Hurricanes and North Korea tensions weigh on markets; Saudi Arabia revises reform plans

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,454	-0.33	-2.04
Bahrain ASI	1,316	1.00	7.79
Dubai FM	3,644	0.19	3.21
Egypt EGX 30	13,433	0.13	8.81
S&P GCC 40	1,034	-1.33	-10.45
Kuwait SE	6,897	0.08	19.99
KSA Tadawul	7,361	1.40	2.08
Muscat SM 30	5,047	-0.11	-12.72
Qatar Exchange	8,675	-1.42	-16.88
International			
CSI 300	3,826	-0.12	15.59
DAX	12,304	1.33	7.17
DJIA	21,798	-0.86	10.30
Eurostoxx 50	3,448	0.11	4.78
FTSE 100	7,378	-0.82	3.29
Nikkei 225	19,275	-2.12	0.84
S&P 500	2,461	-0.61	9.94

Commodities	$/unit	Change (%) weekly	Change (%) YTD
Brent crude	53.8	1.95	-5.35
KEC	51.4	7.22	-5.26
WTI	47.5	0.40	-11.62
Gold	1346.0	1.62	17.04

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.301	-0.30	-1.58
KWD per EUR	0.359	1.13	12.76
USD per EUR	1.203	1.48	14.46
JPY per USD	107.830	-2.20	-7.74
GBP per USD	1.320	1.92	6.98
EGP per USD	17.630	0.23	-2.06

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Bhibor - 3 month	2.45	0.0	35.0
Kibor - 3 month	1.75	0.0	31.3
Qibor - 3 month	2.43	-2.2	64.4
Eibor - 3 month	1.55	1.0	7.2
Saibor - 3 month	1.79	-0.1	-24.1
Libor - 3 month	1.32	0.1	31.9

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.09	-8.5	-44.6
Dubai 2021	2.89	-4.6	-40.9
Qatar 2021	2.56	-10.7	-37.6
Kuwait 2022	2.41	-10.5	n/a
Saudi Arabia 2021	2.72	-10.5	n/a
International			
UST 10 Year	2.06	-9.6	-37.1
Bunds 10 Year	0.32	-6.3	10.9
Gilts 10 Year	1.01	-5.2	-23.4
JGB 10 Year	-0.01	-0.5	-5.4

Source: Thomson Reuters Datastream; as of Friday's close 08/09/2017

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Overview

Tensions between the US and North Korea, US debt ceiling concerns and the impact of successive hurricanes in the Americas weighed on investors' risk appetite last week, pushing global equities down 0.6%. Monetary policy also moved back into focus on Thursday, with comments from ECB President Draghi that the central bank may soon start to unwind its QE program – allied with the view that the next US rate hike will be pushed into next year – sending the euro to a 33-month high versus the US dollar. One concern is that this will jeopardize Eurozone export performance and the region's current economic recovery.

Meanwhile, oil prices rose strongly last week, with Brent reaching a five-month high of nearly $55 per barrel as the fading impact of Hurricane Harvey saw the restarting of US refineries, boosting the demand for crude. The recovery in crude prices was halted, however, by the approach of Hurricane Irma towards Florida, with concerns that it could both affect demand and disrupt oil shipments to and from the US.

In the Gulf, Saudi Arabia is reported to be redrafting the 2020 National Transformation Plan announced last year, with some reforms discarded and targets pushed until later in the decade. The revised report is slated to be presented in October. Although the move will be interpreted as a step back in some areas, a more measured approach could also provide the authorities space to implement signature reforms including the Aramco IPO – some of which will occupy vast amounts of government time. Moreover, there has already been considerable progress in a number of areas, with subsidies cut, the deficit narrowed, excise duties implemented in June and VAT almost certain to be introduced in January. We would not assume a weakening of the government's commitment to the reform agenda.

High frequency data in Qatar reveal the impact of the diplomatic dispute on the tourism sector, with visitor arrivals plunging more than 50% y/y in June-July. The country also suffered another sovereign rating downgrade, this time from Fitch, who cited lack of progress in resolving the crisis. This concern has since been reinforced by comments from the Saudi foreign minister, who declared that if the rift continued for another two years, then "so be it". The weekend also saw the first phone conversation between the Qatari emir and the Saudi crown prince since the crisis began, but further talks have been suspended.

