Fed to move this week; EU and US yields rise; oil prices retreat 8% in week

Key market indicators

Stock markets	Index	Change (%) weekly	Change (%) YTD
Regional			
Abu Dhabi SM	4,457	-3.03	-1.96
Bahrain ASI	1,354	0.90	10.91
Dubai FM	3,520	-1.77	-0.30
Egypt EGX 30	12,853	4.41	4.12
KSA Tadawul	6,917	-1.42	-4.07
Kuwait SE	6,711	-0.83	16.75
Muscat SM 30	5,792	-0.40	0.82
Qatar Exchange	10,467	-2.37	0.29
MSCI GCC	472	-2.43	-0.66
International			
DAX	11,963	-0.53	4.20
DJIA	20,903	-0.49	5.77
FTSE 100	7,343	-0.42	2.80
Nikkei	19,605	0.70	2.56
S&P 500	2,373	-0.44	5.97

Commodities	$/bbl	Change (%) weekly	Change (%) YTD
Brent crude ($/bbl)	51.4	-8.10	-9.59
KEC ($/bbl)	49.4	-8.58	-4.74
WTI ($/bbl)	48.5	-9.08	-9.74
Gold ($/t oz.)	1199.7	-2.79	3.74

Exchange rates	Rate	Change (%) weekly	Change (%) YTD
KWD per USD	0.306	0.13	0.14
KWD per EUR	0.326	0.74	2.55
USD per EUR	1.067	0.46	1.48
JPY per USD	114.74	0.66	-1.82

Interbank rates	%	Change (bps) weekly	Change (bps) YTD
Kibor – 3 month	1.44	0.0	0.0
Qibor – 3 month	1.86	-0.8	7.9
Libor – 3 month	1.12	1.8	12.3

Bond yields	%	Change (bps) weekly	Change (bps) YTD
Regional			
Abu Dhabi 2021	2.54	10.2	-0.8
Dubai 2021	3.19	2.5	-13.3
Qatar 2021	2.82	10.8	-13.4
Saudi Arabia 2021	3.05	9.5	-0.5
International			
UST 10 year	2.57	8.3	14.3
Bunds 10 year	0.48	12.8	27.6
Gilts 10 year	1.24	5.0	-0.5
JGB 10 year	0.09	1.4	4.1

Source: Thomson Reuters Datastream

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Summary

The Fed should hike rates 25 bps this week, and most of the GCC central banks are expected to follow suit. The federal funds rate target would thus go from 0.50-0.75% to 0.75-1.0%. The US bond market and others seem fully priced. The US 10-year note closed the week at 2.57%. The ECB met last week and left things unchanged. However, thanks to continued steady economic data and a subtly tougher Mario Draghi, yields rose in the EU, and the Euro finished the week up against the USD.

A strong nonfarm payroll report, up 235K in February, and unemployment at 4.7%, sealed the fate of the rate hike at the upcoming FOMC meeting on 14-15 March. US wage rises remain contained (see below) and kept expectations of future Fed hikes little changed. In December, the Fed signaled its expectation of 3 rate hikes this year. The Fed will release updated expectations this week, and while "3 hikes" (or less) should remain the majority view, we could see a couple of members move toward a more aggressive stance. In our view, "more than 3 hikes in 2017" is excessive and premature. Nonetheless, a March move is a done deal, as should be at least one more hike this year. As noted, the firmer European data is pressuring rates higher and keeping the euro supported at around 105-107 to the USD, receding political risks have also supported the currency.

Sovereign issuance remains the story in the GCC countries, with recent and/or upcoming supply, including Kuwait. Oil prices (Brent), after holding above $55/bbl for weeks, broke that level last week and fell some 8%; the market is concerned about the ability of OPEC to manage supply, amid rising US crude production and US crude stocks.

International macroeconomics

USA: The February employment report showed solid job gains of 235K, putting the 3-month average at 209K. (Chart 1.) Unemployment fell to 4.7%. The gains were no doubt helped by good weather, which boosted construction employment by 58k. The report makes it a virtual certainty that the Fed will hike rates on 15 March. Expectations of further hikes were kept in check by the wage data. Hourly earnings rose by 2.4% y/y, with little sign of acceleration. (Chart 2.) To us, this means the Fed is not "behind the curve" and does not need to significantly revise its current stance.

