NBK CAPITAL INVESTMENT STRATEGY & ADVISORY

MENA MARKETS REVIEW

ISSUE 019

MAY 2018

HIGHLIGHTS

- US equities continue to post positive returns in the face of continued volatility and increasing geopolitical concerns
- Politics weigh down on Europe's markets causing them to slip back into negative territory
- Emerging Markets continue to underperform for the fourth month straight on the back of political instability and continued talks of trade wars
- Brent Oil performed positively for the third month on the back of rising global geopolitical tensions
- GCC equity markets have suffered from weakened investor confidence caused by global political concerns despite rising oil prices

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TRADE TENSIONS AND POLITICAL CRISES IN EUROPE PRESENT RISKS TO GLOBAL GROWTH

The past month has seen concerns over the global trade environment intensify, with the expiration of US wavers on import tariffs on key allies including Europe and North America prompting a backlash from the EU, which is threatening its own counter measures. Meanwhile, political crises in both Italy and Spain rattled European bond markets, although tensions somewhat eased in early June. While the world economy is still set to record robust growth of nearly 4% this year, the OECD's latest report said that these and other risks "loom large" on the outlook, with growth still too dependent on government support and the need for structural reform increasingly urgent.

The US economy continues to perform strongly, despite signs of a moderation in growth early in the year as well as tightening monetary policy. The second release of 1Q18 GDP data saw growth revised down a touch to an annualized 2.2% from 2.3% (2.9% in 4Q17) on the back of slightly softer consumer spending and inventories; growth in the former slipped to just 1.0% from a very robust 4.0% the preceding quarter. But some analysts believe GDP growth could rebound to as high as 4% in 2Q18 helped by the impact of tax cuts, a tightening labor market and a stronger contribution from both inventories and net trade.

High–frequency indicators point to underlying strength in the consumer sector. Jobs growth picked up to 223,000 in May, beating its average for the first four months of 2018, while unemployment fell to 3.8% from 3.9% in April, reaching its lowest in 18 years. Consumer confidence, though slightly off its recent highs, remains extremely strong, while home prices are rising at a decent pace despite rising mortgage rates. Having dipped in Q1, data for April show that consumer spending got off to a strong start to Q2, up 0.6% m/m, backed up by solid income growth. The consumer sector accounts for more than two-thirds of the US economy.

Although there are concerns among US manufacturers about the impact on costs and prices of recent tariff measures on imports of steel and aluminum, survey evidence suggests that the impact on demand has so far been minimal, with the ISM and PMI manufacturing gauges for May reporting rising orders, work backlogs and lengthening delivery times. Advanced data also show little tariff-related fallout on the merchandise trade deficit, which narrowed to $68 billion in April. But the report could take on greater significance once data on the post-tariff exemption period, starting June, is released later this summer.

The strong jobs figures for May were seen supporting the case for more aggressive Federal Reserve policy tightening this year. This is beyond the almost certain 0.25 bps rate hike expected at its policy meeting in mid-June – the second increase of the year which will take the target rate range to 1.75–2.00%. It also lifted the (futures market) probability of two additional rate hikes in 2018 to 35%, having softened earlier in the month on Italy-related concerns. The Fed's preferred inflation gauge, the PCE measure, hit the 2.0% target in April for only the fourth time in five years, though the less volatile 'core' measure remained at 1.8%.

Economic indicators for the Eurozone were mixed but mostly soft in May and hint at a period of lower, if still healthy, growth. The Eurozone composite PMI came in well below expectations at 54.1 and down for a fourth consecutive month while consumer sentiment was little changed. Inflation jumped sharply to 1.9% mainly due to higher commodity prices, but core inflation was still well below the ECB's 2% target, at 1.1%.

Political factors were also at the fore across Europe. Following a tumultuous lead up, a populist, anti-establishment coalition government was sworn in Italy. Its policy agenda includes a flat tax and the rollback of increases in the retirement age – all of which could strain already vulnerable public finances. Meanwhile in Spain, a corruption scandal led to the exit of the prime minister with a minority government led by socialist opposition leader Pedro Sánchez set to take the reins.

These developments may warrant more caution from the ECB. The bank is currently expected to end its QE program by end-2018 and start to hike interest rates by mid-2019. However, further softness in the data and increased political uncertainty could see the latter pushed back. The ECB will meet on 14 June, but no major announcements are expected until July.