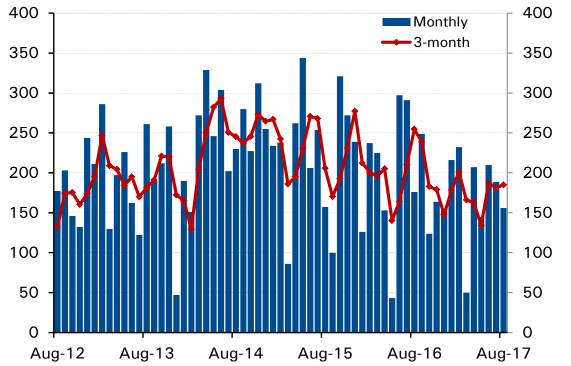
International macroeconomics

USA: President Trump threw his support behind the Democrat's plan to temporarily increase or suspend the debt ceiling for three months, a move that would avoid a government shutdown. The latter would have risked eroding the US's credit rating. Markets had been anticipating a budget fight toward the end of September. The deal is only a temporary respite, with the fight now pushed to December.

The employment report headline was weaker than expectations, though overall it continued to indicate a healthy labor market. Nonfarm payrolls rose by 156,000, with the 3-month moving average remaining mostly

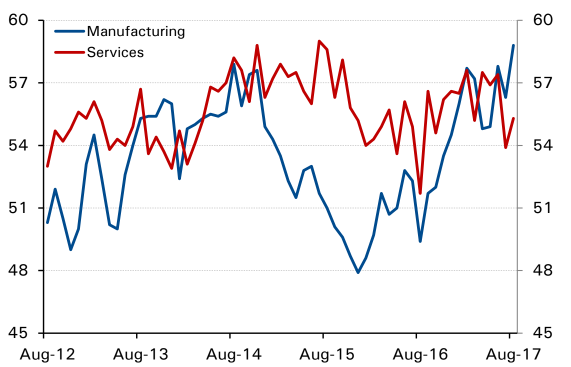
Chart 1: US new nonfarm jobs

(thousand)



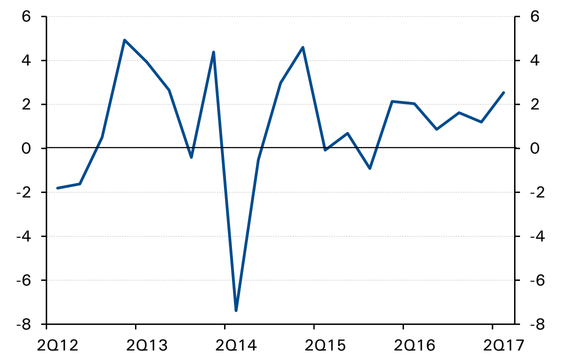
Source: Thomson Reuters Datastream

Chart 2: US ISM activity indexes



Source: Thomson Reuters Datastream

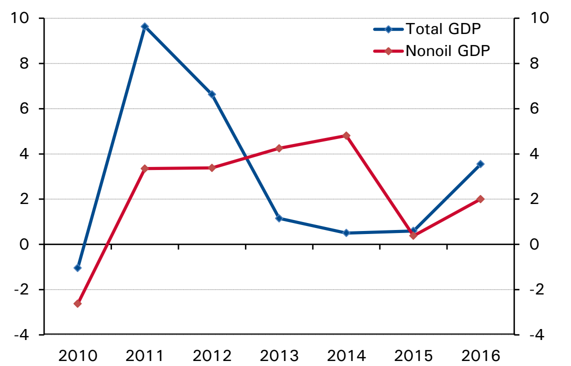
Chart 3: Japan's annualized real GDP



Source: Japan Cabinet Office

Chart 4: Kuwait real GDP growth

(% y/y)



Source: Central Statistical Bureau

steady at 185,000. The unemployment rate moved up slightly to 4.4%. Wage inflation remains very steady under 2.5% and affords the Fed time before its next hike. (Chart 1.)

The ISM indexes for August continued to show resilience. The manufacturing index was particularly strong at 58.8, rising to its highest level since 2011. (Chart 2.)

Eurozone: August's final EZ PMI composite stood at 55.7, unchanged from July and validating the EZ's still buoyant economic activity. Meanwhile, inflation surprised in August, exceeding expectations and coming in at 1.5% y/y, lifted by a pick-up in energy prices. The ECB has revised lower its inflation outlook for 2017 and 2018, to 1.5% and 1.2%, respectively, on account of a stronger euro, which last week hit its highest level versus the US dollar since early 2015. The ECB did, however, bump up its growth projection for 2017 (2.2%), reflecting the recent stronger momentum.

