NBK CAPITAL STRUCTURED INVESTMENTS & ADVISORY

MENA MARKETS REVIEW

ISSUE 026

DECEMBER 2018

HIGHLIGHTS

- Financial markets went into panic mode during the last few weeks of 2018. Fears of a global economic slowdown, tightening Fed, and trade wars were the main triggers of the sell-off.
- Emerging markets had a much milder December than their developed peers but still ended the year with steep declines.
- Oil rebounded off the year lows supported by declining OPEC production in December. Brent had retreated by 35% in Q4 2018 and 20% for 2018.
- Despite the volatility in global markets and the decline in oil prices, GCC equities managed to close the year mostly in the green, supported by a strong performance from Saudi Arabia and Abu Dhabi.

December Fed rate hike to be followed by a pause

As widely expected, the Federal Reserve hiked interest rates by 25 bps at its December meeting, the fourth increase of the year and leaving the target rate range at 2.25-2.50%. Although the Fed revised down its forecasts for growth and inflation and its guidance for rate hikes in 2019 to two from three, it also announced no change to its plans to slow or reverse its program of bond sales ('quantitative tightening'). Financial markets interpreted this as hawkish, triggering a sharp sell-off in equities. The Fed's outlook is still at odds with the consensus view on rates: futures markets are now pricing in just a 5% chance of a rate hike in 2019 – a much less aggressive view on policy tightening than a few weeks ago. Comments by Fed chairman Jay Powell in early January however suggest that the bank may be moving in a dovish direction.

GDP growth for 3Q18 was revised down a touch to 3.4% from 3.5% on fractionally softer (though still strong) consumer spending, but still supported by a decent inventory build. The news flow over the past month has been dominated by downside risks, fueling concerns of a slowdown in 2019. These include the plunge in equity prices and impact of tighter Fed policy, the absence of a resolution of the trade war with China, and from December 22nd the partial government shutdown due a row between President Trump and Congress over funding for the proposed border wall with Mexico. The latter has persisted into 2019 and affected some 800,000 federal employees. Although the direct economic impact of the shutdown is not expected to be large, it underscores fears over policy deadlock and confrontation as the Democrats took control of the House of Representatives in early January.

High frequency economic data has generally reinforced the view that growth continues to soften albeit from very robust levels. The composite PMI edged down to 53.6 in December from 54.4 in November but remains firmly in growth territory. However, there was a major surprise in the December labor market data, with employment smashing through expectations to rise 312,000 and its largest climb since February, while wage growth accelerated to 3.2%. The Atlanta Fed 'nowcast' estimates growth at 2.7% in 4Q18, which if achieved would leave full-year 2018 growth at 2.9% – the highest since 2015. The Fed's revised forecasts put growth at 2.3% in 2019.

Meanwhile inflation rates have continued to come down, mostly reflecting the impact of the recent fall in oil prices on gasoline costs. Personal Consumption Expenditure (PCE) inflation hit an 11-month low of 1.8% in November, though 'core' inflation edged up slightly to 1.9%. There is still little sign of recent tariff measures filtering through to consumer prices, but this could change if tariffs on imports from China are increased from 10% to 25% in March when the current truce expires.

ECB ends asset purchase program

Economic conditions in the Eurozone continued to soften in December. The regional PMI fell to 51.3, its lowest pace of expansion in four years, as political turmoil and trade uncertainty weighed on manufacturing and services activity. The decline was led by a board contraction in France following weeks of street protests. Global trade uncertainty also continued to negatively impact Germany's export sector and business confidence. Wages in the Eurozone however, grew at their fastest pace since the financial crisis, climbing 2.4% in 3Q18, reflecting still tightening labor markets.

The European Central Bank confirmed the end of its asset purchase program in December but reaffirmed its intention to keep interest rates at their current level "at least through summer of 2019" and adjusted its guidance on the re-investment of proceeds from maturing bonds, which will be maintained well beyond the first rate hike and for as long as necessary. Meanwhile, it lowered its projections for both growth and inflation for 2019 by 0.1% to 1.7% and 1.6% respectively, while 2020 projections were unchanged.

