OPEC deal pushes oil prices above $50; US jobs seal the fate of a December Fed hike; Election watch in Europe

Key Market Indicators

Stock markets	Index	Change (%)	
		weekly	YTD
Abu Dhabi SM	4,309	0.84	0.04
Bahrain ASI	1,178	-0.72	-3.14
Dubai FM	3,361	1.11	6.66
Egypt EGX 30	11,548	1.72	64.83
KSA Tadawul	7,094	4.37	2.63
Kuwait SE	5,569	0.28	-0.82
Muscat SM 30	5,590	1.25	3.40
Qatar Exchange	9,914	2.05	-4.94
MSCI GCC	464	3.09	6.96

International			
DAX	10,513	-1.74	-2.14
DJIA	19,170	0.10	10.02
FTSE 100	6,731	-1.61	7.82
Nikkei	18,426	0.24	-3.19
S&P 500	2,192	-0.97	7.24

Commodities	$/bbl	Change (%)	
		weekly	YTD
Brent crude ($/bbl)	54.5	15.28	46.08
KEC ($/bbl)	49.0	12.93	72.75
WTI ($/bbl)	51.7	12.20	39.52
Gold ($/t oz.)	1175.7	-0.21	10.88

Exchange rates	Rate	Change (%)	
		weekly	YTD
KWD per USD	0.305	-0.08	0.43
KWD per EUR	0.326	-0.31	-1.21
USD per EUR	1.067	0.75	-1.79
JPY per USD	113.54	0.42	-5.62

Interbank rates	%	Change (bps)	
		weekly	YTD
Kibor – 3 month	1.38	0	-31
Qibor – 3 month	1.72	2	41
Libor – 3 month	0.95	1	33

Fixed income	%	Change (bps)	
		weekly	YTD
Abu Dhabi 2021	2.53	2	N/A
Dubai 2021	3.38	-1	-26
Qatar 2021	2.77	5	N/A
Saudi Arabia 2021	2.96	7	N/A

International	%	Change (bps)	
		weekly	YTD
UST 10 year	2.39	3	12
Bunds 10 year	0.28	5	-36
Gilts 10 year	1.37	-4	-59
JGB 10 year	0.04	1	-21

Source: Thomson Reuters Datastream

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Summary

At its 30 November meeting, OPEC surprised the markets by announcing a 6-month deal to reduce its output to 32.5 million barrels per day, a cap on Iranian production, and a presumed commitment by non-OPEC members to also cut production (see Oil Market section below). Though some details on implementation and compliance are still missing, the agreement is clearly a serious effort by OPEC to rein in global crude supplies—and the markets certainly reacted favorably to the deal, pushing Brent above $50 per barrel ($/bbl), a level that has been hard to sustain so far this year. Local equity markets were, of course, helped by the news and rose in the aftermath.

In the US, nonfarm payroll gains were 178K in November, while unemployment fell to 4.6%, a level not seen since 2007. (Chart 1.) Wage inflation remains controlled and near levels "acceptable" to the Fed; it has averaged 2.5% gains so far this year. The "as-expected" report, i.e. decent job gains and low unemployment, make a Fed hike a near-certainty for the last FOMC meeting of the year on 13-14 December.

Looking at US rates ahead, the recent healthy US data, which predate the election, as well as president-elect Trump's promises of further economic stimulus, have led to higher US interest rates and a steeper curve. The 10-year US note closed the week yielding 2.38%. The report was not, however, strong enough to point to aggressive Fed action in 2017, which is why the reaction was muted in the fixed income and FX markets.

As we write, two elections are scheduled in Europe this Sunday: one for the president of Austria (a largely ceremonial position) and the other for constitutional reform in Italy, which would give the government more sweeping powers. However, like elsewhere (Brexit, Trump), these elections are all turning into a test of anti-establishment sentiment, and seem to be building momentum from one country to the other.