China: China's services sector activity expanded at the fastest pace in three months in August, according to the Caixin purchasing managers' index (PMI). The PMI rose to 52.7 from 51.5 in July. New business orders expanded and improved employment conditions also boosted the figure as hiring activity rose at its strongest pace in four months.

Japan: Japan's annualized real GDP growth for 2Q17 was revised down from 4.0% to 2.5%, as growth in capital spending came in lower than initially estimated. (Chart 3.) However, the economy still grew at its fastest pace in two years on the back of improvements in consumption spending and export growth.

GCC & regional macroeconomics

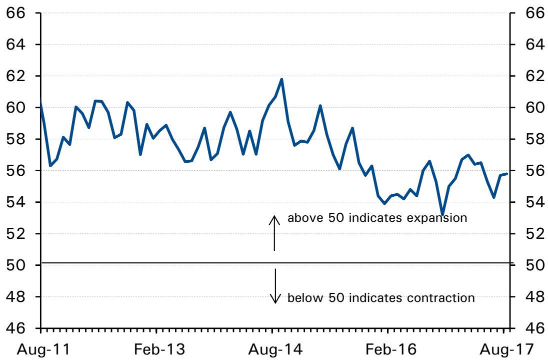
Kuwait: The economy grew by 3.5% in 2016, according to preliminary CSB data, though non-oil growth was below expectations at 2.0% (Chart 4). Non-oil growth for 2015 was also revised to a surprisingly weak 0.4%, from 1.3%. Most, including the IMF and ourselves, were expecting growth above 3% in both years. Much of the 2016 weakness came from soft investment growth (2%), though this appeared to contradict other indicators which suggested stronger capital spending. Sectorally, it was not a surprise that sectors most dependent on consumer spending did poorly, growing by just 0.5% in 2016; by contrast, manufacturing, real estate and financial services, and transportation saw above average growth. Most surprisingly, data showed the construction sector contracting by 6.2% and 3.2% in 2015 and 2016; preliminary 2015 estimate had growth above 8%. This does little to alter our views on 2017 and 2018. We still look for non-oil growth of 3.5-4%.

Four projects were awarded in August worth KD 347 million, the largest being the Kabd Municipal Solid Waste project. The public-private partnership (PPP) project is worth KD 235 million and was awarded to a consortium led by the French engineering company Constructions Industrielles de la Méditerranée (CNIM). A total of 54 contracts have been awarded thus far in 2017, worth KD 2.8 billion.

Saudi Arabia: Saudi Arabia plans to redraft the National Transformation Plan (NTP) that was launched in June 2016. The NTP is the roadmap and guide for the relevant government sectors to aid in achieving the goals of the Vision 2030 development plan. The new plan, dubbed NTP 2.0, will have more achievable targets. The revamped targets will be related to improving the productivity of the government sector – regarding bureaucracy, efficiency, and transparency – as well as boosting female

Chart 5: Saudi PMIs

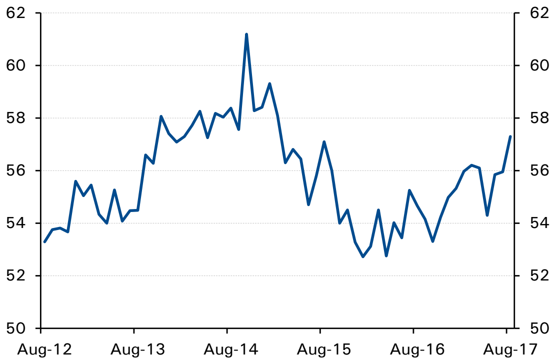
(index)



Source: Markit/Emirates NBD

Chart 6: UAE Purchasing Managers' Index

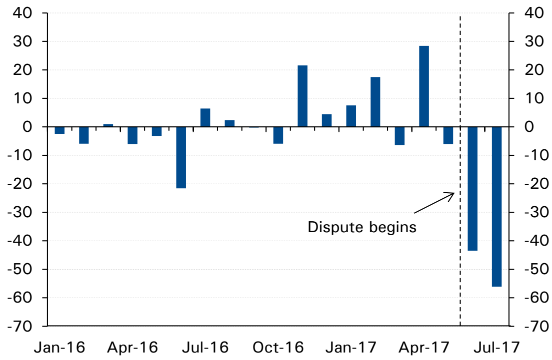
(index)