Several weeks of street protests in France over levies on petrol and heating oil saw President Macron scrap environmental tax plans from the 2019 budget. He also announced a package to boost low income households. These measures will push the budget deficit above of 3% of GDP in 2019 but are expected to be temporary as the President still seeks to follow through with his reform agenda. Although the increase in French deficit spending reinforced the resolve of Italy's populist coalition government in its budget battle with the EU, the weakening Italian economy has forced it to backtrack, avoiding a deeper clash with Brussels. The government will now target a deficit of 2.0% of GDP compared to the previous 2.4%. Italian GDP fell 0.1 q/q in 3Q18 on softer domestic demand, while the manufacturing PMI was below 50 in December.

In the UK, tensions over Brexit continue with Prime Minister Theresa May forced in December to pull the parliamentary vote on her negotiated withdrawal agreement with the EU facing heavy defeat. The vote was postponed until mid-January, with May looking to secure further concessions from the EU before then to help secure a still-improbable win. If the deal is not passed, the prospect of the UK leaving the EU without a deal in March and facing a lengthy period of economic and financial disruption will loom closer.

Japan's GDP sees biggest drop in over four years

Revised data showed Japan's annualized GDP contracting by 2.5% in 3Q18, more than previously estimated and the biggest decline in over four years as the effects of sluggish demand were compounded by natural disaster-related effects. The weakness in demand also continues to be reflected in price data, with core inflation coming in at just 0.9% in November. With downside risks set to persist, the Japanese government lowered its economic growth and inflation forecasts for the 2018 fiscal year ending in March and FY2019. Growth is now expected at 0.9% in FY2018 versus 1.5% initially, while inflation is expected to come in at a slightly lower 1.0%. In an effort to support growth, the Bank of Japan stood pat on its ultra-loose monetary policy last month.

Weak demand takes toll on Chinese manufacturing

Slower demand growth together with the ongoing trade war with the US led to weaker Chinese manufacturing data. The Caixin/IHS Markit purchasing manager's index slid into contractionary territory for the first time in over one-and-a-half years. This was broadly in line with the official PMI data which pointed to a contraction in manufacturing activity for the first time in over two-and-a-half years. China has pledged to up its efforts to support the economy not least through the slashing of taxes and by maintaining sufficient levels of liquidity. In a bid to ease trade tensions with the US, China removed import and export tariffs on selected goods as of January 1st. A further round of negotiations will take place this month in Beijing as the two parties seem keen to reach a deal.

Oil prices continue to decline amid demand fears

The price of Brent crude suffered further losses in December, dropping 8% to end 2018 down 20% at $53.8/bbl. Oversupply concerns and a softer oil demand outlook have sent oil prices down almost 40% from a peak of $86/bbl in early October. Resurgent US crude production, which soared 1.9 mb/d (+20%) in 2018, was among the triggers for the downturn, but higher OPEC+ output was also a factor. President Trump's decision to offer 180-day sanctions waivers to Iran's major crude customers caught the market off guard, forcing OPEC+ to reinstitute production cuts of 1.2 mb/d.

In the GCC, non-oil sector indicators continued to improve, with the Saudi PMI rising to a year-high of 55.2 in November and the UAE PMI edging up to a four-month high of 55.8. Recently-released preliminary estimates of Saudi GDP confirmed the general improvement in activity, with growth in 3Q18 at 2.5% y/y from 1.6% y/y in 2Q18. Moreover, with the publication of their largest ever budget for 2019, which envisages spending rising by 13% y/y budget-on-budget and the deficit narrowing slightly to 4.2% of GDP, the Saudi authorities clearly intend to continue to support the non-oil economy through private sector stimulus, austerity-mitigating social allowances and productive infrastructure investments.

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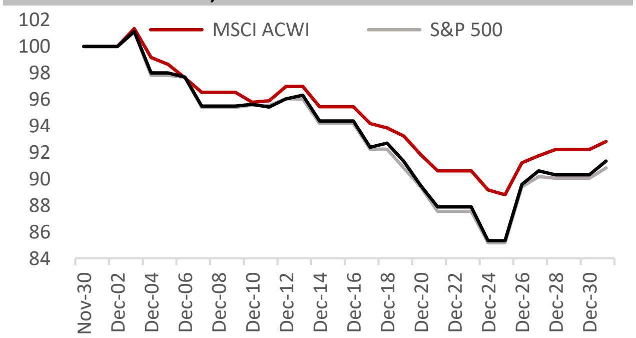
Global Equities

The volatility which characterized the fourth quarter of 2018 intensified during the last month of the year and the market sell-off continued well into the end of December. Fears of a global economic slowdown fueled by trade tensions, in addition to decelerating growth in the US in the middle of a Fed tightening cycle took their toll on global markets during the last few months of the year.