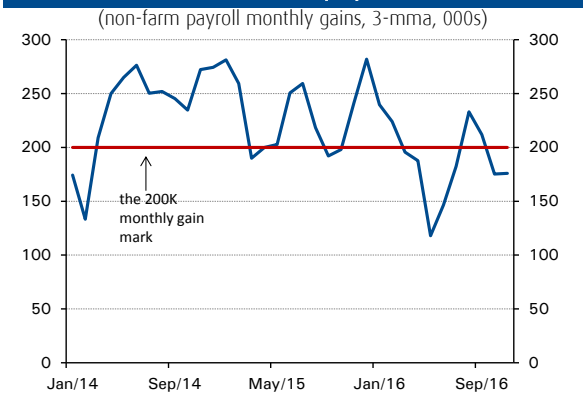
Should the expected "no" prevail in the Italian referendum, PM Renzi has promised to resign, and there are concerns in the markets that, in that case, a needed rescue package for troubled Italian banks would be delayed. We suspect volatility lies ahead but that, ultimately, the Italian government and the ECB would find a way to do "whatever is necessary" to calm the game. Independently, the ECB is expected to tweak its current QE program at its 8 December meeting by extending it by six months.

International Macroeconomics

United States: Recent data point to moderate growth in the US. GDP grew 3.2% in 3Q2016. The manufacturing PMI hit 43.2 in November, matching its best 2016 level. Employment gains were 178k in November and unemployment fell to 4.6%. The data overstate the strength but are enough to get the Fed to do what it wants, and what is already priced in the market i.e. raise the fed funds rate target from 25-50 bps to 50-75 bps on 14 December.

Ahead, much depends on the new Trump administration. Its policies remain unclear at this point. However, given decent economic growth and upcoming stimulus, we think it is reasonable to assume a slightly more aggressive Fed next year, two rate hikes (in line Fed dot-plots for once).

Chart 1: US employment



Source: BLS

Eurozone: Italy's 4 December referendum took center stage last week, with many pondering the uncertainty a negative outcome could entail. A Reuter's survey noted that the ECB may ramp up its purchases of Italian government bonds to stave off any volatility in borrowing rates, while Italian banks are rushing to secure funding as they recapitalize. Other downside risks include the contagion of anti-establishment sentiment across Europe, which ECB governor Mario Draghi condemned in a recent interview. With four days between the vote and the next ECB monetary policy meeting, the uncertainty may feed into the policy decision.

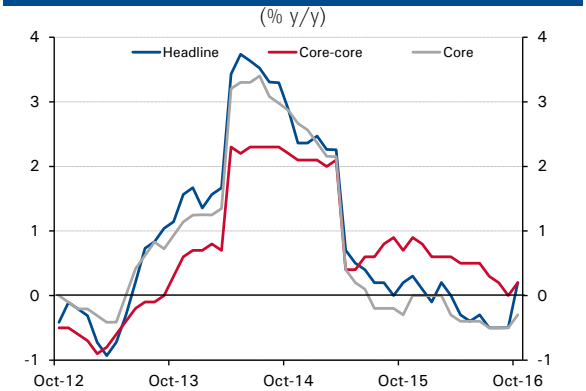
For November indicators, both the Eurozone (EZ) business climate and the EZ economic sentiment indicators came in below expectations, while consumer confidence and inflation came in as expected. A deeper look into the EZ economic sentiment indicator reveals, however, an improvement in consumer and firm inflation expectations. This shift is in line with November EZ inflation, which came in at a 31-week high of 0.6% y/y, and last week's PMI numbers, which highlighted a pick-up in input and output prices.

Favorable rumors have surrounded Greece's second bailout review, with talks expected to be done ahead of the European council meeting on 5 Dec, according to EU commission VP Valdis Dombrovkis. This will pave the way for Greece to commence discussions on debt relief, with the government currently looking to swap some of its floating payments for fixed coupons, as it is wary of the rising rate environment. Such a scheme was, along with extending debt maturities and deferring payments, recommended by the IMF. Floating rate debt accounts for €31 billion of the €163 billion owed to the European Financial Stability Facility and the European Stability Mechanism. Greece's total debt from its three rescue packages stands at €228 billion.

In France, Ex-PM Francois Fillon won his party's nomination, becoming Les Republicains' candidate for the 2017 presidential election. He is expected to be the favorite in a run-off against Marine Le Pen. He proposes a supply-side economic strategy that includes cuts to public spending and a longer work week.

China: China is increasing its efforts to tighten capital controls on foreign-bound investments. The government's main concerns are keeping the renminbi steady and conserving foreign reserve levels. The new regulation will scrutinize Chinese companies pursuing foreign deals valued at $10 billion or more. State-owned enterprises will be monitored for foreign property investments worth $1 billion or more. Foreign investments will not only be capped in magnitude but will have to be related to the firm's core business. The measures, due to be introduced soon, are temporary and will remain in effect until September 2018. The government wants to stabilize outflows as it undergoes a sensitive transition in its leadership next year.