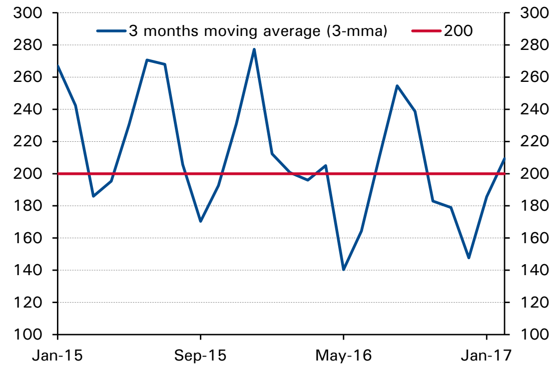
The debt ceiling, suspended until 15 March, needs to be addressed soon. This could create some of the usual jitters. The ceiling reverts back to $20.1 trillion on 16 March. While the Treasury will have some room to maneuver for a little while under that limit, legislative action will be required soon.

Eurozone: A relatively mild week, with the ECB standing pat, Germany's industrial production released, French political developments somewhat muted, and Dutch elections coming into focus.

The ECB kept interest rates and its QE policy intact, despite the pickup in key growth indicators. Still cautious of the turnaround, ECB president Draghi affirmed the central bank's stance in supporting the Eurozone (EZ)

Chart 1: Solid US Feb payroll gains ('000)

(% ch. y/y)



Source: BEA

Chart 2: US hourly wages

(% y/y)

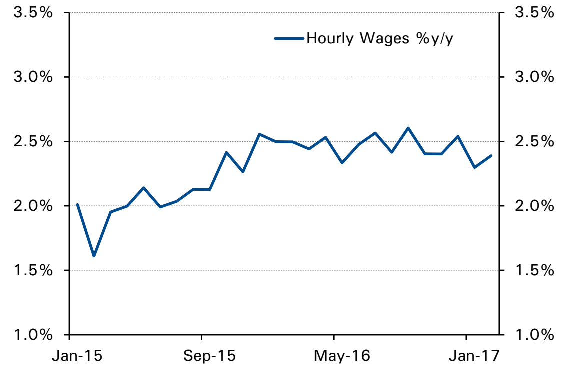


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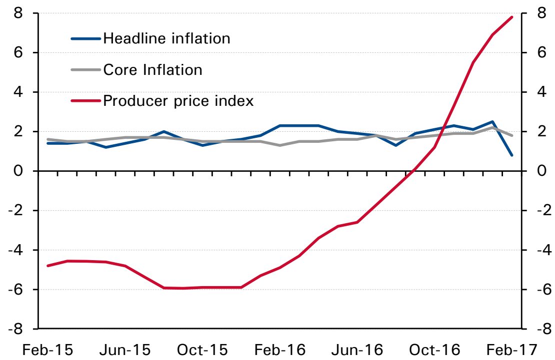
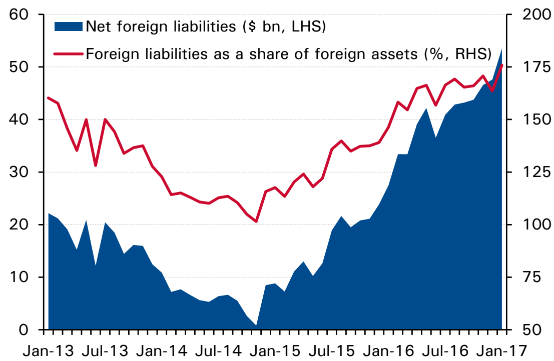
Chart 3: Chinese inflation

(% y/y)



Source: Thomson Reuters Datastream

Chart 4: Qatar banks' foreign liabilities



Source: Qatar Central Bank

recovery, yet hinted at less urgency ahead. The latter was acknowledged by the upwards revision in both growth and inflation outlooks for the EZ. The ECB now expects the EZ to grow by 1.8% in 2017 (last forecasted at 1.6% in Sep 2016), while inflation expectations were bumped up to 1.7% in 2017 (last forecasted at 1.2% in Sep 2016).

The German industrial sector grew by 2.8% m/m in January, beating expectations and joining the raft of indicators that have pointed to a turnaround in Eurozone growth. Meanwhile, in France, Les Républicains (center-right) decided to unanimously support their candidate François Fillon. He, however, continues to trail in third place behind Emmanuel Macron and Marine Le Pen, with Macron gaining in recent polls..