The MSCI All Countries World Index lost more than 7% during December to bring its full year decline to 11.2% while the MSCI EM closed the year down 16.64% after shedding 2.92% in December. Major US indices managed to end the year down in single digits after a record 5% rebound on December 26 that saw the Dow gain more than a thousand points in a single day. The S&P 500 was down 9.18% in December to close the year at a negative 6.24%, while the Dow Jones Industrial Average lost 8.66% in the last month of the year closing 2018 down 5.63%. Both indices had a total drawdown of 19.8% and 18.8% peak to trough in the fourth quarter. Treasury yields, on the other hand, continued their reversal that started at the beginning of November with the 10-year bonds closing the year at 2.69% down from 3.25% in early November. Industrial activity continued to trend down in December as the ISM Manufacturing PMI dropped to 54.1 from 59.3 in the previous month and missed estimates of a decline to 57.9. The Fed's preferred measure of inflation, Personal Consumption Expenditures, declined to 1.8% year-on-year in November compared to a peak of 2.3% in August.

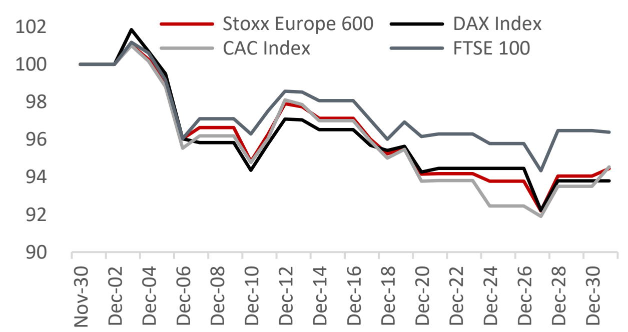
Chart 1: MSCI ACWI, S&P 500 & Dow Jones



Source: Bloomberg *(figures rebased)*

The Stoxx Europe 600 Index retreated by 5.55% during December bringing its losses for the full year to 13.24%. Major European markets saw major declines last month with the French CAC40 down 5.46% and the German DAX down 6.20% resulting in full year losses of 10.95% and 18.26% respectively. European third quarter GDP was revised down to 1.6% from 1.7% in December while the Markit Manufacturing PMI declined to 51.4 from 51.8 in November, and the Markit Services PMI slid to 51.4 in December compared to 53.4 the previous month. Consumer confidence continued to decline recording -6.2, significantly undershooting consensus of -4.2 and last month's level of -3.9.

Chart 2: European and UK Equities

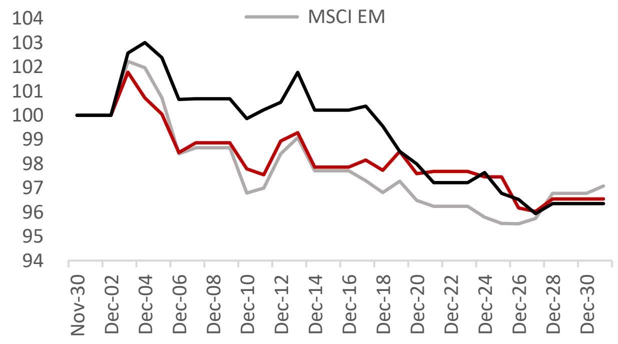


Source: Bloomberg *(figures rebased)*

With mounting anxiety that the UK might be forced to exit the EU with no deal, UK equities extended their losses with the FTSE 100 down 3.61% in December and 12.48% for 2018. The Markit manufacturing PMI increased to 54.2 from 53.1 last month despite prospects of a no-deal Brexit. This increase in manufacturing activity was interpreted as temporary and resulting from front-loading ahead of Brexit. Consumer confidence continued to slide with the Gfk Consumer Confidence Index retreating to -14 in December compared to -13 in November.