GDP fell by an annualized 0.6% in 1Q18, down from growth of 0.6% in 4Q17 and marking the first contraction in activity since 2015. Consumption, investment and export growth all came in weaker – the latter reflecting a less favorable external climate. First estimates of growth in Japan can be volatile, and growth is expected to recover in Q2 helped by the weaker yen in relation to the US dollar as well as the tight labor market. Latest data, for example, showed export growth accelerating from 2.1% y/y in March to 7.8% y/y in April on the back of higher car and manufacturing equipment shipments, while unemployment stood at 2.5% – still one of the lowest rates in the world. Nevertheless, the weak Q1 GDP data could undermine the case for an early winding down of the Bank of Japan's ultra-loose monetary policy.

Having notched up a third consecutive month of gains in May (+3%) and briefly topping a three-and-a-half-year high of $80/bbl, the price of Brent crude oil was on the back foot in early June, pulled down by the possibility of OPEC+ increasing production during the second half of the year. The change in strategy could come after the OPEC ministerial meeting on 22 June. However, although it is likely that the production cut agreement will begin to be wound down slowly in July, it is not a foregone conclusion since the majority of producers do not have the capacity to increase production to mitigate the fall in oil revenue resulting from lower prices. Meanwhile, US crude output continues to break records, surging to a high of 10.76 mb/d in the week-ending 25 May.

With oil prices higher, regional economies continue to improve. Trade surpluses are back, reserves are being replenished – Saudi Arabia's official foreign currency reserves topped $500 billion for the first time in almost a year – and regional non-oil sectors are witnessing increased government spending. Despite ongoing concerns about the fiscal position, the IMF recently revised up its forecast for Bahrain's growth this year to 3.2% from 3.0% on the back of increased infrastructure investment and a recovery in oil production, while S&P reaffirmed Bahrain's long and short-term foreign and local currency ratings at B+/B with a stable outlook based on the kingdom's continued access to foreign capital. Growth in Saudi Arabia, however, remains disappointing, weighed down by barely positive credit growth and contracting bank deposits, even while retail POS activity remains well up on last year at 18% y/y in April. Still, the non-oil PMI managed to improve slightly to 53.2 in May.

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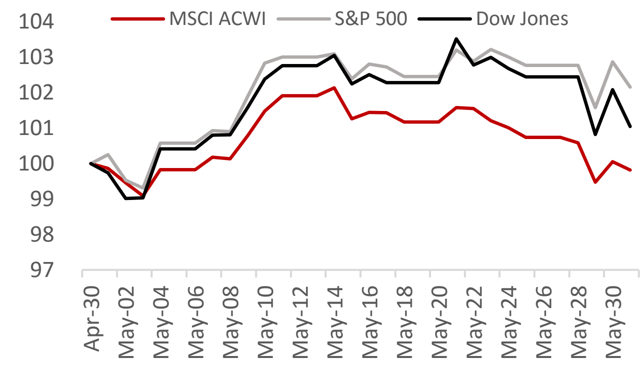
Global Equities

Global equities in May were unable to maintain their positive momentum shedding 0.2% as measured by the MSCI All Country World Index. US equities in May continued their positive run. The S&P 500 and Dow Jones Index each gained 2.2% and 1.1%, respectively. US markets continued to experience volatility fueled by ongoing talks surrounding trade wars with multiple partners including China, Japan, and the EU, President's Trump withdrawal from the Iran nuclear deal, and the on-again off-again meeting with North Korea. On the monetary policy front, the Fed met during the month and did not hike rates, although market expectations are still strong for a June hike.

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

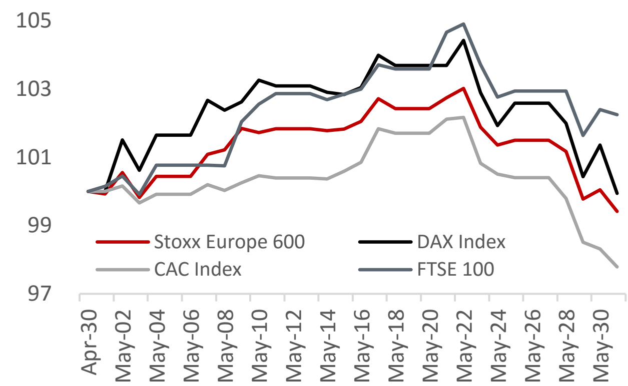


Source: Bloomberg *(figures rebased)*

In Europe, the Stoxx Europe 600 in May was also unable to maintain its positive run from the previous month. The index posted a loss of 0.6%. Sub markets, such as Germany's DAX Index and France's CAC 40 Index performed poorly dropping 0.1% and 2.2%, respectively. Politics in continental Europe took center stage weighing down on both equity and bond markets. In Italy, the President blocked the government coalition's pick for the Minister of Economy prompting a potential constitutional predicament and talks of new elections. In Spain, a no confidence vote saw the current Prime Minister forced out of office. In addition, the US voided the exemption on duties afforded to Europe forcing their hand in determining and implementing a retaliation.

