Saudi king names son crown prince; GCC crisis persists as Qatar rejects demands; ECB & BOE hint at end of easing

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi SM	4,425	-0.14	-2.66
Bahrain ASI	1,310	-0.22	7.34
Dubai FM	3,392	-0.30	-3.93
Egypt EGX 30	13,396	-0.16	8.51
S&P GCC 40	1,032	-1.91	-10.70
Kuwait SE	6,763	-0.14	17.65
KSA Tadawul	7,426	n/a	2.99
Muscat SM 30	5,118	n/a	-11.49
Qatar Exchange	9,030	n/a	-13.47
International			
CSI 300	3,667	1.21	10.78
DAX	12,325	-3.21	7.35
DJIA	21,350	-0.21	8.03
Eurostoxx 50	3,442	-2.87	4.60
FTSE 100	7,313	-1.50	2.38
Nikkei 225	20,033	-0.49	4.81
S&P 500	2,423	-0.61	8.24

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	47.9	5.23	-15.66
KEC	45.5	6.21	-12.97
WTI	46.0	7.04	-14.30
Gold	1240.7	-1.23	7.89

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.303	-0.23	-0.91
KWD per EUR	0.339	0.00	6.57
USD per EUR	1.142	2.06	8.66
JPY per USD	112.350	0.98	-3.87
GBP per USD	1.303	2.43	5.59
EGP per USD	18.070	-0.36	0.39

Interbank rates	%	Change (bps) weekly	YTD
Bhibor - 3 month	2.40	-2.5	30.0
Kibor - 3 month	1.75	6.3	31.3
Qibor - 3 month	2.44	0.0	66.0
Eibor - 3 month	1.52	0.1	3.9
Saibor - 3 month	1.78	0.0	-25.4
Libor - 3 month	1.30	0.3	30.1

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2021	2.34	8.0	-19.4
Dubai 2021	2.94	-0.1	-35.8
Qatar 2021	3.10	22.0	16.6
Kuwait 2022	2.66	13.0	n/a
Saudi Arabia 2022	2.84	3.0	n/a
International			
UST 10 Year	2.30	15.8	-13.0
Bunds 10 Year	0.47	21.4	26.3
Gilts 10 Year	1.26	22.4	1.9
JGB 10 Year	0.08	2.9	3.5

Source: Thomson Reuters Datastream; as of Friday close

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Summary

Economic data remained generally robust in advanced markets. In Europe, the consistently solid data prompted a shift in the outlook for central bank policy. Last week, this shift was bolstered by relatively hawkish statements on inflation by ECB president Mario Draghi. The Bank of England also surprised markets when governor Mark Carney suggested rate hikes are likely in the coming months.

At the same time, another global ransomware attack, which hit Europe the hardest, continued to highlight the risk faced by businesses of random and disruptive attacks. Tech stocks were hit in Europe, though the impact in the US was more limited.

The Qatar crisis, which entered its fourth week, looked farther from being resolved after Qatar rejected the Saudi-led coalition's list of demands. Qatar faces further isolation after the UAE threatened to impose additional sanctions and possibly even expel the country from the GCC alliance.

Meanwhile, the Saudi King moved to further consolidate power as he elevated his son, Mohammed bin Salman (MBS), to the position of crown prince. Markets reacted positively to the news, with MBS's promotion seen as a vote of confidence in his stewardship of ambitious reforms.

The US dollar slipped against the euro on the hawkish Draghi statements, with the dollar index recording its lowest level in nine months. (Chart 2.)

Brent firmed up last week after slipping for a month; it was back above $47 per barrel by the end of the week though still down more than 15% ytd.

International macroeconomics

US: The Trump administration's political agenda continued to face hurdles last week after the Senate postponed a vote on Republican healthcare legislation until it returns in a week from its 4 July recess. The bill, driven by a promise to "repeal and replace" Obama's signature healthcare reform, continued to face opposition from a handful of Republicans.

The IMF revised down its forecast for US growth in 2017 and 2018 and expressed doubts that a pro-growth agenda, even if implemented, could push growth to its promised 3% pace in the near term. Growth is seen stuck at 2.1% in 2017-2018 after which it is expected to ease slightly.

Consumer confidence remained strong, with the June figure beating expectations at 118.9. (Chart 1.) This was tempered by Markit's flash PMI for June, which was weaker than expected on softer manufacturing.

