Weekly Economic and Markets Review

NBK Economic Research Department I 4 November 2018

International & MENA

Global stocks end dismal October on a high note; crude prices drop as US softens Iran sanctions position

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,921	0.79	11.87
Bahrain (ASI)	1,313	-0.18	-1.39
Dubai (DFMGI)	2,805	2.51	-16.76
Egypt (EGX 30)	13,202	1.37	-12.10
GCC (S&P GCC 40)	1,125	0.79	14.25
Kuwait (All Share Index)	5,069	0.59	4.94
KSA (TASI)	7,879	0.56	9.04
Oman (MSM 30)	4,425	-0.63	-13.23
Qatar (QE Index)	10,281	1.26	20.62
International			
CSI 300	3,290	3.67	-18.37
DAX	11,519	2.84	-10.83
DJIA	25,271	2.36	2.23
Euro Stoxx 50	3,214	2.54	-8.26
FTSE 100	7,094	2.23	-7.72
Nikkei 225	22,244	5.00	-2.29
S&P 500	2,723	2.42	1.85

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.68	5.3	73.7
Dubai 2022	4.13	-0.7	99.2
Qatar 2022	3.75	4.3	67.7
Kuwait 2022	3.67	1.3	86.7
Saudi Arabia 2023	4.19	8.3	97.7
International			
UST 10 Year	3.21	13.8	80.3
Bunds 10 Year	0.44	8.6	1.2
Gilts 10 Year	1.49	10.8	30.5
JGB 10 Year	0.13	1.8	7.8

3m interbank rates	%	Change (bps) weekly	YTD
Bhibor	3.70	0.0	97.5
Kibor	2.06	-6.3	18.8
Qibor	2.82	1.6	8.2
Eibor	2.72	3.8	91.8
Saibor	2.77	2.4	87.5
Libor	2.58	7.2	88.7

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.303	-0.06	0.68
KWD per EUR	0.347	-0.52	-2.37
USD per EUR	1.139	-0.14	-5.09
JPY per USD	113.2	1.15	0.45
USD per GBP	1.297	1.08	-4.01
EGP per USD	17.86	0.00	0.73

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	72.8	-6.17	8.91
KEC	71.02	-3.73	11.84
WTI	63.1	-6.58	4.50
Gold	1230.9	-0.13	-5.77

Source: Thomson Reuters Datastream; as of Friday's close 2/11/2018

Overview

Global equities rose last week amid high volatility, delivering a positive end to a still-dismal October which saw major indices down 5-9% m/m on rising interest rates, a tech stock sell-off, the EU-Italy budget stand-off and trade war concerns. US economic news remained strong however. Although core inflation eased to 2% in September, strong employment gains and a rise in wage inflation to a post-financial crisis high firmed expectations for a December rate hike, pushing up bond yields and the US dollar. By contrast, growth in the Eurozone slumped to a four-year low of 0.2% q/q in Q3, which could put pressure on the ECB to postpone the wind-down of its QE program by end-year as currently planned.

Brent crude oil prices fell for the fourth consecutive week, this time by 6% to finish at $73/bbl and now 16% below the early October high of $86. US energy sanctions on Iran restart tomorrow, but the US indicated that it would extend waivers for eight countries – thought to include China, Japan and India – implying that the near-term hit to Iranian oil output could be smaller than expected. Crude prices were also knocked down by rising US production, news that Russian output hit a post-Soviet era high of 11.4 million b/d in October and concerns over the demand outlook due to the US-China trade war.

Almost all Gulf countries saw improvements in their 'Doing Business' scores in this year's survey by the World Bank. The UAE saw the biggest gains thanks to a large improvement in access to credit. It was also easily the best placed Gulf country, ranked just outside the top ten at 11 from 21 last year and compared to an average rank of 82 for the rest of the GCC out of 190 countries surveyed. Gulf countries scored high for 'paying taxes' category, while 'resolving insolvency' was the main weak spot.

