No change at FOMC; US employment and wages steady; solid January PMIs for KSA and UAE

Key market indicators

Stock markets	Index	Change (%)	
		weekly	YTD
Regional			
Abu Dhabi SM	4,446	-3.85	-2.20
Bahrain ASI	1,308	0.59	7.15
Dubai FM	3,624	-2.10	2.63
Egypt EGX 30	12,806	-2.18	3.74
KSA Tadawul	7,099	-0.51	-1.55
Kuwait SE	6,844	-0.13	19.06
Muscat SM 30	5,803	0.90	1.01
Qatar Exchange	10,570	-3.82	1.28
MSCI GCC	478	-1.82	0.56
International			
DAX	11,651	-1.38	1.48
DJIA	20,071	-0.11	1.56
FTSE 100	7,188	0.05	0.64
Nikkei	18,918	-2.82	-1.03
S&P 500	2,297	0.12	2.62

Commodities	$/bbl	Change (%)	
		weekly	YTD
Brent crude ($/bbl)	56.8	2.32	-0.02
KEC ($/bbl)	52.4	-0.02	0.96
WTI ($/bbl)	53.8	1.24	0.20
Gold ($/t oz.)	1219.7	2.41	5.47

Exchange rates	Rate	Change (%)	
		weekly	YTD
KWD per USD	0.305	-0.13	-0.26
KWD per EUR	0.328	0.03	3.08
USD per EUR	1.078	0.81	2.55
JPY per USD	112.70	-2.05	-3.57

Interbank rates	%	Change (bps)	
		weekly	YTD
Kibor – 3 month	1.44	0.0	0.0
Qibor – 3 month	1.84	0.6	6.3
Libor – 3 month	1.03	-0.5	3.6

Bond yields	%	Change (bps)	
		weekly	YTD
Regional			
Abu Dhabi 2021	2.39	-9.7	-16.1
Dubai 2021	3.10	-9.2	-22.3
Qatar 2021	2.67	-3.2	-27.9
Saudi Arabia 2021	3.00	-0.2	-5.6
International			
UST 10 year	2.47	-1.1	3.8
Bunds 10 year	0.41	-4.7	20.7
Gilts 10 year	1.38	-8.6	14.3
JGB 10 year	0.10	1.8	4.9

Source: Thomson Reuters Datastream

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Summary

Following big market moves since the US election in November 2016, things appear to be consolidating. The focus is now fully on the new Trump administration: policy execution near-term and policy direction for the near future. The markets were impressed by the speed and intensity of action: several orders and directives issued in the first few days of office, including re-opening the door on two large, previously stalled, oil pipelines (Keystone XL and Dakota Access).

However, the markets also appear somewhat concerned about issues of execution (travel restrictions), potential overreach, policy delivery (e.g. on tax cuts and health care reform). It could be a while before the new administration finds its footing and before markets (and the media) get used to Mr. Trump's new, unprecedented, modus operandi; all the while volatility is up.

The Fed met last week and left things unchanged, which was as-expected. The January nonfarm payroll data showed good gains of 227K and steady wage inflation. Both show little urgency for the Fed to move again before midyear.

Eurozone GDP growth came in at 1.7% for 2016, a tick higher than the 1.6% of the US. However, that is the first time Europe matches the US in a long time, and is one factor behind the USD's recent correction versus the EUR, now above 1.07 (USD/EUR).

Oil prices are still trading above $55/bbl (Brent) as recent production data appear to confirm a decent degree of compliance by OPEC/non-OPEC countries with their November agreement to reduce output.

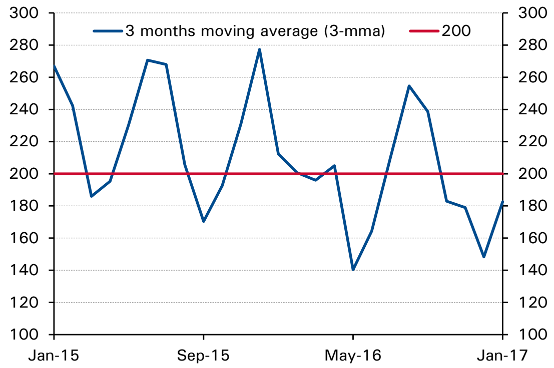
The first 2017 indications from KSA and the UAE show moderate and improving growth for both. The purchasing manager's indexes (Markit PMIs) rose in January for both countries, to 56.7 and 55.3, respectively. Egypt's index remained stuck at low levels (43.3).