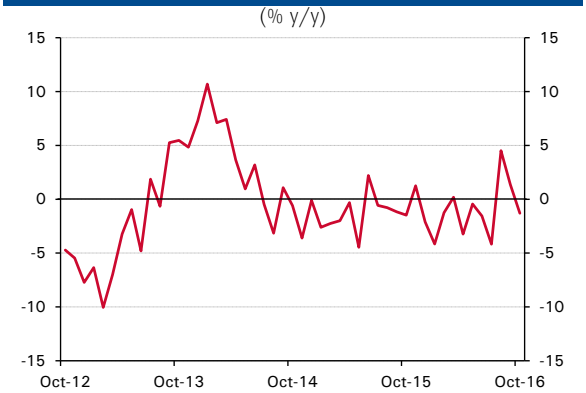
Chart 2: Japan consumer price inflation



Source: Thomson Reuters Datastream

Japan: Japan's consumer price inflation witnessed its first rise in eight months in October as a weaker yen pushed the cost of imports higher. However, at 0.2% y/y (Chart 2.) it still remains very weak and far below the Bank of Japan's (BOJ) 2% inflation target. The core-core rate, which excludes food and energy costs and is the BOJ's preferred measure, edged up marginally to a mere 0.1% y/y.

Chart 3: Japan industrial production



Source: Thomson Reuters Datastream

Growth in Japanese industrial production fell back to contractionary territory in October, falling by -1.3% y/y. (Chart 3.) Industrial production has struggled to eke out gains since sales taxes were hiked back in 2014. Those had dampened consumer demand and hampered the manufacturing sector. We may see production gather some pace in the near-to-medium term especially if the weaker yen props up exports.

GCC & Regional Macroeconomics

Kuwait: The Amir of Kuwait reappointed Prime Minister Sheikh Jaber al-Mubarak al-Sabah to form the next government following parliamentary elections last week that saw 60% of the Assembly's members replaced. The move was no surprise and reflects intentions to continue with the outgoing government's overall agenda, including its commitment to maintain capital spending plans while pursuing fiscal reforms.

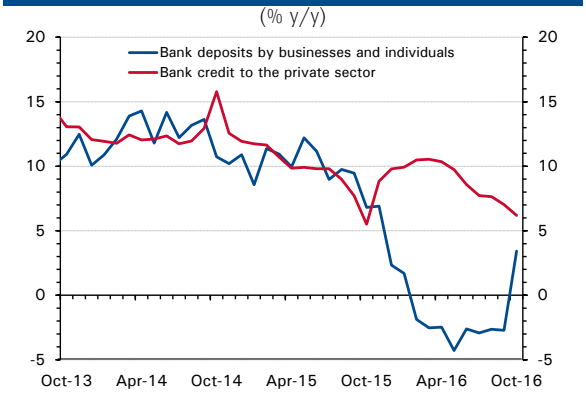
The Ministry of Finance (MOF) announced the outline for its FY17/18 budget. MOF projects expenditures growing by 3.2% and oil revenues rising by 33% on the basis of a higher oil price of $45 per barrel and steady production. Non-oil revenues are expected to grow by 7%. The MOF thus projects a deficit after the Future Generations Fund of KD 7.6 billion (or 20% of GDP). We estimate the deficit will come in well below this at around KD 3 billion (8% of GDP) largely on expectations of a higher oil price and planned hikes in electricity and water tariffs. Shamal Azzour Al-Oula, Kuwait's first private power and water company is now fully operational after completing its plant in the south of Kuwait at a cost of $1.7 billion. Kuwait Investment Authority hopes to offer 50% of the company to Kuwaiti nationals soon.

Profits of listed companies continued to signal softness during the first nine month of 2016. The low oil price environment has put pressure on results, with weakness more pronounced in non-bank financial services and real estate. Earnings of 166 corporates declined by 6% y/y, though results surprised analysts to the upside.

The Central Bank of Kuwait (CBK) issued a 3-year floating rate note on behalf of the Ministry of Finance (MOF) this week. The KD 100 million issuance was priced at 1.5% (37.5 bps over the 6-month CBK bond rate). The MOF has issued KD 1.58 billion in new debt thus far in FY16/17, raising the public debt to KD 3.17 billion (9.5% of GDP).

Kuwait sent a request for proposals to international banks in preparation for an international bond issuance, expected sometime in 1Q17, which could raise up to $10 billion.