The Dutch elections due 15 March 2017 may present us with a barometer for the anti-establishment mood that has swept the EZ of late. Recent Dutch polls, however, show support weakening for the anti-immigrant, anti-European Union Freedom Party led by Geert Wilders. A win by the anti-establishment party is also seen as a non-major event—unless it garners a majority (unlikely). Recent Dutch governments have been usually formed through coalitions, and there has been little interest by other parties to work with Wilder's party.

UK: In the UK's Spring Budget, unveiled last Wednesday by Chancellor of the Exchequer Philip Hammond, key takeaways include:

(1) UK economic growth for 2017 was revised up from 1.7% to 2.0%, but from 2018-2020 it will slow to an average of 1.7%.

(2) Public sector net borrowing in 2017 was brought down to GBP 51.7 billion from GBP 68.2 billion.

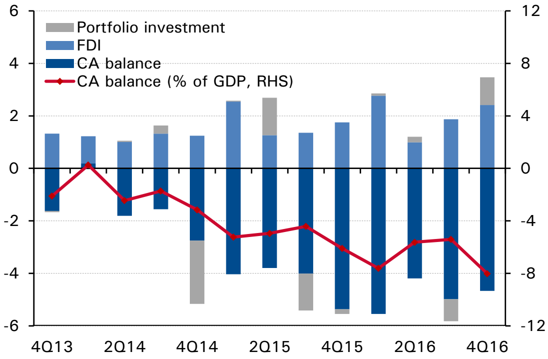
(3) National insurance (NI) contributions from self-employed workers to rise.

The last measure could be potential bone of contention for Tory backbenchers.

The House of Lords delivered PM Theresa May's second defeat in two weeks when it voted, again overwhelmingly, by a majority of 98 peers (366 to 268) to back an amendment to the government's Brexit bill that would require the government to go back to Brussels and renegotiate with the EU if the terms were not deemed by parliament to be satisfactory and sufficiently in the UK's interest. The PM has all along been advocating a "take it or leave it" type of vote on the final Article 50 bill.

China: Chinese prices took on diverging trends in February 2017. The headline inflation figure eased to 0.8% y/y from January's 2.5% y/y, while output prices by producers and wholesalers rose by 7.8% y/y—the highest figure in more than 8 years. (Chart 3.) Headline inflation declined due to easing food prices. The continued rise in the producer price index (PPI), however, is due to increasing energy costs; the PPI may start to ease though as the base effect wears off and steady energy costs come into play. While the headline inflation rate may be far below the central bank's target of 3%, it should not lead to monetary easing, given the looming risks of assets bubbles and growing debt.

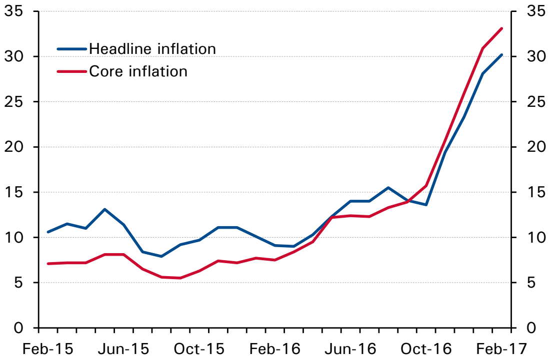
Chart 5: Egypt balance of payments



Source: CBE, Thomson Reuters Datastream, NBK estimates

Chart 6: Egypt inflation

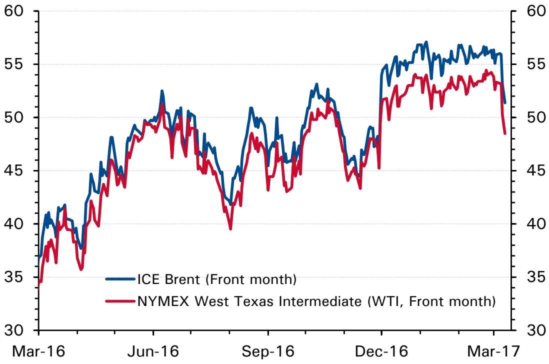
(% y/y)



Source: Central Bank of Egypt, Thomson Reuters Datastream

Chart 7: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

GCC & regional macroeconomics

Kuwait: Kuwait is thought to be close to issuing its debut international bond, which is expected this month. The government is looking to raise up to $9.5 billion, with expectations of 5-year and 10-year tranches. Given solid financial fundamentals and ratings, pricing is expected to be similar to Abu Dhabi's. Abu Dhabi's 2021 bonds traded at 2.50% on 8 March, while the 2026 bonds traded at 3.34%.