After a brief breather in November, Japan's Nikkei 225 dived 10.45% in December to close the year down 12.08% after losing 17% during the fourth quarter. Third quarter annualized GDP declined by 2.5% against estimates of a decline of 1.9% while the GDP deflator recorded -0.3% for the same period. The preliminary reading of the Nikkei manufacturing PMI showed a slight advance to 52.4 in December compared to 52.2 during the previous month. Unemployment continued its advance higher registering 2.5% in November compared to 2.4% and 2.3% in the previous two months.

Chart 3: MSCI EM vs South Korea vs China



Source: Bloomberg *(figures rebased)*

Despite the negative performance, emerging markets managed to outperform global equities during December. The MSCI EM Index declined by 2.92% closing the year with a total loss of 16.64%. Major emerging markets indices declined during the month, but the declines were relatively mild compared to global peers. MSCI Asia ex-Japan was down 2.93%, while the Russia Stock Exchange was down 1.42% and India's NIFTY 50 and Taiwan Stock Exchange closed down 0.13% and 1.62% respectively.

Oil rebounded from the year lows with Brent bouncing off the USD 50/bbl mark in late December after data showed OPEC output plunging by 530,000 barrels a day in December, even before the deal to curb output came into effect in January. The decline in output was the result of planned cuts by Saudi Arabia and unintentional cutbacks from Libya and Iran. Libyan output was down 110,000 barrels as the country's biggest oil field, Sahara, was put offline by violent demonstrators, while Iran's output was down 120,000 barrels a day due to sanctions.

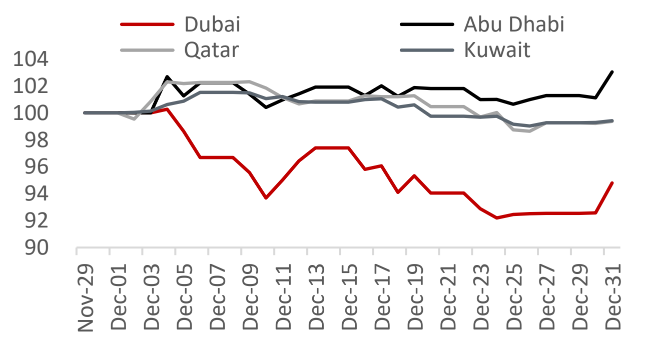
Regional Equities

Like most other GCC central banks, SAMA raised its repo rate by 25 bps to 3.0% and the reverse repo by the same amount to 2.5% following the Fed rate increase in December.

The Central Bank of the UAE also followed suit with a 25-bps hike on its Certificates of Deposit, while Bahrain raised its interest rate by 25 bps on the one-week deposit facility and its overnight rate to 2.75% and 2.5% respectively. Qatar Central Bank did the same and increased overnight deposits rates by 0.25% to 2.50%. The Central Bank of Kuwait, on the other hand, decided to keep its discount rate unchanged at 3.0%

Despite the slide in oil prices and the global turmoil in financial markets, MENA equities performed fairly well during the last month of the year. The S&P GCC Composite was up 0.83% in December bringing its full year advance to 11.47% supported by a robust performance in Saudi Arabia, Abu Dhabi, and Qatar.

Chart 4: Performance of Dubai, Abu Dhabi, Qatar & Kuwait



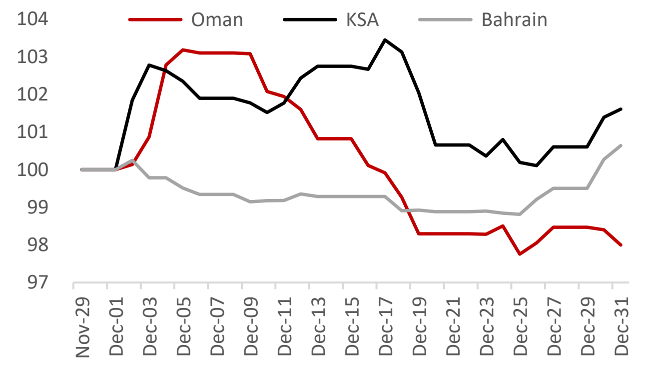
Source: Bloomberg *(figures rebased)*

In Saudi Arabia, the Tadawul All Share Index (TASI) managed to add 1.6% during December in a rather volatile month to bring its full year performance to 11.5%. Saudi GDP advanced by 2.5% during the third quarter compared to a year ago mainly driven by expanding oil output. This compares to an increase of 1.6% during the second quarter. While the oil sector expanded by 3.7%, the non-oil sector growth decelerated to 2.1% from 2.4%. The Saudi budget for 2019, however, shows a 7% increase in spending which could support private sector growth in the coming year.