Chart 4: Saudi bank deposit & credit growth

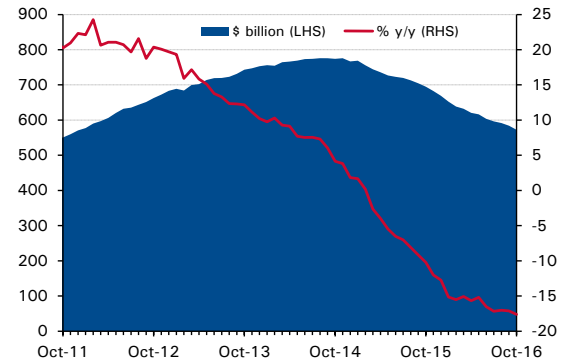


Source: SAMA

Saudi Arabia: Latest data showed that bank credit to the private sector continued to moderate, slowing to 6.2% y/y in October, further confirming the deceleration in the Saudi non-oil sector witnessed this year. (Chart 4.) Private sector deposits moved into positive y/y basis for the first time this year, growing by 3.4% y/y in October. A faster pace of payments by the government to private sector entities is thought to be behind the improvement in the deposit base and in liquidity.

The kingdom's net foreign assets fell by $10.8bn m/m (-17.6% y/y) to $575 billion in October. (Chart 5.) The decline comes despite the issuance of $17.5 billion in sovereign bonds; those have yet to significantly affect the banking system. The outflows could be related to the release of

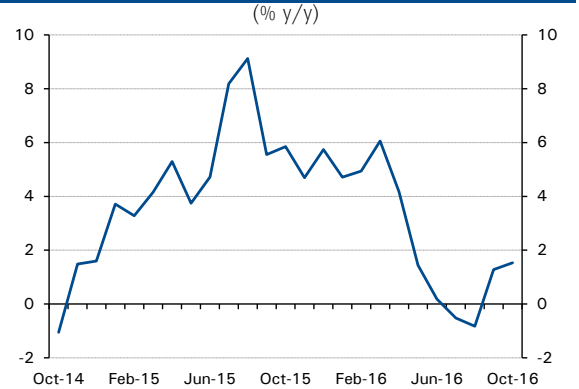
Chart 5: Saudi net foreign assets



Source: SAMA

Chart 6: Egypt real credit growth

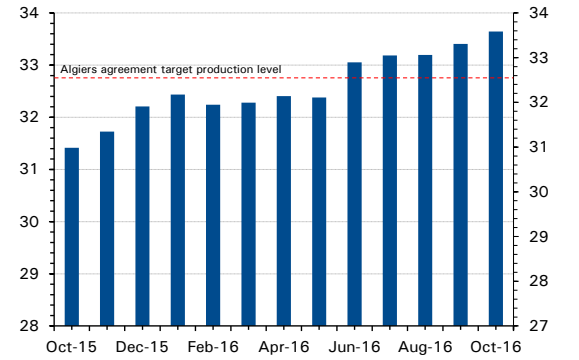
(% y/y)



Source: CBE, Thomson Reuters Datastream, NBK estimates

Chart 7: OPEC crude oil production

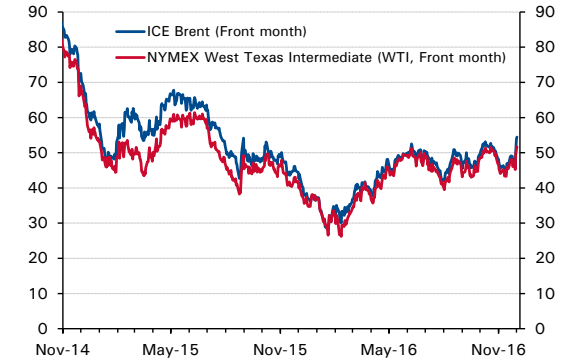
(million barrels per day, mb/d)



Source: OPEC secondary sources

Chart 8: Benchmark crude oil prices

($ per barrel, $/bbl)



Source: Thomson Reuters Datastream

monies to foreign contractors, higher imports and/or remittances abroad or capital outflows, including the transfer of $2.0 billion to the Central Bank of Egypt in October.

Qatar: Qatar's Ministry of Development Planning and Statistics published the country's trade data for October 2016. In sum, the trade surplus fell by QR 4.0 billion to QR 7.7 billion, a sharp fall of 34.0% y/y. Exports of goods contracted by 14.9% y/y due to weaker hydrocarbon exports. Imports expanded by 32.7% m/m and 6.5% y/y, with the US, Germany and China as the top sources of Qatar's imports.