The UK's equity market in May, like the US, was able to preserve its positive performance from the previous month. The FTSE 100 posted a gain of 2.3%, making it a top performer relative to other developed markets. On the Brexit front, nothing much has changed with the EU chief negotiator claiming that no major progress has been reached since March. The Bank of England opted to not increase rates during their meeting, as was expected by market participants.

Chart 2: European and UK Equities

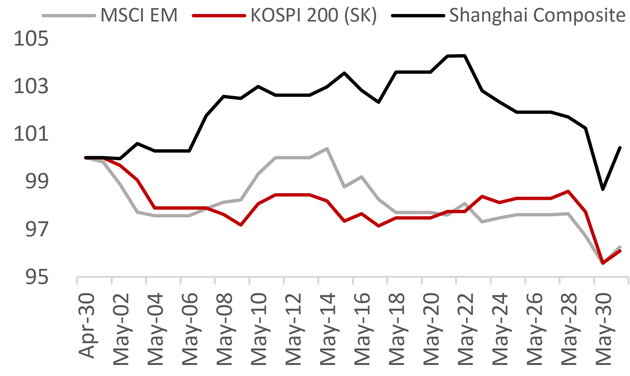


Source: Bloomberg *(figures rebased)*

Japan's Nikkei 225 in May posted a loss of 1.2%. Over the past several months, Japan's economy has been seen as moving in the right direction, growing. Amplifying concerns is the trade war brewing between the US and Japan, as it was the only major trading partner that did not receive an exemption. Towards the end of the month, Prime Minister Abe informed the WTO that Japan was ready and willing to retaliate. During the middle of the month, figures pertaining to Q1 2018 coming out of Japan indicated the economy had contracted for the first time since 2015.

Emerging markets have been unable to put a stop to the losses in their equity markets. In May, the MSCI Emerging Market Index suffered losses of 3.8%, placing its YTD return in negative territory for the first time in 2018. Overall markets have been pushed down by the rise in the US dollar and global geopolitical concerns ranging from elections in Venezuela, the falling apart of the Iran nuclear deal, the uncertainty around the meeting between the US and North Korea's heads of state, and a brewing trade war between the two largest global economies. The Chinese stock market in May gained 0.4% as measured by the Shanghai Composite Index while the South Korean KOSPI200 Index dropped 4.0%.

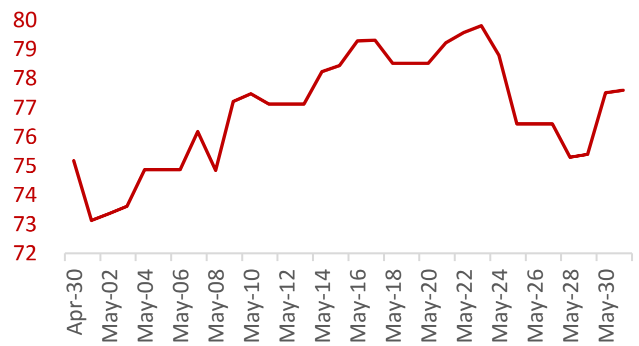
Chart 3: MSCI EM vs South Korea vs China



Source: Bloomberg *(figures rebased)*

Brent Oil in May closed up 3.2% continuing its positive performance for the third month running. On a YTD basis the commodity is up 16%. Supporting the rally in oil's price during the month were the US's withdrawal from the Iran nuclear deal and the talk of renewed sanctions, the economic crisis in Venezuela and its effect on production, the increase in demand, and the tightening of crude inventories. A meeting next month between OPEC and non-OPEC countries is expected to address the supply issues. Gold, unlike oil, continues to perform negatively, dropping 1.3% in May.