International macroeconomics

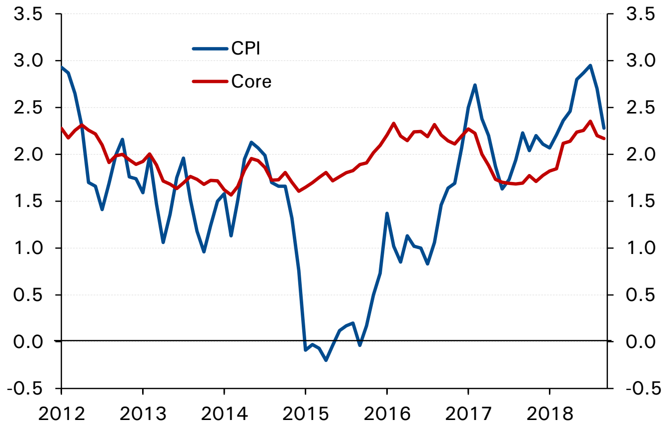
USA: A host of key economic data revealed continued robust strength in the US economy and also firmed – despite moderate inflation data and recent financial market volatility – expectations for a Fed rate hike in December. Non-farm payrolls rose by a very solid and much better-than-expected 250,000 in October, more than double the 118,000 recorded in

September and leaving the unemployment rate holding at a 49-year low of 3.7%. And in a further sign of labor market tightness, wage growth picked up to 3.1% y/y from 2.8% in September and a more than nine-year high, though part of this rise was a base effect following a weak number a year earlier.

Stronger wage pressures should eventually feed through into higher consumer prices. Core personal consumption expenditures inflation – the Fed's preferred measure of price pressures – eased to 2.0% in September from 2.2% in August and in line with the bank's target. (Chart 1.) The headline rate was unchanged, also at 2.0%. But inflation is still trending higher than at the start of the year and given the tight labor market, data showing consumer spending still rising at a vigorous 5.0% y/y and the Conference Board's consumer sentiment index at an 18-year high in October, the Fed will remain watchful of potential overheating.

Chart 1: US PCE inflation

(% y/y)

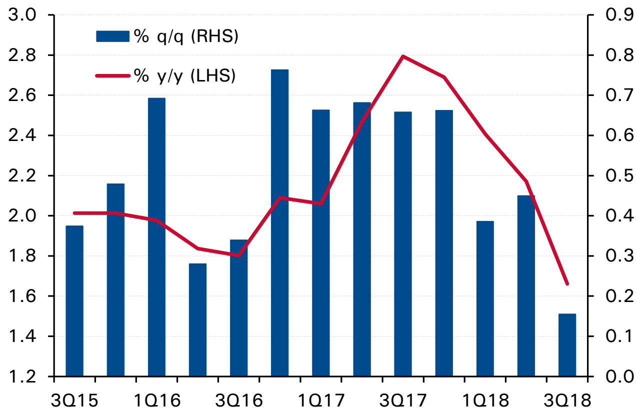


Source: Thomson Reuters Datastream

Non-consumer-related indicators were slightly more mixed. PMI and ISM survey indicators of manufacturing activity for October were either stable or eased, but conditions remain strong overall with cost pressures elevated. There were further signs of weakening in the housing market, the most prominent soft spot in the US economy. The Case-Schiller house price index increased 5.5% y/y in August, down from 6.0% in July and flat month-on-month. Meanwhile the international trade deficit also widened to $54 billion in September from $53 billion in August on rising imports, and the bilateral deficit with China increased to $40 billion despite the increase in tariffs.

Eurozone: European growth eased more than expected last week, coming in at 0.2% q/q compared to analyst expectations of 0.3%. (Chart 2.) This was the region's slowest expansion since 2014, and potentially reflects weaker momentum in Germany due to a softer global trade environment, and no growth in Italy. Meanwhile, inflation hit its highest in six years (2.2%) on the back of rising energy prices. Core inflation (1.1%), although up, increased less-than-expected. (Chart 3.)

Chart 2: Eurozone GDP

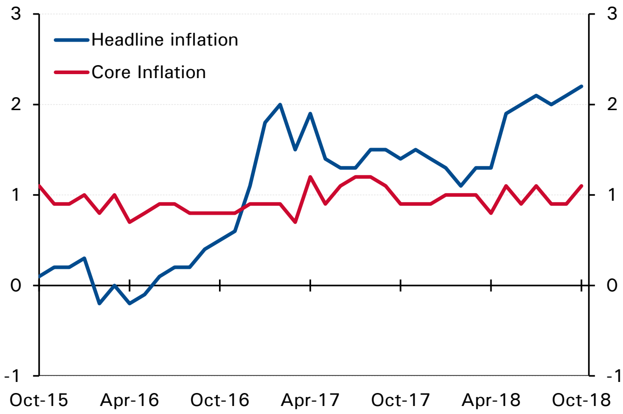


Source: Thomson Reuters Datastream

The political backdrop remains fraught. Despite opposition from the EU, Italy remains resolute in expanding its deficit, offering few concessions, with matters made worse by Italy's poor growth. Brussels is now seriously considering adopting a formal Excessive Debt Procedure as early as November 21. The German political outlook was also shaken by Chancellor Merkel's resignation as leader of the center-right CDU after 18-years at its helm. Together with Brexit, these developments cloud the outlook for the EU ahead of a major change of guard in 2019 when EU elections are expected to take place and the new European Central Bank governor will be replaced.