Source: Markit

Chart 7: Visitor arrivals to Qatar

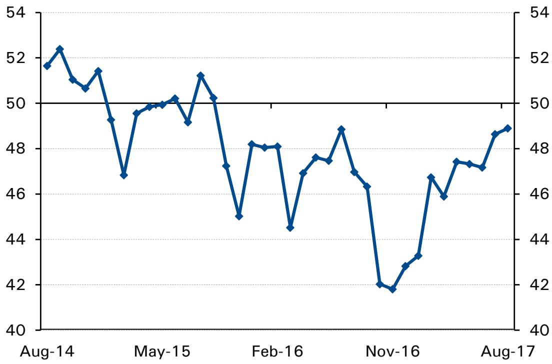
(% y/y)



Source: MDPS/NBK

Chart 8: Egypt PMI

(index)



Source: IHS Markit

participation in the labor force.

The latest, August, PMI data signaled continued positive activity in the private sector. The headline figure registered an expansionary 55.8 compared to 55.7 in July, though it remains below its long-run average of 58.1. (Chart 5.) The improvement is mostly attributed to an increase in new orders in response to strong local and international demand.

UAE: The latest data for the UAE's PMI pointed to a further climb in non-oil sector activity (Chart 6). The headline PMI rose to an over two-year high of 57.3 in August with new orders and output robust, thanks to an ongoing improvement in domestic conditions. This more than offset ongoing softness in new export orders.

Qatar: The economic impact of the diplomatic crisis continues to play out. In late August, Fitch became the latest rating agency to lower the country's sovereign rating, to AA- from AA, citing the lack of progress in resolving the dispute with its neighbors. The move had little market impact, with key gauges of risk including sovereign bond yields and credit default swaps even drifting lower in the days after the announcement. The new rating still represents a high investment grade, and brings Fitch's rating into line with the other main agencies – Standard & Poor's having downgraded Qatar in June, right after the crisis began. All agencies have left Qatar's rating outlook at 'negative', however, threatening further downgrades.

The Saudi foreign minister announced to reporters last week that if the rift continued for two years then "so be it" and the concern is that the dispute may have settled into an uncomfortable equilibrium whereby conditions do not deteriorate further, but no improvements are seen, either. Over the weekend it was reported that a phone conversation took place between the Qatari emir and Saudi crown prince – the first contact since the crisis began – but that further contact had been suspended over a protocol issue.

There are also clear signs of the crisis in high frequency external data. Visitor arrivals from the Gulf region plunged 82% y/y in the June-July period. Arrivals from elsewhere dropped by a smaller amount, but given the importance of tourism from the Gulf region, overall arrivals were still down 51% y/y. (Chart 7.) Meanwhile, merchandise imports slumped 38% y/y in the same June-July period, reflecting disruption arising from the trade embargo. Exports were also affected but by less, leaving the trade surplus around $1.4 billion per month higher than a year earlier.

Oman: Moody's changed its Omani banking outlook to "negative" on concerns of weaker government support amid a deteriorating operating environment. They expect Oman to overshoot its OMR 3 billion deficit projection for 2017, as well as anemic real growth for that same year. This is in-line with our forecasts.

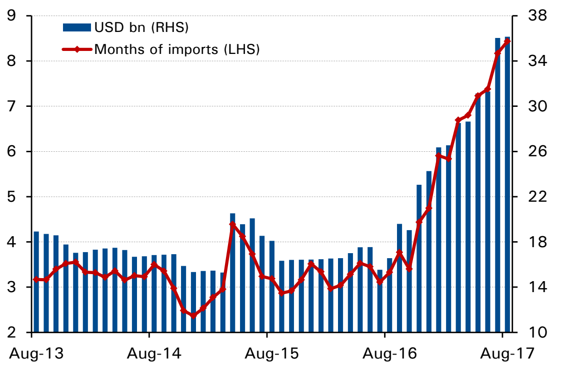
Egypt: The PMI continued to move higher in August; however, at 48.9 (Chart 8), the index remained inconsistent with recent GDP figures, which showed robust growth of 4.9% y/y in 2Q17. Exports remained a particular source of strength. The output index was also up. At the same time, inflationary pressures eased, though they remained relatively elevated.

The CBE's foreign reserves were up $0.1 billion in August to $36.1 billion, or an estimated 8.4 months of imports (Chart 9). Foreign reserves, which have increased significantly since their low in July 2016, are now just above their pre-2011 level.