Eurozone: The Eurozone flash PMI fell to a five-month low of 55.7, as the service sector waned. Still, the quarterly average of 56.4 for 2Q17 remains the highest since 1Q11. Some PMI components continued to improve, reflecting the prevalent sense of optimism. This coincided with the release of positive business sentiment surveys across Europe, which beat expectations for most, and strong flash core inflation readings for June, which came in at 1.2% y/y, up from 1% in May.

Chart 1: US consumer confidence

(index)

Source: Thomson Reuters Datastream

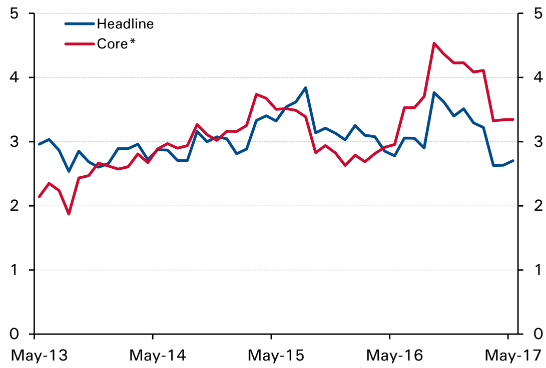
Chart 2: US dollar index

(index)

Source: Thomson Reuters Datastream

Chart 3: Kuwait inflation

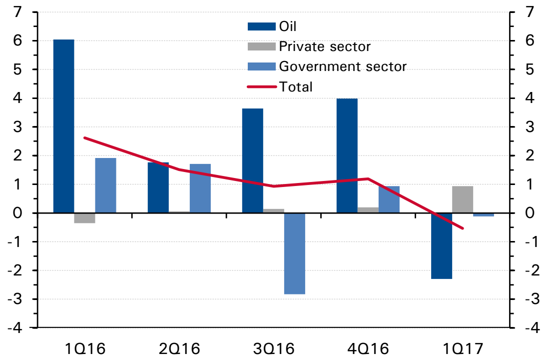
(% y/y)



Source: Central Statistical Bureau, *estimated by NBK

Chart 4: Saudi real GDP growth

(% y/y)



Source: Saudi General Authority for Statistics (GASTAT)

Italy's government bailed out two mid-size Italian banks, in a move that reassured markets but challenged attempts to reduce the burden on taxpayers from bank failure. The deal, which set aside €17 billion of taxpayer money to cover the cost and received the blessing of the European Commission, sidetracks EU regulation requiring a bail-in.

As expected, French President Macron's party, "La République en Marche", won a parliamentary majority, taking 350 out of 577 seats. The Socialists, the biggest losers in the election, secured 45 seats (they lost 283). This left the right-of-center "Les Républicains" as the largest opposition party with 137 seats (down 88 seats). Macron's strong showing provides him with the solid mandate he needs to pursue deep reform.

UK: PM Theresa May won a crucial vote in the House of Commons that will enable her to push forward her government's Brexit plans. However, a slender majority of 14 disguised deep divisions in her party and in Parliament. Nonetheless, after a deal with the Democratic Unionist Party of Northern Ireland, the PM can press on with pushing through key legislation to incorporate EU legislation into UK law, the so-called "Great Repeal" bill.

The governor of the Bank of England, Mark Carney, appeared to suggest that an interest rate rise could be on the cards before long. The governor said that "some removal of monetary stimulus is likely to become necessary" in the context of strong wage, investment and export growth. These conditions would be needed to offset weaker consumption. The currency markets took Mr. Carney's comments at face value, with Sterling rising 1.3% against the US dollar by Tuesday's close. The market's reaction echoed a similar one the previous week when the BoE's Chief Economist, who is known to be among the more dovish members of the MPC, remarked that he expects to vote for an interest rate rise soon.

GCC & regional macroeconomics

Kuwait: CPI inflation was steady at 2.7% y/y in May, as growth in most components was unchanged. (Chart 3.) Core inflation, which excludes food items, also held steady at 3.3% y/y. Inflation has eased in recent months, thanks largely to more modest growth in housing rent. Rents eased to 4.3% recently, down from over 7% in November 2016.