Saudi Arabia: The government intends to sell sukuk this year to local institutions alongside its plans to issue USD-denominated sukuk in the international market. The authorities expect to raise between $10-15 billion from the international bond markets and about SR 70 billion ($18 billion) from the local market. The sovereign issuance will also coincide with Saudi Aramco's first domestic sukuk issuance, which is expected by mid-year. News of the potential domestic sovereign issuance pushed banking stocks in the Tadawul index lower last Wednesday; banks are worried that the sukuk sale could drain liquidity from the banking system.

Qatar: Qatar's external debt situation came under scrutiny last week after ratings agency S&P changed its outlook on Qatar to "negative" from "stable" over Qatari banks' increasing foreign liabilities. These reached 176% of foreign assets in January, with net foreign liabilities exceeding $50 billion. S&P reported that this could pressure the country's cash position in view of the fact that country needs a secure source of funds to finance its budget deficit. Fiscal revenues are expected to be supported this year by higher oil and gas prices, which have already improved government liquidity. Credit figures show steady growth, in line with previous months, at 12% y/y in January 2017, bolstered by growing public sector lending growth at 21.8% y/y. Non-resident deposits are growing at 125% y/y and outpacing growth in external assets, fuelling concerns about Qatar's level of indebtedness. (Chart 4.)

Egypt: The current account deficit narrowed by 13% y/y to $4.7 billion in 4Q16, though it rose slightly to 8% of GDP due to the large decline in the value of the pound. The trade deficit improved thanks to healthy export growth. Growth in remittances was also strong, while tourism and Suez Canal receipts continued to decline. The balance of payments benefited from significant official support as the IMF loan agreement was finalized. FDI and portfolio inflows were also healthy. (Chart 5.)

Inflation rose to 30.2% y/y in February, as consumer prices continued to feel the impact of November's currency float and the related large depreciation of the pound. The monthly rise in prices was the smallest since the float, suggesting prices are beginning to stabilize. We expect the inflation rate to remain elevated during most of 2017, before it eases to around 10-15% y/y towards the end of the year. (Chart 6.)

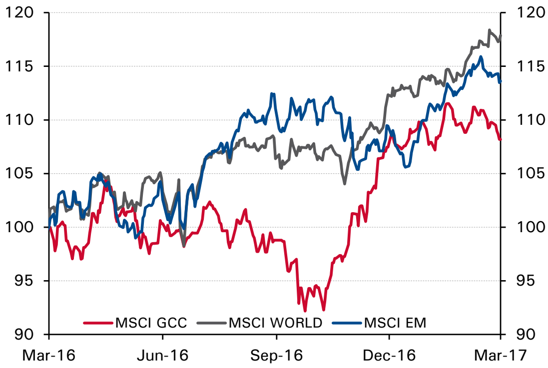
Lebanon: Lebanon's Purchasing Manager's Index (PMI) was stable at 47.7 points in February but still indicative of a private sector operating in a relatively weakened state. The rate of decline in activity did, however, slow from its 2016 average of 45.7.

Markets – oil

It seemed only a matter of time before oil prices would break free of the tightest range in more than a decade. Both markers, Brent and WTI, fell by more than 8% last week to close at $51.37/bbl and $48.49/bbl on Friday, after weekly US petroleum data showed crude stocks reaching record highs. (Chart 7.) With doubts creeping in about the efficacy of the supply

Chart 8: Global stock markets

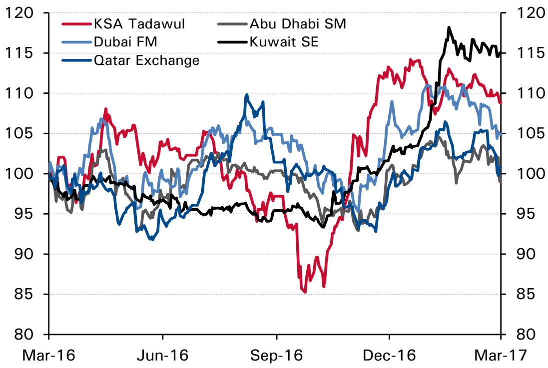
(rebased, 10 Mar 2016=100, total return)