Turkey: After slowing for three consecutive months, consumer price inflation rose in August to 10.7% y/y from 9.8% y/y in July as inflation in

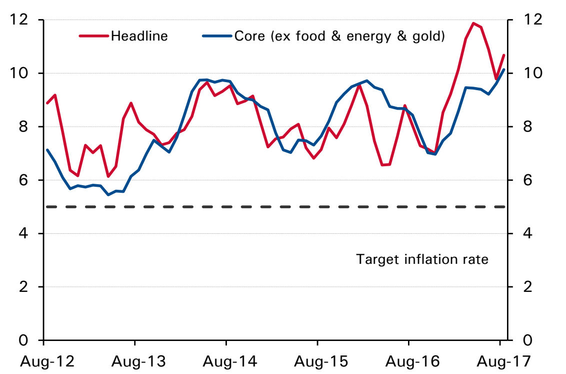
Chart 9: Egypt foreign reserves

(% y/y)



Source: MDPS/NBK

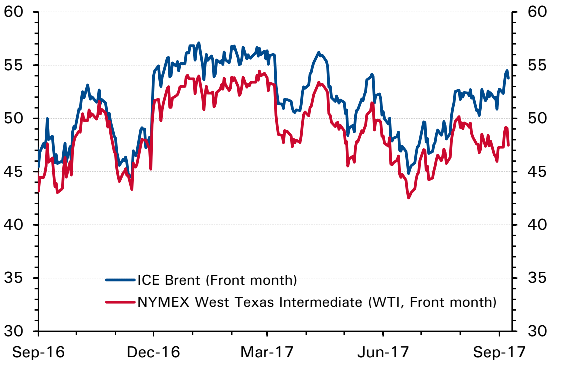
Chart 10: Turkey consumer price inflation



Source: Thomson Reuters Datastream

Chart 11: Benchmark crude oil prices

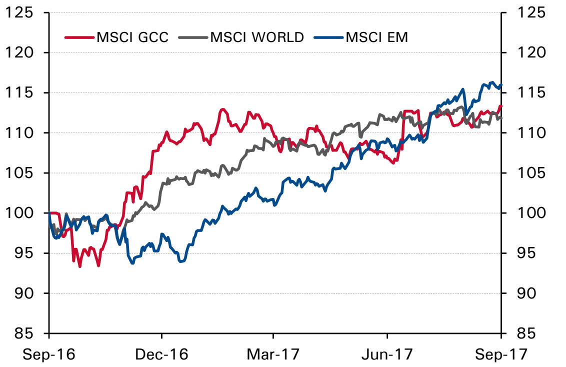
($/bbl)



Source: Thomson Reuters Datastream

Chart 12: Total return indices

(rebased, 8 August 2016=100)



Source: Thomson Reuters Datastream

most components picked up. Turkey is a net importer of oil and the pick-up in oil prices over the last year, together with a weak lira, have continued to push inflation in the transport component higher. With inflation remaining far above the central bank's target of 5%, liquidity conditions are projected to remain tight in the near-to-medium term. (Chart 10.)

Markets – oil

With Brent and WTI closing the week at $53.78/bbl and $47.48/bbl, respectively, oil prices recouped some of their Hurricane Harvey-induced losses. (Chart 11.) Brent gained almost 2% on the previous week while WTI had risen by a smaller 0.4% w/w as the re-opening of shuttered refineries in Texas boosted demand for crude feedstock.

More than two weeks after the category 4 hurricane made landfall and the impact on the US oil and gas industry is becoming clearer: refineries, pipelines, ports and rigs had all been forced to cease operation. According to the latest EIA petroleum statistics, in the week ending 1 September, 749,000 b/d (8%) of US crude production had been knocked out (with total output falling to 8.7 million barrels) and 3.2 million barrels (18%) of total US refinery crude throughputs had been suspended (with refinery utilization rates falling to 79.9% of total capacity). Also, imports and exports of crude were both severely curtailed. Meanwhile, crude stockpiles increased by 4.6 million barrels for their first weekly gain in at least 2 months, while gasoline and distillate stocks, unsurprisingly, decreased.

Markets – equities

Equity markets retreated last week as investors shifted back to risk-off mode. US debt ceiling concerns, hurricanes and escalating tensions with North Korea weighed on investors' risk appetite and the MSCI World All Country index was off 0.6%. US equities fell with the S&P 500 and DJIA closing the week down 0.6% and 0.9%, respectively. European equites fared better but closed the week marginally higher with the Euro Stoxx 50 up 0.1%. Emerging market equities also retreated with the MSCI EM down 0.3%. (Chart 12.)