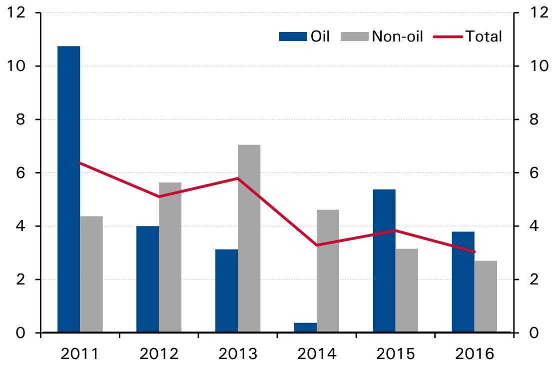
Saudi Arabia: The Saudi economy shrank in 1Q17 for the first time since the financial crisis. Real GDP declined by -0.5% y/y as output in the oil and gas sector contracted by -2.3% y/y, as a result of the crude oil production cuts implemented as part of the OPEC/non-OPEC agreement. (Chart 4.) Non-oil growth, however, rebounded to 0.6% y/y, thanks mainly to an improvement in private sector output.

King Salman bin Abdulaziz Al Saud elevated his son, Prince Mohammed bin Salman, to crown prince and next in line to the throne. Mohamed bin Nayef was removed from his position as crown prince. Analysts and markets are viewing this move as mostly positive, arguing that it provides some clarity, and further supports the implementation of the Vision 2030 plan, of which MBS is the architect. This echoes our view, although we caution that the prince needs to mitigate his inexperience by the presence of suitably qualified and experienced counsel.

The Saudi state news agency reported a royal order that reinstated Saudi civil service and military allowances retroactively to September 2016, the date of their first cancellation. The reinstatement will cost the government up to SR 6 billion ($1.6 billion). The move was done to stimulate consumer spending and confidence, the Minister of Finance said.

Chart 5: UAE real GDP

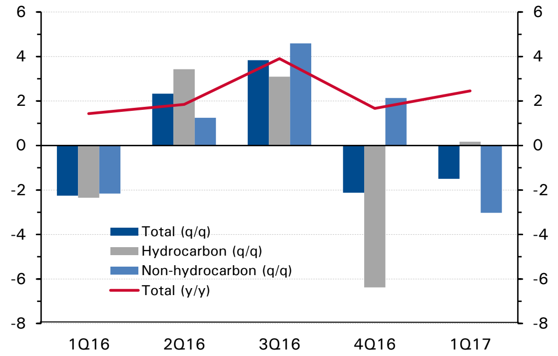
(% y/y)



Source: Federal Competitiveness & Statistics Authority

Chart 6: Qatar real GDP growth

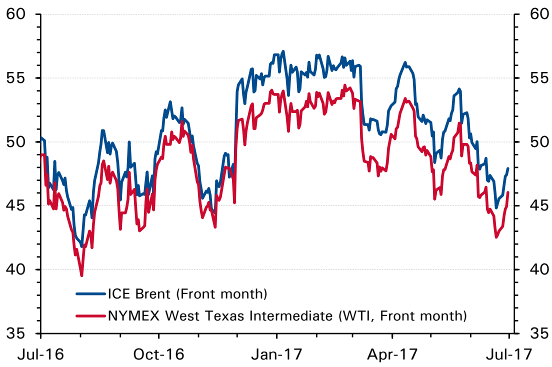
(%)



Source: Ministry of Development Planning & Statistics (MDP&S)

Chart 7: Crude oil prices

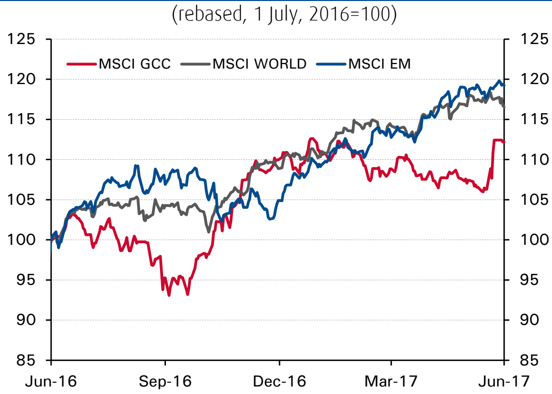
($/bbl)



Source: Thomson Reuters Datastream

Chart 8: Total return indices

(rebased, 1 July, 2016=100)



Source: Thomson Reuters Datastream

UAE: According to provisional data, real GDP growth in the UAE moderated from 3.8% in 2015 to 3.0% in 2016, as growth in both the oil and non-oil sectors softened. (Chart 5.) Growth in the oil economy retreated from 5.4% in 2015 to 3.8% 2016, while non-oil growth softened from 3.2% to 2.7%. Whilst growth in the oil sector is expected to be more limited in the medium-to-long term on the back of production cuts (OPEC agreement), the non-oil sector is expected to gather pace amid stronger gains in the transport, manufacturing and construction sectors.