Source: Thomson Reuters Datastream

Chart 9: GCC stock markets

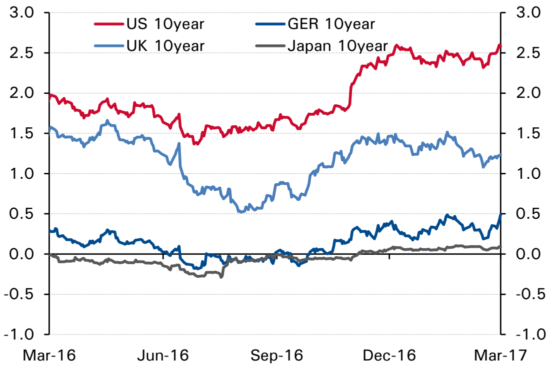
(rebased, 10 Mar 2016=100))



Source: Thomson Reuters Datastream

Chart 10: Global bond yields

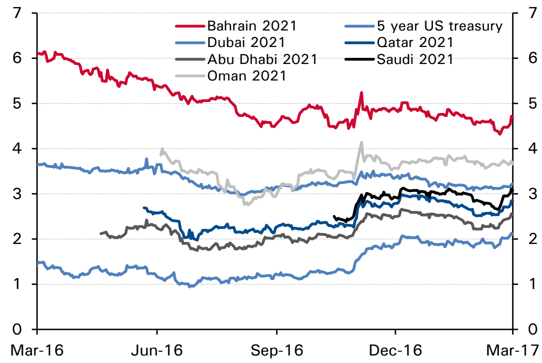
(%)



Source: Thomson Reuters Datastream

Chart 11: GCC bond yields

(%)



Source: Thomson Reuters Datastream

cut agreement in the face of rising US production, oil witnessed its sharpest one day sell-off for 13 months last Wednesday, dropping 5% on the day. Significantly, Brent is now trading at its lowest level since the 30 November OPEC production cut agreement; WTI's price is where it was on the eve of the agreement.

The sell-off was catalyzed by US inventories rising for a ninth consecutive week to 528 million barrels, US crude production posting yet another week of increases (by 56,000 b/d to 9.08 mb/d). Oil's plunge has come after weeks of record net accumulation of longs by hedge funds and speculators. These were/are expecting firmer oil prices in 2017 following the OPEC/non-OPEC production cut agreement.

Markets – equities

Equities saw some profit-taking, with the MSCI World retreating 0.1% on the week. Markets were in a wait-and-see mode ahead of the US employment data, which sealed the deal for the March rate hike. The S&P 500 and DJIA were off 0.4% and 0.5%, respectively. European stocks advanced slightly, with the Euro Stoxx 50 up 0.4% following strong gains the previous week. Also in Europe, investors seemed to be a bit cautious ahead of the ECB's meeting late in the week. Meanwhile, emerging market equities saw some profit-taking, with the MSCI EM retreating 0.4%. (Chart 8.)

Regional markets continued to underperform, with the MSCI GCC index losing 1.4%. The Abu Dhabi and Qatari markets retreated noticeably for the second consecutive week, down 3% and 2.4%, respectively, mostly on disappointing dividend announcements and ex-dividend trading kicking off. Other markets were also down on the week due to a lack of catalysts. Finally, the sharp decline in oil prices late in the week was no help. (Chart 9.)

Markets – fixed income

Bond markets started the week digesting last week's hawkish Fed talk, with benchmark bond yields at multi-week highs. Their movements have been ranged, however, as investors awaited a decision from the ECB, and US non-farm payroll numbers, which ended up virtually confirming a hike by the Fed this week. Politics were also subdued last week, lending little direction to the market. European yields were pushed higher following the ECB's MPC meeting, as Draghi's dovish statement was almost contradicted by his hawkish remarks during the press conference. This saw 10-year bunds climb to 0.48%. A healthy US non-farm payroll, which was interpreted by the markets as neutral, further boosted yields, with US 10-year notes edging higher to 2.57%. These seemed to have overshadowed the largest shift in oil markets seen in recent months, with international benchmark yields little affected by the drop in crude prices. (Chart 10.)

However, GCC yields on paper that matures in 2021 did seem to be impacted by the negative changes in oil markets. Yields rose across the board with Saudi breaching 3%. Saudi's 2021 paper added 10 bps on the week. Abu Dhabi's 2021, which is usually less volatile, added 10 bps as well. (Chart 11.)

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