It was a short trading week for regional equities due to the Eid-al-Adha holiday. GCC markets outperformed with the MSCI GCC up 0.8% on the week as oil prices recovered on hurricane season and geopolitical worries. Saudi and Kuwaiti stocks continued to lead as we head closer to the potential decision by FTSE to upgrade both markets to emerging market status. Meanwhile, Qatar underperformed with its general index down 1.4%. Fitch recently downgraded Qatar's sovereign ratings. (Chart 13.)

Markets – fixed income

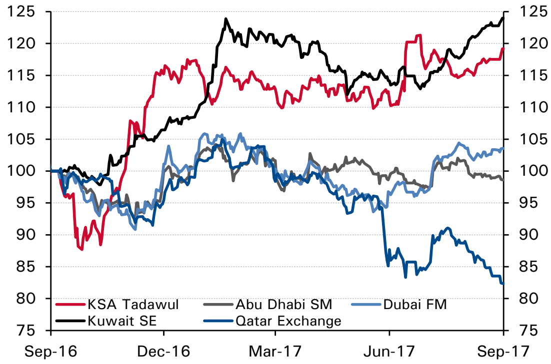
Benchmark yields were lower on the week, but range bound, oscillating within tight intervals. Trading was dominated by North Korea, the hurricane season, and dovish Fed/ECB talk.

Dovish Fed talk and the resignation of its vice chairman Fischer saw investors remain cautious. This also reduced the likelihood of a December hike, down to 27% from 35% last week. Meanwhile, growing concern over North Korea and the damage done by hurricanes Harvey and Irma had investors increasingly buy into safe-haven debt. As a result, US 10-year yields decreased by 10 bps over the week to settle at 2.06%, their lowest all year. (Chart 14.)

As for bunds, the inflow of healthy economic data (inflation and GDP confirmation, and PMI) did little to offset investors' passiveness ahead of

Chart 13: GCC markets

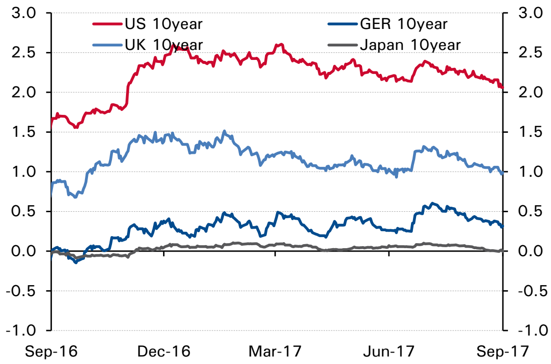
(rebased, 8 August 2016=100)



Source: Thomson Reuters Datastream

Chart 14: Global benchmark yields

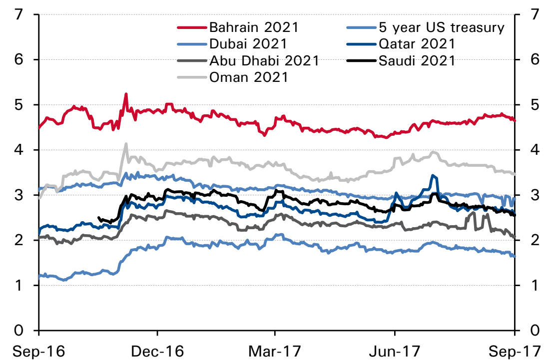
(%)



Source: Thomson Reuters Datastream

Chart 15: GCC yields

(%)



Source: Thomson Reuters Datastream

the ECB's meeting. Yields did see a bump following the meeting, on some talk of QE taper, but they reverted back following the weaker ECB inflation outlook. 10-year bunds shaved 6bps by week's end, dipping to 0.32%. (Chart 14.)

GCC sovereign yields tracked their US counterparts, decreasing over the week. Debt maturing in 2021 for Abu Dhabi and Qatar and 2022 for Kuwait and Saudi Arabia declined by 9-11 bps. Other rates were down during the week as well. (Chart 15.)

The Bank of Canada increased its policy rate by 25 bps to 1.00% on stronger than expected data. The move came earlier than expected, surprising markets. This was its second rate hike this year. Expectations of possibly one more hike before the end of 2017 have spiked.

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