Qatar: Foreign Minister Mohammed bin Abdulrahman Al-Thani rejected outright some of the 13 demands that Qatar's neighbors, Saudi Arabia, Bahrain, the UAE and Egypt, were insisting on in order to bring the almost month-long diplomatic dispute to an end. As the 10-day ultimatum approaches expiry on Sunday, the Qataris insisted that severing links to terrorist organizations and expelling Iranian Revolutionary Guards, which were among the list of demands, could not be met because "no such links exist". There was no comment on the fates of the Turkish airbase on Qatari soil or state broadcaster, Al-Jazeera, both of which Saudi Arabia and its coalition would like to see shut down. The UAE threatened Qatar with more sanctions if the demands are not met.

Despite the mediatory efforts of Kuwait's Emir and US Secretary of State Rex Tillerson, neither side appears willing to back down. International opinion appears to have shifted in sympathy with Qatar, with many countries viewing the list of demands as unreasonable. The Saudi approach is also far from getting full US backing; US Senator and Chairman of the Senate Foreign Relations Committee, Bob Corker, is looking to force a swift resolution by threatening to block all US arms sale to the GCC until the dispute is resolved. While the Qataris have insisted that they are open to further dialogue, they increasingly view the dispute as a Saudi-orchestrated attack on their sovereignty and have vowed to resist it at all cost. Qatar has asked the UN to intervene in the dispute.

The Qatari riyal has taken a battering, with the currency trading far below its peg to the US dollar in offshore markets. Trading has been volatile, with the riyal falling at one point to 3.81 to the dollar, more than 4% below its fixed rate of 3.64.

The economy grew by 2.5% y/y in 1Q17. The non-hydrocarbon growth, which was the driving force, saw its slowest pace in several years of 4.9% y/y. Hydrocarbon sector output was flat. (Chart 6.)

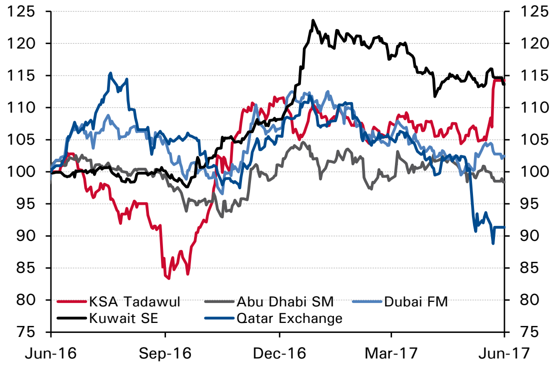
Qatar Investment Authority (QIA), the country's SWF, has transferred to the Ministry of Finance $30 billion worth of its domestic holdings (8.8% of the SWF's estimated assets of $340 billion). The move, which saw stakes in 18 companies including QNB and Ooredoo transferred, is part of a restructuring and efficiency drive. Dividends to the Qatari treasury from these holdings are estimated to be in the region of QR 3 billion ($824 million), or 11.4% of non-hydrocarbon revenues.

Oman: Rating agency Fitch affirmed Oman's long-term rating at BBB (one notch above speculative grade), but changed its outlook from stable to negative. Fitch cited a pressured fiscal stance and increasing dependence on external financing as some of the factors behind the more cautious outlook. Oman was downgraded to speculative by S&P in May. We expect a fiscal deficit of 13% of GDP in 2017 with GDP growth virtually flat.

Egypt: Fuel prices were hiked on 29 June in a widely anticipated move ahead of the new fiscal year. Prices were increased by 43-55% for the various fuel grades at the pump and doubled for butane gas in an effort to

Chart 9: GCC Markets

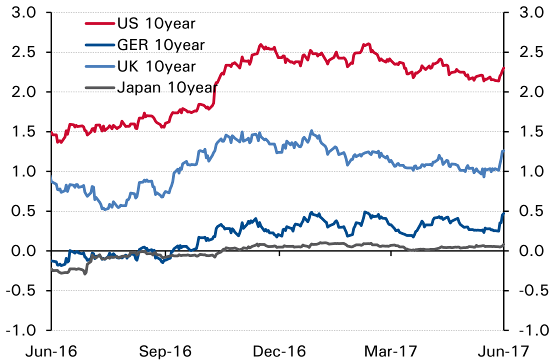
(rebased, 1 July, 2016=100)