Oman: The Sohar oil refinery (capacity 116,000 b/d) was shut down temporarily due to technical issues. The shutdown is unlikely to materially impact our oil outlook for 2016, however. Oil production has picked up in 2016 as the authorities moved to offset low oil prices; it is expected to grow by 2.5% to average over 1 million barrels per day.

Egypt: The finance minister announced plans to raise $2.5-3 billion in an international bond issue by mid-January and as much as $6 billion throughout 2017. The issuance will help plug a deficit projected at EGP 320 billion ($18 billion) in FY16/17, and comes on the heels of a $12 billion IMF loan agreement.

Credit growth was steady at 15.3% y/y in October; real credit growth improved for the second consecutive month, rising to 1.5% y/y. (Chart 6). Credit growth had suffered earlier in 2016 as economic activity slowed. We expect growth to begin to improve gradually following Egypt's recent decision to float its currency.

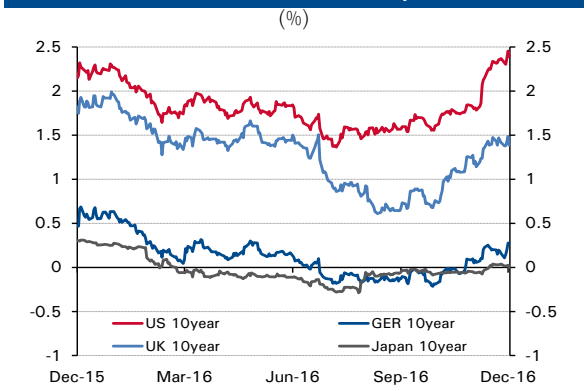
Markets - Oil

The much anticipated OPEC 'supply cut' meeting did not disappoint. Delivering a stunning riposte to the OPEC naysayers, the 13-member group (Indonesia's membership was suspended) agreed to cut output by 1.2 mb/d to 32.5 mb/d for a period of 6 months, effective January 2017. (Chart 7.) This is the group's first supply cut since the financial crisis, marking a reversal of the Saudi-led strategy of allowing market supply/demand dynamics to determine prices. All members, with the exception of Iran, Nigeria, and Libya will be required to reduce output by 4.5% from October's reference production level. While Saudi Arabia and its GCC neighbors are expected to shoulder the bulk of the production cuts, somewhat surprisingly, Iran agreed to cap its own production at a level 0.2 mb/d short of its oft-mentioned target of 4.0 mb/d.

Furthermore, non-OPEC, led by Russia also agreed to rein in output by 0.6 mb/d (details yet unclear). The impact on global supply/demand balances and global crude stocks, which are above their 5-year historical average, could be profound. As well as the reinstatement of individual country quotas, OPEC also agreed to the creation of a committee, chaired by Kuwait, to monitor compliance with the new production targets.

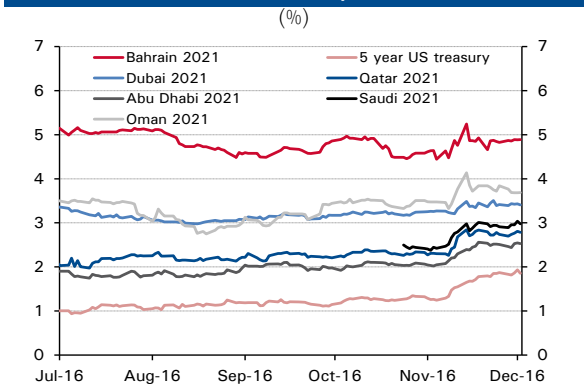
The impact on oil markets was striking: Brent and WTI recorded their biggest daily gain in 9 months, surging by more than 8% to $50.4/bbl and $48.9/bbl, respectively on the announcement. (Chart 8.) The gains weren't limited to oil prices, either, with energy indices such as the S&P 500 Oil and Gas Exploration and Production Index and the MSCI AC Asia Pacific Energy Index rising by as much as 10.8% and 4.5%, respectively—their largest increase in at least 5 years. The biggest beneficiary of OPEC's production cut is arguably US shale, with higher oil prices providing US