International macroeconomics

USA: To no one's surprise, the Fed/FOMC kept rates and policy unchanged at the January meeting. January non-farm payrolls gained 227K, somewhat better than the previous 3 months. (Chart 1.) However, the trend is little changed as the numbers were helped by mild January weather. The unemployment rate was up one tick to 4.8%. Wages, which some had argued were picking up, are still having a difficult time breaking 2.5% y/y. (Chart 2.) We think that steady wages and inflation are another reason the Fed will take its time raising rates this year, and were one factor pressuring the USD this week.

The big picture remains one of good growth for the US, as the purchasing managers indexes (PMIs) for both manufacturing and non-manufacturing posted good levels, respectively 56.0 and 56.5.

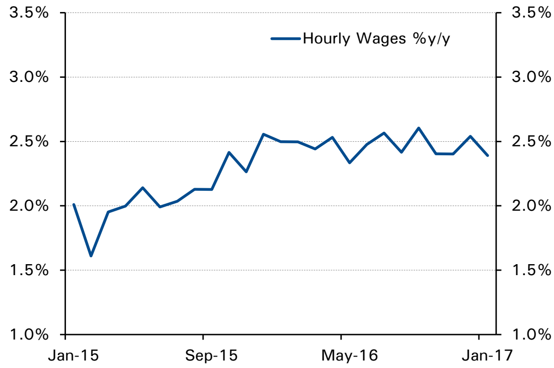
Chart 1: US non farm payroll gains (000s)



Source: BLS

Chart 2: US hourly wages

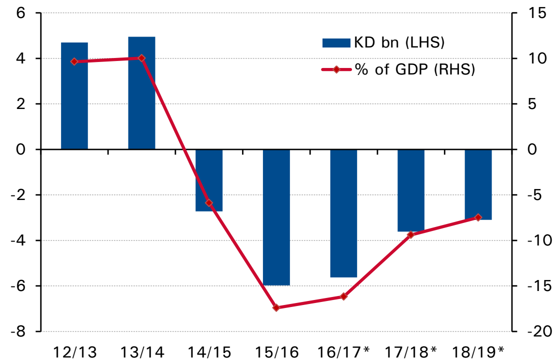
(% y/y)



Source: ISM

Chart 3: Kuwait budget balance

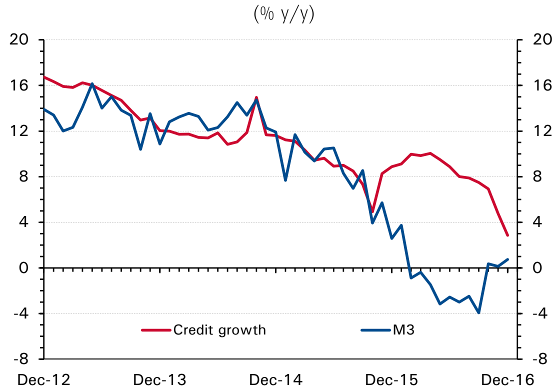
(after payment to the FGF)



Source: Ministry of Finance, NBK estimates, *estimate/forecast

Chart 4: Saudi money supply (M3) and credit growth

(% y/y)



Source: SAMA

Eurozone: French election developments were in focus this week as markets increasingly see the April/May race as a major event on the back of looming uncertainty. Indeed, the futures curve of the Euro Stoxx 50 Volatility Index, called the VSTOXX, is showing a pick-up in April contract prices compared to those for May (higher prices indicate higher expected volatility in European stocks). Uncertainties were amplified following an investigation into a scandal involving François Fillon's wife, which saw the center-right presidential candidate fall out of favor in the polls. Meanwhile, Emmanuel Macron (centrist-independent) is gaining momentum, with investors and polls now expecting him to be the most likely candidate to fend off Marine Le-Pen (far-right) in a second round of voting. His chances of success, however, are somewhat marginal and weighed down by the likelihood of a greater level of unexpected support for the far-right, fueled by a populist backlash.

Data releases were largely positive; chief among them was the Eurozone's (EZ) flash GDP estimate, which surprised on the upside. The EZ flash 2016 GDP estimate came in at 1.7% y/y, slower than the UK's 2.0%, but faster than the US's 1.6%. EZ flash inflation beat expectations as well. It was up on the month and came in strong at 1.8% y/y, its highest reading since February 2013. The pick-up was driven by a rise in energy prices, which, once excluded, saw the core inflation rate unchanged at 0.9%. Meanwhile, manufacturing PMIs for the Eurozone were strong at 55.2.