Chart 3: Eurozone inflation

(% y/y)



Source: Thomson Reuters Datastream

Japan: As widely expected, the Bank of Japan kept its monetary policy steady last week, maintaining its short-term interest rate target at -0.1% and its pledge to guide 10-year government bond yields to around 0%. Monetary policy is likely to remain loose for the time being, especially after the central bank cut its 2018 inflation forecast to 0.9% from 1.1% (July). The forecast for 2019 was also revised down, from 1.5% to 1.4%.

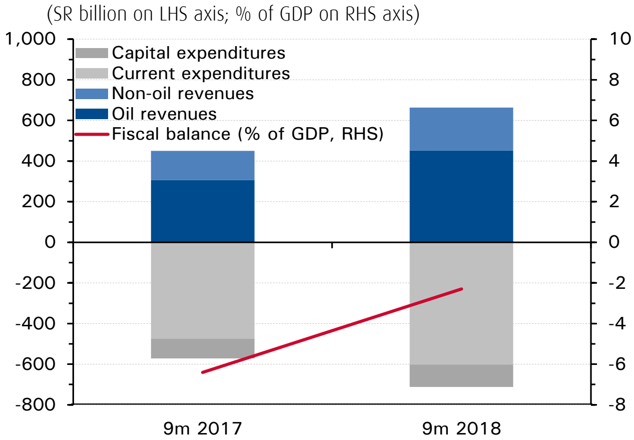
China: The Chinese central bank set its official yuan midpoint at a new 10-year low against the dollar, in an attempt to support its weakening economy. Indeed, newly-released manufacturing data pointed to further signs of a slowdown in the economy: the official purchasing manager's index fell from 50.8 in September to an over-two-year low of 50.2. This was mainly attributed to a contraction in export orders, a sign that the trade war with the US is weighing on the external sector.

GCC & regional macroeconomics

Saudi Arabia: The Ministry of Finance reported 3Q18 and 9-month budget performance figures that show an improving fiscal picture. The 3Q18 deficit came in at SR7.2 billion ($1.9 billion), down from SR48.7 billion ($13 billion) in 3Q17. On a cumulative year-to-date basis (to the end of September), the deficit had narrowed to SR49 billion (estimated at 2.3% of GDP), compared to SR121 billion (6.4% of GDP) over the same period in 2017. (Chart 4.)

Chart 4: Saudi fiscal balance (9-months)

(SR billion on LHS axis; % of GDP on RHS axis)



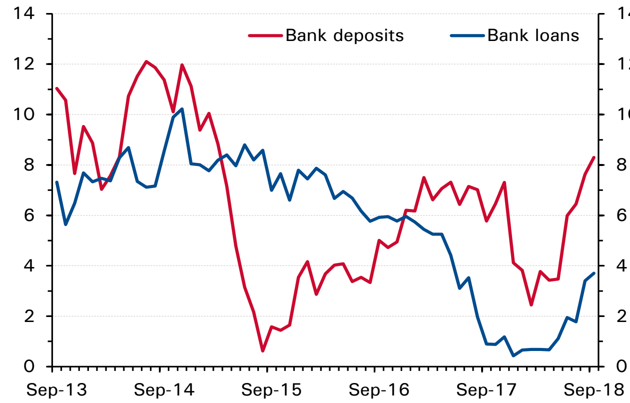
Source: Saudi Ministry of Economy

The lower deficit in 3Q18 was attributed to higher oil revenues (+63% y/y) and, importantly, higher non-oil revenues, which surged (+223% y/y) thanks to the introduction of VAT and other excise/expatriate fees. Government expenditures also increased (+21% y/y), which, given its important role in supporting demand and investment, augurs well for the economic outlook. The government did not obtain any deficit-financing in 3Q18.

UAE: Lending activity has continued to gather momentum. Loan growth expanded from 3.4% y/y in August to an over-one-year high of 3.7% y/y in September, mainly on the back of a continued improvement in lending to the corporate sector. (Chart 5.) Deposit growth also extended its recovery, climbing from 7.6% y/y to an over-three-year high of 8.3% y/y during the same period, as higher oil prices helped replenish government deposits.