Chart 9: Global benchmark yields



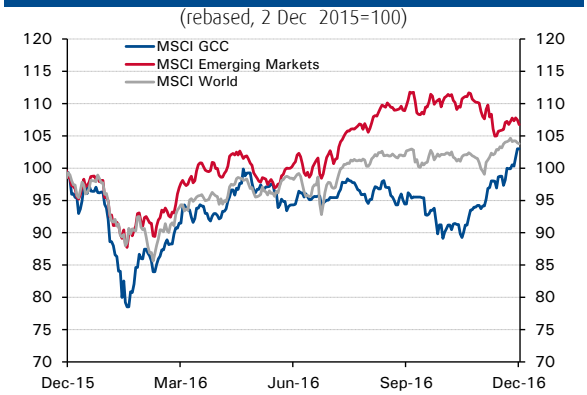
Source: Thomson Reuters Datastream

Chart 10: GCC yields



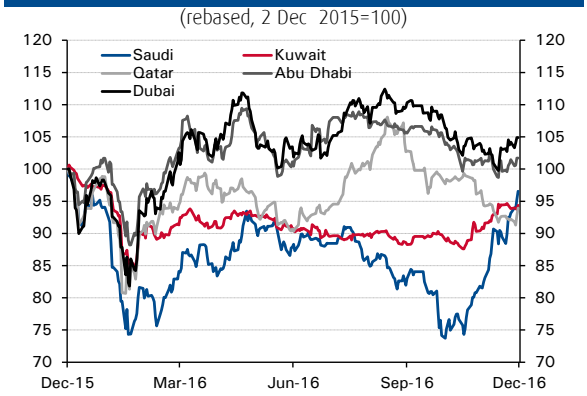
Source: Thomson Reuters Datastream

Chart 11: Total return indices



Source: Thomson Reuters Datastream

Chart 12: GCC Markets



Source: Thomson Reuters Datastream

energy companies, many of whom were struggling with negative cash flows, a much needed boost to bring back online idled rigs.

Moreover, higher prices should stimulate further investment in global oil capacity, without which, as the IEA has repeatedly stressed, future oil supplies could be imperiled, leading to dramatic price spikes.

Markets - Fixed income

Benchmark yields started the week off their monthly highs but shot up on news of the OPEC deal, only to be brought back down by upcoming European political events. The announced cut in oil production saw inflation expectations move higher, placing upward pressure on rates and offsetting downward pressures brought by pension funds and other institutional investors executing month-end trades. Safe haven buying associated with European political uncertainty, however, capped the increase later in the week, with investors awaiting the outcome of the Italian referendum and Austrian presidential elections.

With the Trump induced sell-off and the OPEC deal, US treasuries saw their largest monthly increases since May 2013, rising 56 bps in November. Meanwhile, Bunds, JGBs, and Gilts, were up between 7 bps and 18 bps on the month. (Chart 9.)

Following a stress test on UK banks, BOE governor Mark Carney noted that banks are well "capitalized to support the real economy even under a broad severe and synchronized stress scenario." The Royal Bank of Scotland fell short of the requirement, however, and will therefore require further capitalizing. Global growth was highlighted as the most significant risk to the UK's financial stability, with expectations of thinning capital inflows in the event of a slowdown. This may tighten financial conditions and add pressure on the currency.

GCC yields edged higher on uncertainty over the OPEC meeting. Saudi Arabia and Qatar benchmarks increased by up to 7 bps on the week, while Abu Dhabi and Dubai were flat. Oman moved in the opposite direction, with yields dropping 15 bps as a deal meant less forward pressure on its public finances. (Chart 10.)

Saudi's interbank rates continued to decline w/w, reflecting improved liquidity conditions. The 3-month rate dropped 3 bps to 2.07% as of 2 December; the benchmark rate has fallen 31 bps from its peak of 2.38% in October.

Markets - Equities

Global equities lost some momentum last week, though some still managed to register gains. The S&P 500 total return index was off 0.9%, while the Euro Stoxx 50 closed the week down by 1.1% as markets awaited the results of Italy's referendum. Emerging market equities fared relatively well despite a notable pick up in EM outflows that was brought about by Trump's victory. The MSCI EM retreated 0.5%. (Chart 11.)

GCC markets outperformed, with the MSCI total return index closing the week up 3.1%. This was mostly based on continued solid performance by the heavily weighted Saudi stocks. KSA's Tadawul gained 4.4% on the week as the market kept its post-bond issuance momentum. It then got a further boost from OPEC's deal. The other regional markets, lacking a catalyst of their own, seemed to track oil markets closely. (Chart 12.)

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