Qatar was the GCC's best performer for 2018 with an advance of 20.8% despite the marginal decline of 0.63% during December. GDP recorded an annual growth of 2.2% in the third quarter of 2018, up from 1.7% in the second quarter.

Abu Dhabi came in second with a positive performance of 11.8% after a solid December which saw the ADX General Index advance 3.0%. Dubai's DFM General Index, on the other hand, was the worst GCC performer for 2018. Dubai lost a total of 24.9% during the year after sliding by more than 5% in December. The negative performance was fueled by the turmoil in international markets and particularly the decline in emerging markets given the high exposure Dubai has to international investors.

Chart 5: Performance of Oman, KSA, & Bahrain



Source: Bloomberg *(figures rebased)*

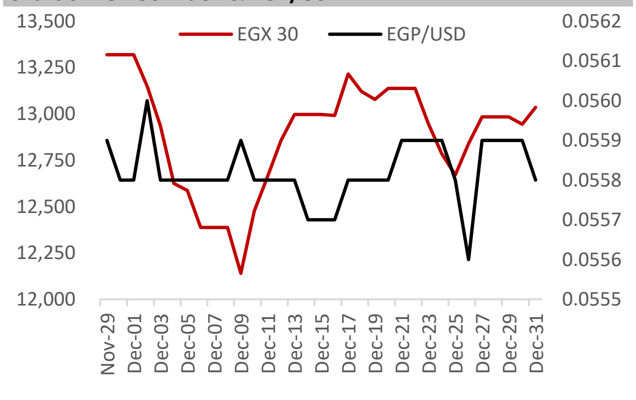
Oman was the second worst performer with a decline of 2.0% in December which added to the previous months' losses and accumulated a negative 15.2% for the year. Higher oil income during the year helped Oman reduce its budget deficit which, according to the National Center for Statistics and Information, declined to OMR 2.043 billion during the first 10 months of 2018 compared to OMR 3.2 billion for the same period in 2017.

Kuwait's performance was relatively stable during December as the Boursa Kuwait All Share Index declined marginally by 0.58% bringing its accumulated performance since its launch around the beginning of the year to 1.59%.

In the broader MENA region, the S&P Pan Arab Index was up 0.65% for December and 6.16% for the year, while Egypt's EGX 30 was down by 2.13% bringing its full year performance for 2018 to a negative 13.21%.

Egypt kept interest rates on hold in December with inflation having fallen back to within the central bank's 10-16% target range, and with prices expected to increase following the planned reduction in fuel subsidies later this year.

Chart 6: EGX 30 Index & EGP/USD



Source: Bloomberg

After speculation that the fifth tranche of the IMF's USD 12 billion loan program will be delayed following the postponement of an IMF review of Egypt's economic reforms, the Central Bank governor confirmed that the USD 2 billion tranche will be received in January 2019. The loan program was offered to Egypt in 2016 after it agreed to embark on a large-scale economic reform program which includes the devaluation of the currency, implementing value-added tax (VAT), and cutting energy subsidies.

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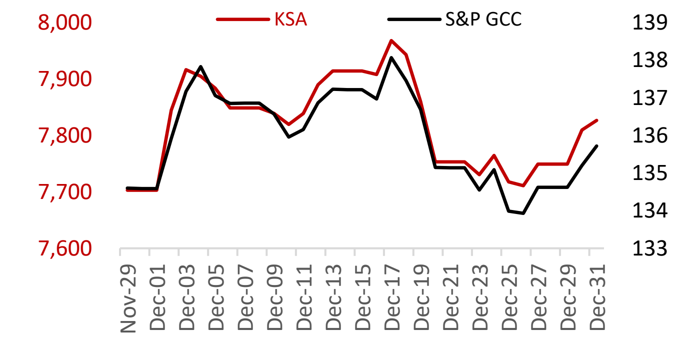
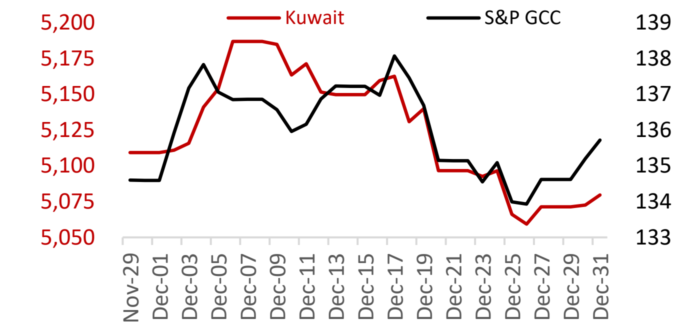
Stock Market Performance – *as of December 31, 2018:*