Source: Thomson Reuters Datastream

Chart 10: Global bond yields

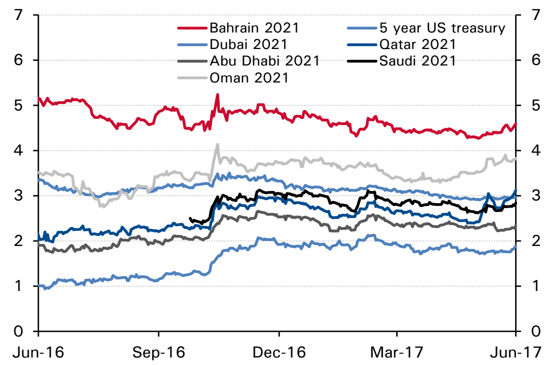
(%)



Source: Thomson Reuters Datastream

Chart 11: GCC bond yields

(%)



Source: Thomson Reuters Datastream

reduce the subsidy bill by about 25% in FY17/18. A 50% drop in the pound and a higher price of oil have more than doubled the cost of fuel subsidies since November, despite a 30% hike in retail prices then.

Markets – oil

Oil prices reversed some of their losses last week to close up at $47.9/bbl (Brent) and $46.0/bbl (WTI) on Friday, an increase of up to 5.2% week-on-week (w/w). (Chart 7.) Indeed, Brent posted seven consecutive trading sessions of gains since falling to a 10-month low of $44.8/bbl on 21 June. Oil's reversal was partly in response to relatively bullish US data: the EIA reported the largest drop in US crude production since July 2016, by 100,000 b/d, and continuing, albeit, smallish declines in gasoline and distillate stocks. Oil rig counts also witnessed their first fall (2 rigs) since January. Nevertheless, oil prices remain down by around 15% in 2017, and it is difficult to see the fall in crude production and rig counts as anything other than a blip, especially as US crude inventories actually increased last week. The call for deeper OPEC/non-OPEC production cuts grows louder each week.

Markets – equities

Global energy and banking shares, though buoyed over the week by recovering oil prices and steepening global yield curves, failed to lift markets, which were otherwise preoccupied with yet another global cyberattack. Advanced markets continued to move sideways, with the MSCI world index down 0.2%. In the US, the DJIA and the S&P 500 were down 0.2% and 0.6%, respectively. In Europe, shares were weighed down by the "ransomware" attack, which hit Europe hardest, and fears of central banks removing stimulus soon. The Eurostoxx 50 was down 2.87%. Bank shares saw some gains on news of a bailout of two mid-size Italian banks early in the week, but not enough to counter declines elsewhere. Emerging markets were slightly more upbeat, with the MSCI EM up 0.2%. (Chart 8.)

Regionally, Saudi dominated with the news of Mohammed bin Salman being elevated to crown prince coinciding with MSCI's decision to place Saudi Arabia on its EM watch list. Saudi stocks jumped on the news with the market up 9%. (Chart 9.)

Qatari stocks endured more pressure as the political crisis lingered. The general index is down 9% since the onset of the crisis. The stock exchange alleged that institutional investors from Saudi, UAE and Bahrain were dumping shares in order to drive down the market.

Other GCC markets were down on the week, but the MSCI GCC index was flat on Saudi's heavy weight gains. Falling oil prices remain the main theme for the region. Meanwhile, volumes continued to fall.

Markets – fixed income

Fixed income markets were jolted from their passive state following what markets perceived as hawkish remarks by European central bankers. A positively worded address by ECB president Mario Draghi and growing intentions to raise rates by BOE governor Mark Carney sent Bund and Gilt yields higher to levels not seen in months; US Treasury yields also moved up. US 10-year yields were up 16 bps, their biggest weekly increase since early March, settling at 2.30%. 10-year bunds and 10-year Gilts were both up between 21 and 22 bps on the week, reaching 0.47% and 1.26%, respectively. (Chart 10.)

Most regional yields on sovereign debt seem to have held relatively steady despite the ongoing rift with Qatar. The exception was Qatar, which saw yields move up significantly over the week; Qatari debt maturing in 2021 breached 3% for the second time this year, finishing off at 3.1%, a rise of 22 bps. Sovereign yields on bonds maturing in 2021 were up 8 bps for Abu Dhabi and flat for Dubai, while 2022 bonds for Saudi were up 3 bps. Kuwait's 2022 bond was up 13 bps, ending the week at 2.66%. (Chart 11.)

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