Chart 4: Oil Prices – USD per Barrel (Brent)



Source: Bloomberg

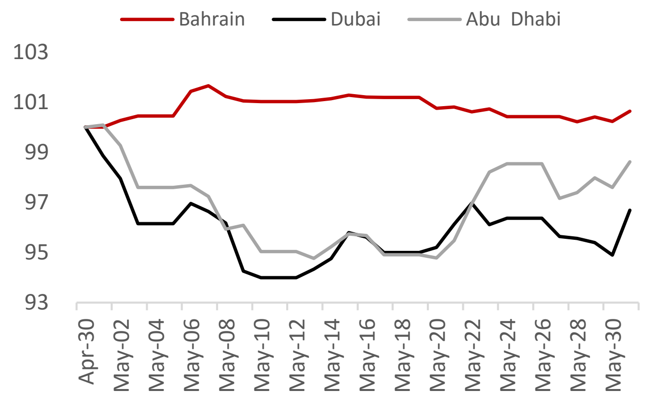
Regional Equities

GCC equities ended the month in the green 0.2% as measured by the S&P GCC Index. The GCC equity markets were dragged down by geopolitical tensions, which weakened investor confidence. The best performing index was Bahrain Bourse's All Share Index while the rest of the equity markets closed in the red. The worst performing index was Dubai's DFM General Index followed by Oman, Qatar, Abu Dhabi, Kuwait and Saudi Arabia. MENA equities, as measured by the S&P Pan Arab Composite Index, closed the month in the red 1.4% with Egypt's EGX 30 posting negative returns.

The Bahrain Bourse All Share Index was the best performing GCC index in May, closing the month up 0.6%. Bahrain's credit default swap rates spiked to near multi-year highs in May to 383 bps on the five-year government debt amidst a global sell-off of emerging market debt. Bahrain's fiscal deficit and growing debt are also contributing factors. The yields on five-year government debt also increased to a record high of 7.36%. S&P has affirmed Bahrain's long and short term foreign and local currency sovereign credit ratings at B+/B with a stable outlook citing the central bank's ability to meet the demand for foreign currency in the upcoming 12 months.

The UAE equity markets' performed poorly in May with Dubai's DFM General Index, the worst performing GCC index for the month, closing down 3.3%, and Abu Dhabi's ADX General Index closing down 1.4%. Dubai's equity market was dragged down by weakness in the real estate sector as prices and rents continue to decline on rising supply. During the month, the UAE cabinet approved the new investment law allowing for 100% foreign business ownership by the end of 2018 in an attempt to drive FDI inflows and the local real estate market. According to a report by Moody's, the UAE is expected to achieve GDP growth of 2.1% in 2018 and 3.9% in 2019 as well as witness growth in non-oil GDP.

Chart 5: Performance of Bahrain, Dubai & Abu Dhabi



Source: Bloomberg *(figures rebased)*

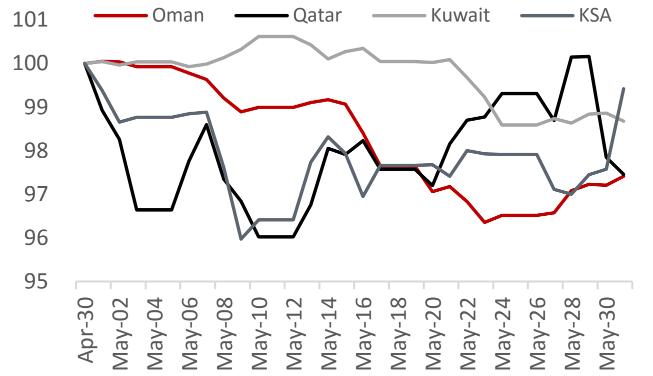
Oman's MSM 30 continued to drop in May, posting losses of 2.6%. Tourism continues to play a major role in driving Oman's economic development with a projected future investment of $50 billion in the hospitality sector through 2040. The government currently holds a 12% share in the investment, leaving the remaining 88% to the private sector. Oman's central banks has announced the issuance of government development bonds worth OMR 100 million which can be used as collateral to obtain loans from commercial licensed banks and be traded through the Muscat Securities Market.

The Qatar Exchange Index retreated following last month's strong performance, posting losses of 2.5%. In a similar move to the UAE, Qatar has passed a draft law permitting 100% foreign business ownership however unlike the UAE, this applies to all economic sectors. The Central Bank of Qatar's international reserves and foreign currency liquidity increased in April to $39.8 billion from $37.8 billion in March, signifying the central bank's ability to support the local currency.

Kuwait's equity market, after concluding its second month under the new structure, continues to underperform, registering losses of 1.3% in May, as measured by the Kuwait Stock Exchange All Share Index. The parliament's budget committee has stated that value-added tax will not be implemented before 2021 however, they do plan to proceed with the introduction of excise tax on select products such as tobacco, energy drinks and carbonated drinks. The Central Bank of Kuwait issued bonds worth KWD 360 million with a maturity of 6 months and priced at 2.375%.