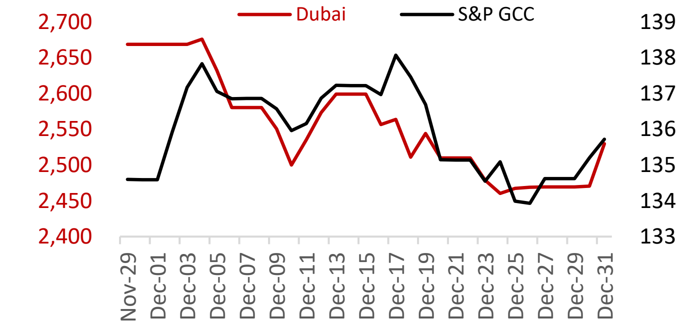
Saudi Arabia



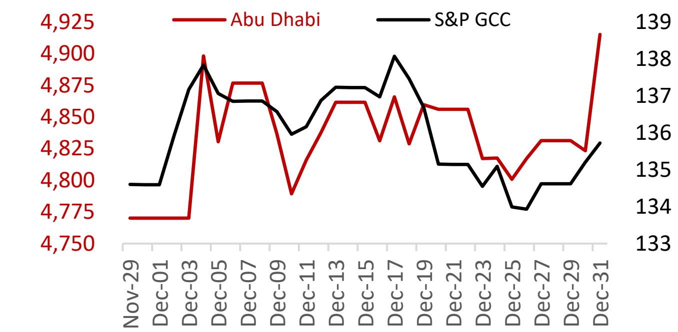
Kuwait



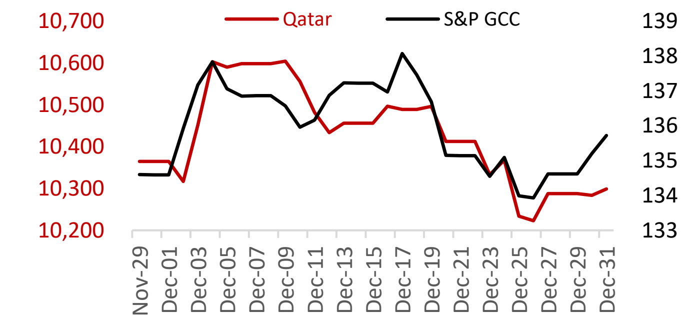
Dubai



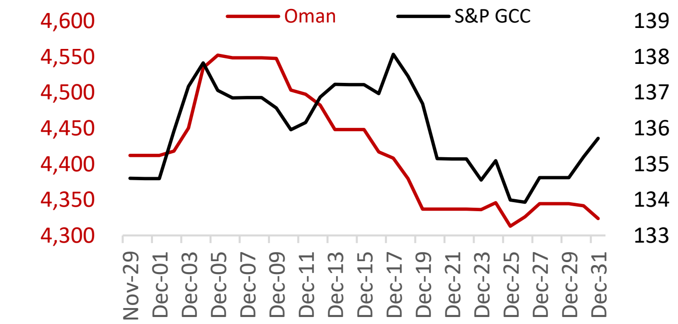
Abu Dhabi



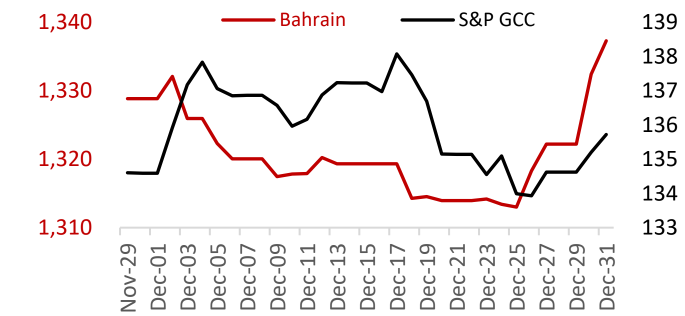
Qatar



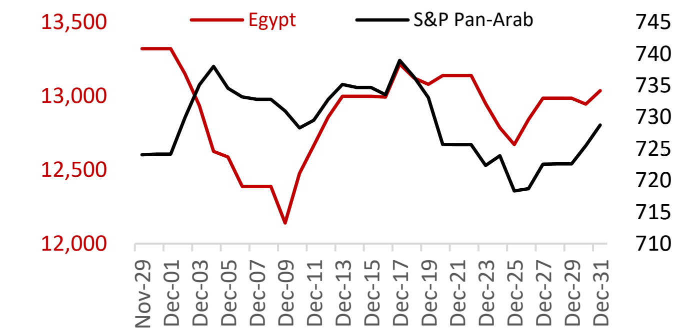
Oman



Bahrain



Egypt



All indices are in local currencies, except for the S&P GCC and S&P Pan Arab, both of which are denominated in USD.
Source: Bloomberg

Market Data – *as of December 31, 2018:*

Equity*	Last Price	% Change			
		Monthly	Quarterly	YTD	1Yr Trailing
Global					
MSCI AC World Index (USD)	455.66	-7.17%	-13.08%	-11.18%	-11.18%
MSCI EAFE (USD)	1,719.88	-4.96%	-12.86%	-16.14%	-16.14%
MSCI EM (USD)	965.67	-2.92%	-7.85%	-16.64%	-16.64%
US					
S&P 500 Index	2,506.85	-9.18%	-13.97%	-6.24%	-6.24%
Dow Jones Industrial Average	23,327.46	-8.66%	-11.83%	-5.63%	-5.63%
NASDAQ Composite Index	6,635.28	-9.48%	-17.54%	-3.88%	-3.88%
Russell 2000 Index	1,348.56	-12.05%	-20.51%	-12.18%	-12.18%
Developed					
Stoxx Europe 600	337.65	-5.55%	-11.88%	-13.24%	-13.24%
FTSE 100 Index	6,728.13	-3.61%	-10.41%	-12.48%	-12.48%
DAX Index	10,558.96	-6.20%	-13.78%	-18.26%	-18.26%
CAC 40 Index	4,730.69	-5.46%	-13.89%	-10.95%	-10.95%
Nikkei 225	20,014.77	-10.45%	-17.02%	-12.08%	-12.08%