China: China's manufacturing PMI for January came in at 51.3, in line with December's 51.4. This marks the sixth consecutive month of expansionary activity in the manufacturing sector. A strong housing market and the government's increased spending on infrastructure have supported the industrial sector. Non-manufacturing activity also showed growth in January, with the PMI at 54.6. A strong services sector is necessary for the government's plan to transition from export-led growth to a domestic-driven economic expansion.

Japan: The Bank of Japan (BOJ) stood pat on its monetary policy, holding its short-term interest rate at −0.1% and the 10-year bond yield around the 0% mark. The BOJ remained confident about reaching its 2% inflation target by March 2019 without any further stimulus (at least for the time being), on the back of a healthy and gradual economic recovery.

UK: The government secured its mandate from the House of Commons to begin Brexit negotiations. MPs voted 498 to 114 in favor of invoking Article 50, with only 47 Labour MPs and 1 Conservative MP defying their party's stance and voting against the bill. Following the vote, PM Theresa May submitted a 'white paper' that outlined the government's negotiation position vis-à-vis the EU.

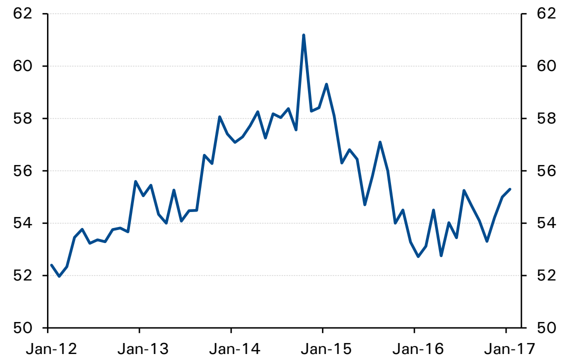
Input price inflation accelerated at the quickest pace in 25 years according to Markit's monthly survey. 55% of firms attributed price rises to the weak exchange rate. The overall index hit 55.9 in December, indicative of healthy expansion.

GCC & regional macroeconomics

Kuwait: The government unveiled the Kuwait National Development Plan (KNDP) under the "New Kuwait" slogan. The plan, also dubbed Kuwait Vision 2035, seeks to transform the country into a financial, cultural and institutional leader. The plan appears to bring together a number of ongoing initiatives into a renewed and more comprehensive vision for the country's development which includes structural and fiscal reforms, as well as capital spending plans.

Chart 5: UAE PMI

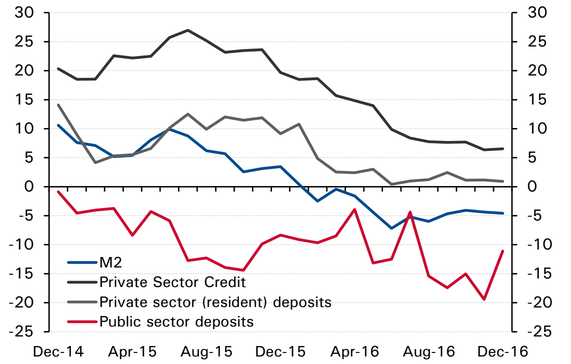
(index)



Source: Markit/Emirates NBD

Chart 6: Qatar money supply, deposit & credit growth

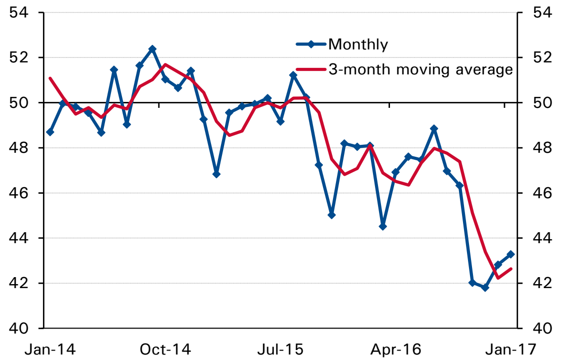
(% y/y)



Source: Qatar Central Bank.

Chart 7: Egypt PMI

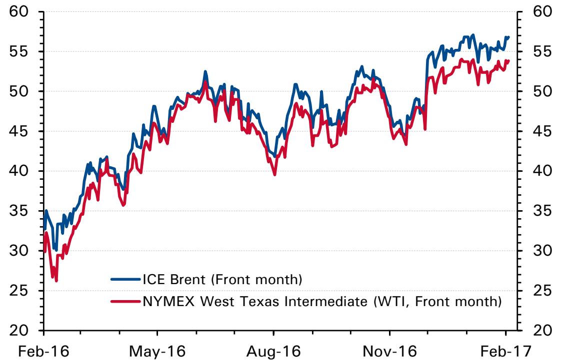
(index)



Source: Markit

Chart 8: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

The cabinet approved the FY17/18 budget and sent it to the National Assembly for a vote. The draft budget projects expenditures at KD 19.9 billion, 5.3% higher than FY16/17. Growth in current expenditures (5.8%) outpaced capital spending growth (3%). The draft projects a deficit of KD 7.9 billion (21% of GDP) based on an oil price of $45 per barrel; we think a smaller deficit of 9.4% of GDP (KD 3.6 billion) is likely (Chart 3.)

