lockdowns as the government struggles to reign in rising virus cases is a major downside risk. The IMF's latest projections are for GDP to contract by a downwardly revised 10.3% in FY20/21 on a larger-than-expected slowdown in the second quarter, and rebound by 8.8% in FY21/22.

Concerns over oil demand amid virus resurgence

Oil market sentiment shifted markedly in September over spiraling coronavirus infections and the impact on oil demand of further mobility restrictions in the autumn. Oil prices recorded their first month of losses since March, with Brent futures falling 9.6% to $41.0/bbl by September's close. (Chart 5.) Prices have risen slightly since to range around $43/bbl (as of 16 Oct), buoyed by OPEC data that showed OPEC-10 posting a second consecutive month of >100% compliance in September, rising Chinese crude demand and further crude stock drawdowns in the US. Nevertheless, with northern hemisphere economies especially facing the re-imposition of partial curfews and mobility restrictions, the recovery in oil demand growth is likely to be delayed. The IEA sounded a warning that the outlook "remains fragile" and that there is only "limited headroom" for the market to absorb the scheduled additional supplies of OPEC+ crude from January 2021 as well as returning Libyan exports. OPEC may opt to leave the current production cuts in place when it next meets at the ministerial level at the end of November.

Chart 5: Brent crude oil price

($ per barrel, end of month*)



Source: Refinitiv * Latest figure is for October 16

Meanwhile, speculation about the timeframe for peak oil demand intensified after oil major BP released an eye-opening report in which it said that the coronavirus pandemic may halt any further gains in oil demand and accelerate the irreversible shift away from fossil fuels. 2019's level of 100 mb/d may therefore have been the peak. OPEC, in its energy outlook that was published afterwards, diverged from this view: the group believes that oil demand will recover to pre-pandemic levels in 2022 and continue to grow for 20 years. The IEA, in turn, expects growth to plateau within 10 years, but it chose to emphasize the delay in the oil demand recovery due to persistent Covid-19.

Head Office

Kuwait
National Bank of Kuwait SAKP
Shuhada Street,
Sharq Area, NBK Tower
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait France SA
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
34h Floor, NBK Tower
Shuhada'a street, Sharq Area
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353