Hang Seng Index	25,845.70	-2.49%	-6.99%	-13.61%	-13.61%
Emerging Markets					
Russia Stock Exchange	2,358.50	-1.42%	-4.72%	11.79%	11.79%
Turkey - Borsa Istanbul 100 Index	91,270.48	-4.34%	-8.69%	-20.86%	-20.86%
MSCI Asia ex Japan	596.60	-2.93%	-8.96%	-16.38%	-16.38%
Shanghai Composite	2,493.90	-3.64%	-11.61%	-24.59%	-24.59%
India - NIFTY 50	10,862.55	-0.13%	-0.62%	3.15%	3.15%
Taiwan Stock Exchange	9,727.41	-1.62%	-11.62%	-8.60%	-8.60%
Brazil Ibovespa Index	87,887.26	-1.81%	10.77%	15.03%	15.03%
Mexico Stock Exchange	41,640.27	-0.22%	-15.89%	-15.63%	-15.63%
MENA					
S&P Pan Arab (USD)	728.72	0.65%	-1.55%	6.16%	6.16%
S&P GCC Composite (USD)	135.72	0.83%	-1.09%	11.47%	11.47%
KSA - Tadawul All Share Index	7,826.73	1.61%	-2.16%	8.31%	8.31%
Dubai - DFM General Index	2,529.75	-5.21%	-10.77%	-24.93%	-24.93%
Abu Dhabi - ADX General Index	4,915.07	3.04%	-0.41%	11.75%	11.75%
Qatar Exchange Index	10,299.01	-0.63%	4.95%	20.83%	20.83%
Boursa Kuwait All Share Index	5,079.56	-0.58%	-0.95%	1.59%	N/A
Oman - Muscat Securities Market 30 Index	4,323.74	-2.00%	-4.84%	-15.21%	-15.21%
Bahrain Bourse All Share Index	1,337.26	0.64%	-0.10%	0.42%	0.42%
Egypt - EGX 30	13,035.77	-2.13%	-10.91%	-13.21%	-13.21%
Morocco - MADEX	9,233.00	1.13%	0.20%	-8.59%	-8.59%
Jordan - ASE Index	1,863.13	2.45%	-3.55%	-10.48%	-10.25%