Chart 5: UAE bank loan and deposit growth

(% y/y)



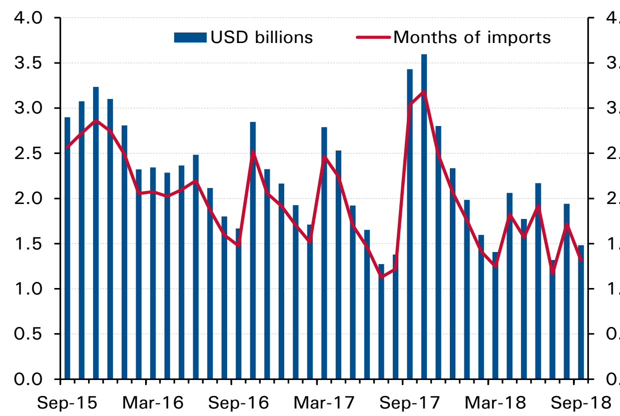
Source: Central Bank of the UAE

Meanwhile, in a bid to improve the stability of the financial system, the UAE federal authorities issued a new central bank law. This law aims to ensure that the central bank's foreign reserves are prudently managed and that UAE financial institutions and activities, including lending activities, are effectively regulated.

Separately, in an effort to boost foreign investment, the UAE president issued a new law to establish a Foreign Direct Investment Unit in the Ministry of Economy. The unit will be responsible for promoting initiatives that help create a more attractive investment environment.

Bahrain: S Large fiscal and external deficits continue to put downward pressure on international reserves. The kingdom's reserves slid from $1.9 billion in August to $1.5 billion in September (1.3 months of imports). (Chart 6.) Bahrain is set to receive up to $2 billion of the $10 billion GCC financial support package by the end of this year, which should provide some fiscal relief.

Chart 6: Bahrain central bank reserves



Source: Central Bank of Bahrain

Egypt: The International Monetary Fund has reached an agreement with Egypt to disburse another $2 billion from the country's $12 billion extended fund facility, upon IMF executive board approval of a fourth review of the three-year program. In this context, according to the finance ministry, Egypt aims at an external credit ceiling of $14.3 billion in fiscal year 2019-2020, bringing total external debt to $103 billion, and repaying $10.3 billion to foreign lenders in fiscal year 2019-2020.

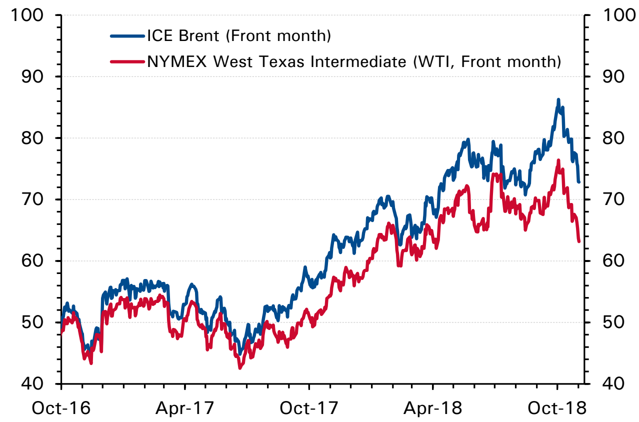
Turkey: The central bank hiked its inflation forecasts for 2018 and 2019 amid continued inflationary pressures stemming from the weakness in the lira. The bank now expects inflation in 2018 to come in at 23.5%, over 10 percentage points higher than its forecast of three months ago. In 2019, it expects inflation to moderate a little to 15.2%. Meanwhile, the lira fell 2% after investors were caught by surprise when the government announced a temporary tax cut on selected consumer goods, which could worsen the state's already weakened finances.

Markets – oil

Last week saw oil prices decline for the fourth consecutive week as fears eased over the severity of US sanctions on Iran and a consequent shortage of oil. By Friday's close, Brent had fallen to $72.8/bbl (-6.2% w/w) and WTI had dropped to $63.1/bbl (-6.6% w/w), with both markers extending their losses to a six-month low. (Chart 7.)

Chart 7: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

The US had earlier indicated that it would be willing to extend sanctions waivers temporarily to eight countries, including China, Japan, India and South Korea, which signaled to the market that the oil supply shortfall due to sanctioned Iranian barrels may not be as severe as earlier envisaged. The bearish shift in sentiment was given extra impetus with the news that US crude production reached a new all-time high of 11.2 mb/d (w/e 26 October) and that OPEC had ramped up output by a further 430,000 b/d to 33.3 mb/d in October – its highest level since 2016 – according to Bloomberg preliminary estimates. Sanctions on Iran go into full force tomorrow, although President Trump indicated over the weekend that he would be open to reaching a new comprehensive nuclear agreement with the Islamic Republic.