The central bank approved the opening of a second branch by Al Rajhi Bank in Kuwait. This marks the second time a foreign bank is allowed to have a second active branch in the country (QNB received approval in 2014). Twelve foreign banks currently operate in Kuwait, though their share of total bank assets remains relatively limited at 4.4% (2015).

Saudi Arabia: The latest reading of the Saudi PMI showed that activity in the non-oil economy improved to its highest level, 56.7, since August 2015. Private sector firms reported strong growth in a range of metrics, including new orders and output. Repayment of monies due to private sector contractors in late 2016 plus higher oil prices and improved liquidity have contributed to the improvement.

Central bank data released last week showed that in December the Saudi money supply (M3) increased at the fastest rate in 11 months (0.7% y/y), as deposits clocked in their fastest annual rise since January 2016 (0.8% y/y). With credit growth slowing to 2.9% y/y in December, banks' LD ratio also fell to its lowest level (86.6) in 11 months. (Chart 4.)

Reflecting the easing of liquidity constraints, the Saudi 3-month interbank rate (SAIBOR) fell below the central bank's repo rate of 2.0% for the first time since April 2016. Since reaching a high of 2.4% in October, interbank rates have been trending downwards thanks to injections of liquidity into the banking system from, for example, the $17.5 billion sovereign bond issuance and the $28.0 billion repayment by the government to private contractors.

The Saudi cabinet officially approved the introduction of VAT in 2018. The rate is expected to start at 5%..

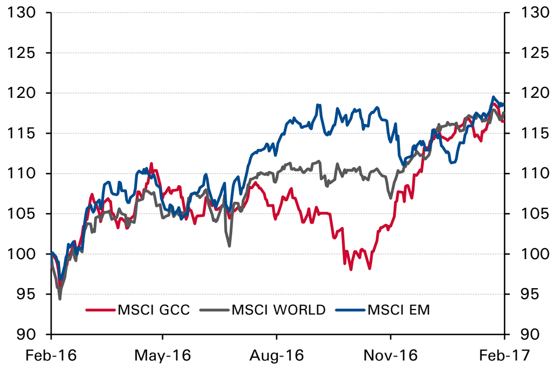
UAE: The UAE's headline PMI ticked up to a 6-month high of 55.3 in January, as both new export orders and new orders rose. (Chart 5.) New export orders remained in recovery mode (a reflection of an improvement in external demand). Furthermore, both future output and output continued to hold strong at 59.0 and 61.0, respectively.

Qatar: Public sector deposits increased in December, ending 2016 at QAR 185.9 billion ($50 billion), a rise of 4.5% m/m, signaling an easing in liquidity. The pickup reverses the downward trend in government deposit growth witnessed in 2H2016, although government deposits remain down -11.1% y/y. (Chart 6.) Private sector credit, which comprises 60% of total domestic credit, grew at the robust pace of 6.5% in December 2016—in line with November's 6.4% y/y. The IMF's Article IV memo states that the rise in credit to the public sector has bolstered private sector credit growth. The risk going forward, though, is that increased public investment could overheat the economy.

Egypt: January's PMI rose slightly to 43.3, but remained far below where it needs to be for a healthy recovery. (Chart 7.) Output and new orders were disappointing. While new orders and the output index rose slightly, both remained below 40; new export orders slipped. The employment index also dropped to its lowest level since the EGP floatation. Inflationary pressures remained significant; the output price and staff cost indexes

Chart 9: Global stock markets

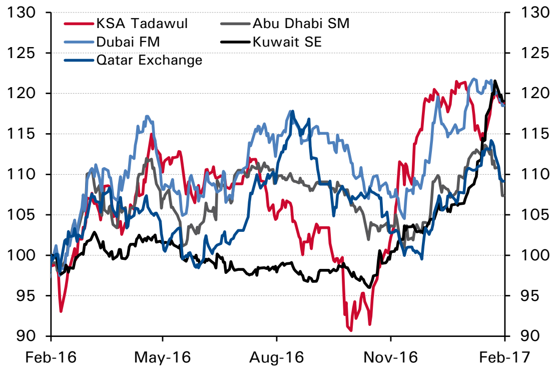
(rebased, 4 Feb 2016=100, total return)