**All Indices are in local currency, unless otherwise noted.*
***YTD is as of index inception on April 1, 2018.*
Source: Bloomberg

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Market Data – *as of December 31, 2018:*

Fixed Income	Last Price	% Change Monthly	Quarterly	YTD	1Yr Trailing
Bond Indices					
J.P. Morgan Global Agg Bond (USD)	562.92	1.87%	1.15%	-1.23%	-1.23%
Barclays US Agg Bond	2,046.60	1.84%	1.64%	0.01%	0.01%
US Government Total Return Value Unhedged (USD)	2,184.56	2.13%	2.54%	0.88%	0.88%
Bloomberg Barclays US Corp Bond Index	2,829.02	1.47%	-0.18%	-2.51%	-2.51%
Bloomberg Barclays US Corp High Yield Bond Index	1,909.36	-2.14%	-4.53%	-2.08%	-2.08%
Global Treasury ex US Total Return Index Value Unhedged	633.49	2.77%	1.94%	-0.89%	-0.89%
Global Agg Corporate Total Return Index Value Unhedged	249.77	1.24%	-0.81%	-3.57%	-3.57%
JPM Emerging Market Bond Index (USD)	770.70	1.46%	-1.19%	-4.61%	-4.61%
Bloomberg Barclays EM High Yield Bond Index (USD)	1,249.48	0.99%	-0.74%	-4.73%	-4.73%
US Treasury Yields (%)	**Current**		**3 M ago**	**6 M ago**	**12 M ago**
3 Month Yield	2.355		2.207	1.961	1.376
2 Year Yield	2.488		2.811	2.524	1.883
5 Year Yield	2.511		2.951	2.721	2.206
10 Year Yield	2.684		3.063	2.831	2.405
30 Year Yield	3.015		3.218	2.959	2.740
Global Treasury Yields (%)	**Current**		**3 M ago**	**6 M ago**	**12 M ago**
British 10 Year Gilt	1.277		1.528	1.277	1.190
German 10 Year Bund	0.242		0.422	0.305	0.427
Japan 10 Year Treasury	0.003		0.130	0.029	0.048

Commodities	Last Price	% Change Monthly	Quarterly	YTD	1Yr Trailing
Precious Metals					
Gold Spot	1,282.49	5.08%	7.69%	-1.56%	-1.56%
Silver Spot	15.50	9.08%	5.73%	-8.52%	-8.52%
Energy					
WTI Crude	45.41	-10.84%	-38.01%	-24.84%	-24.84%
Brent Crude	53.80	-8.36%	-34.96%	-19.55%	-19.55%
Natural Gas	2.94	-36.25%	-2.26%	-0.44%	-0.44%

Currencies	Last Price	% Change Monthly	Quarterly	YTD	1Yr Trailing
EUR-USD	1.147	1.33%	-1.18%	-4.48%	-4.48%
GBP-USD	1.275	0.04%	-2.13%	-5.62%	-5.62%
USD-JPY	109.690	-3.42%	-3.53%	-2.66%	-2.66%
KWD-USD	3.296	0.30%	-0.14%	-0.52%	-0.52%

Interbank Rates (%)	1M	3M	6M	12M
London Interbank	2.503	2.808	2.876	3.005
Saudi Interbank	2.801	2.975	3.115	3.341
Emirates Interbank	2.615	2.838	3.185	3.574
Qatar Interbank	2.731	2.906	3.089	3.303
Kuwait Interbank	2.125	2.375	2.625	2.813

Source: Bloomberg

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