Markets – equities

International equities registered their worst month in six years, with stocks marred by increasing worries over global growth, unusually high corporate earnings, and US trade pressures. The MSCI AC world index ended October down 7% m/m, but was up 0.9% w/w last week thanks to promising remarks by President Trump over trade. US stocks edged higher, buoyed by record earnings, strong economic data, and easing trade concerns, with the S&P and the DJI both up 2.4% w/w. Meanwhile, slower European growth and political uncertainty were offset by strong corporate earnings, with the Eurostoxx 50 rising 2.5% w/w. The softer tone on trade also helped emerging markets stage a rebound, with the MSCI EM index up 5.4% w/w. (Chart 8.)

Chart 8: International equity indices

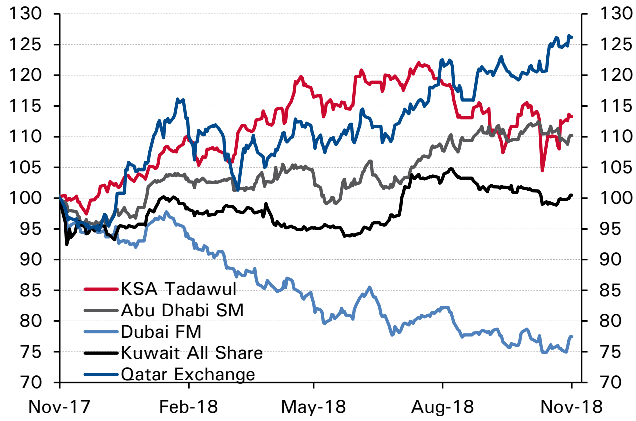
(rebased, 2 November 2017=100)

Source: Thomson Reuters Datastream

Regional equity markets underperformed, with the MSCI GCC index up 0.6% w/w, but remain supported by strong corporate earnings and oil. Dubai led the pack (+2.5%), thanks to healthy banking and real estate profits, and was followed by Qatar (+1.3%), which is now up 21% YTD. While Saudi (+0.6%), benefitted from good earnings announcements, geopolitics still weighed. Kuwait (0.6%), on the other hand, was lifted by its banks, which saw their aggregate nine-month profits outperform regional peers. (Chart 9.)

Chart 9: GCC equity markets

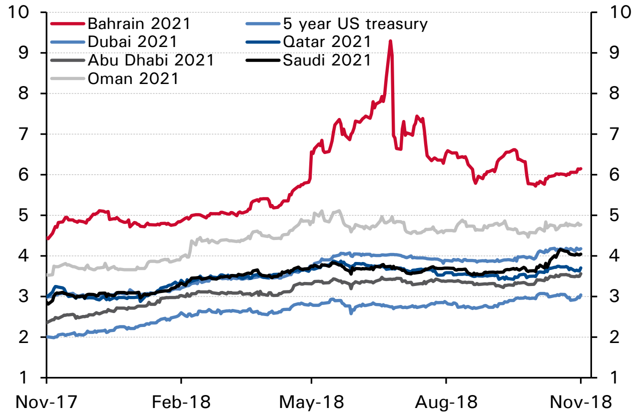
(rebased, 2 November 2017=100)



Source: Thomson Reuters Datastream

Chart 11: GCC bond yields

(%)



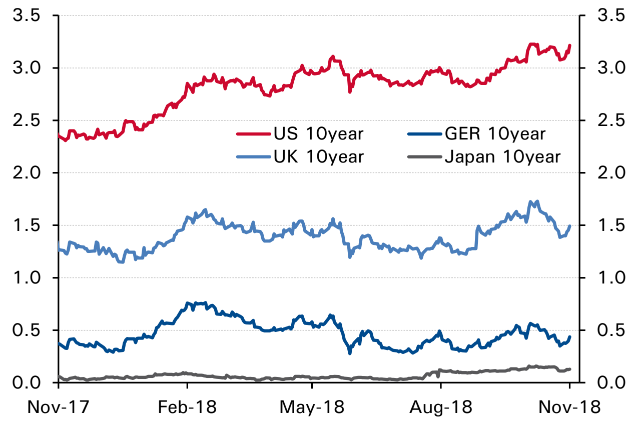
Source: Thomson Reuters Datastream

Markets – fixed income

International yields were higher thanks to strong US economic data and a softer tone on trade from Mr. Trump. US 10-year treasury rates climbed 14 bps last week, while 10-year bunds were up a smaller 9 bps, as slower European growth offset the impact of higher inflation. (Chart 10.) Regional bonds were mostly higher by 1-8 bps, tracking US treasuries up. (Chart 11.)

Chart 10: Global bond yields

(%)



Source: Thomson Reuters Datastream

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