Source: Thomson Reuters Datastream

Chart 10: GCC stock markets

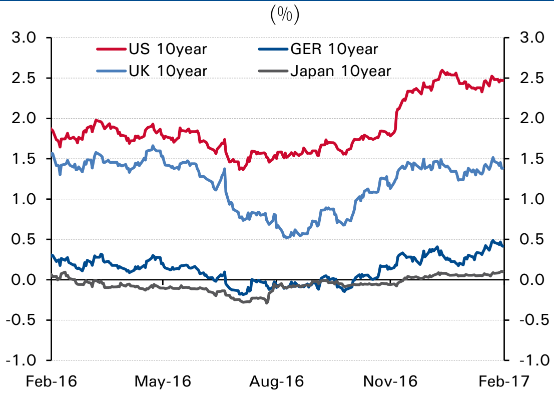
(rebased, 4 Feb 2016=100))



Source: Thomson Reuters Datastream

Chart 11: Global bond yields

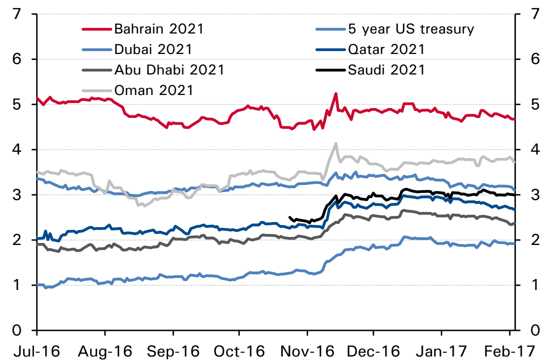
(%)



Source: Thomson Reuters Datastream

Chart 12: GCC bond yields

(%)



Source: Thomson Reuters Datastream

jumped to recent highs.

Steps are being taken to privatize Egypt's third largest bank. State-owned Banque du Caire is expected to list its shares on the stock exchange next week in preparation for an IPO by the middle of 2017. The move comes at a time when officials are seeking to prop up capital markets and attract foreign investors, building on the success of the international bond offering and IMF loan deal.

Markets – oil

Oil prices continued to range around \$55-56/bbl for Brent and \$52-53/bbl for WTI. (Chart 8.) Despite the limited volatility, oil prices closed down on December, by -2.0%, which is the first m/m decline since the end of October. While markets are expectantly eyeing the forthcoming publication of production data from OPEC, which is likely to confirm that the group has cut production to the target level, US shale has quietly been filling the void. US production is already up by 5.8%, or 487,000 b/d, from its 2016-low, with 30% (145,000 b/d) of that gain coming in the last month while OPEC reined in its output.

Markets – equities

Equity markets were mixed last week, with the MSCI World and S&P 500 up 0.2%; the DJIA closed the week down 0.1%. European equities did not do as well, with the Euro Stoxx 50 closing the week down 0.7% despite favorable economic data out of the euro area. Emerging market equities also retreated, with the MSCI EM dropping 0.5% as concerns over Mr. Trump's protectionist rhetoric were renewed. (Chart 9.)

Regional markets retreated. The MSCI GCC index declined 1.8% with all the main markets closing the week in the red. The more internationally-driven markets saw the biggest declines, with Qatar, Abu Dhabi and Dubai's general indices falling 3.8%, 3.8% and 2.1%, respectively. Profit announcements in these markets were mixed and a lack of domestic interest failed to support the markets. Kuwait finally took a breather from its remarkable performance since the beginning of the year, and it remains the best performer thus far in 2017. (Chart 10.)

Markets – fixed income

A bland Fed FOMC release, an uneventful BOJ MPC announcement, and an expected BOE MPC action saw bond markets driven by data, politics, and corporate earnings this week. Carefully scripted statements by central bank officials all painted a picture of a pick-up in both economic growth and inflation, but fell short of affirming a hawkish outlook. Strong data releases, coupled with positive 4Q16 earnings from the US and Europe, provided some lift for 10-year benchmarks early in the week, with Bunds breaching a one-year high. Rates later retreated in the week on uncertainties over President Trump's policies, Europe's developing political risk, and lower-than-expected US wage growth. US 10-year treasuries ended the week little changed, down 1 basis point, while bunds were down 5 basis points. (Chart 11.)

All 2021 GCC paper yields were down on the week, benefitting from a steady oil price and the Fed's inaction. Yields dropped by up to 10 basis points, with Abu Dhabi and Dubai seeing the largest drops. (Chart 12.)

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