The Tadawul All Share Index posted losses of 0.6% in May following last month's positive performance. Saudi Arabia recorded a budget deficit of SR 34.3 billion in Q1 2018, a 31% increase from last year's deficit and is projecting a deficit of SR 195 billion, 7.3% of GDP, in 2018. Total spending increased by 18% year-over-year and revenues increased by 15% mainly supported by higher non-oil revenues including VAT, excise taxes and the Public Investment Fund's returns. The Kingdom plans to balance the budget by 2030. In addition, the government sold SR 3.95 billion worth of domestic sukuk in May by reopening an issue from April.

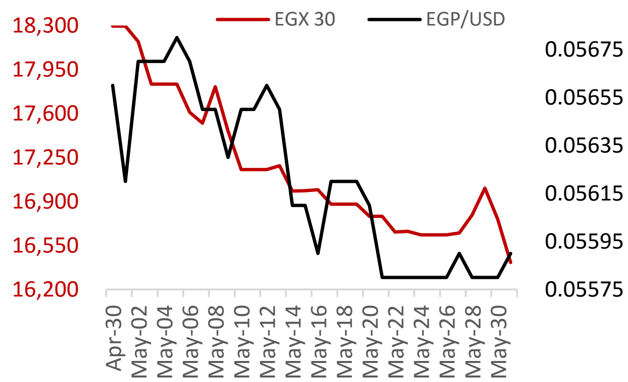
Chart 6: Performance of Oman, Qatar, Kuwait & KSA



Source: Bloomberg *(figures rebased)*

Egypt's EGX 30 broke its winning streak for the year, ending the month of May down 10.3%. Egypt's central bank left its key policy interest rates unchanged following their meeting in May, citing strong economic growth, falling unemployment, rising oil prices and possible further subsidy cuts this year. The Central Bank of Egypt has already cut rates twice this year by a total of 200 bps and is targeting inflation of 13% +/- 3% by Q4 2018. S&P has upgraded Egypt's credit rating to B from B- with a stable outlook, citing strong economic growth and rising external foreign exchange reserves. The IMF has approved another payment of $2 billion of a $12 billion loan after concluding its third review of the economic reforms Egypt has undertaken, bringing the total to $8 billion so far.

Chart 7: EGX 30 Index & EGP/USD



Source: Bloomberg

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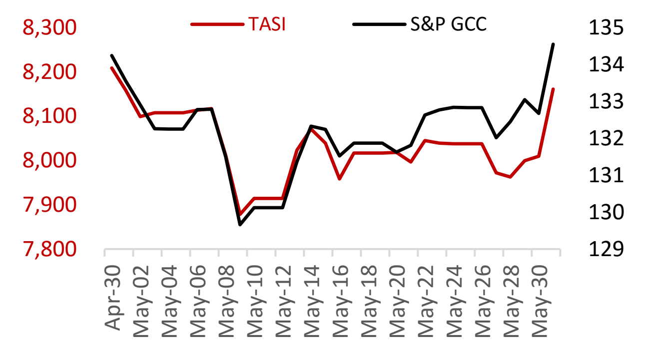
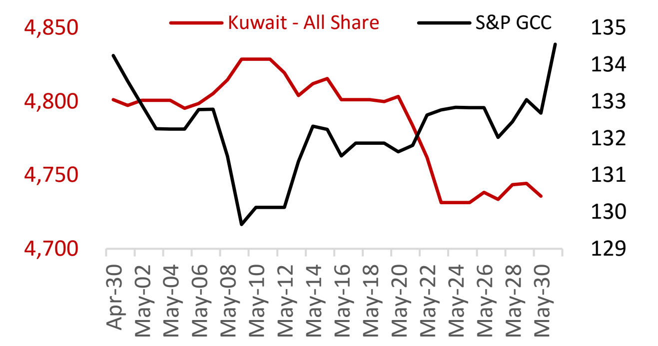
Stock Market Performance – *as of May 31, 2018:*

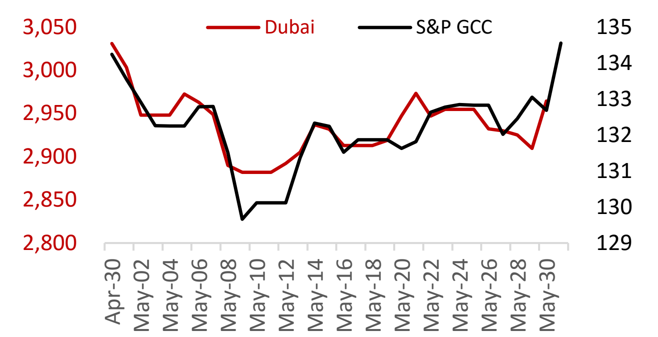
Saudi Arabia



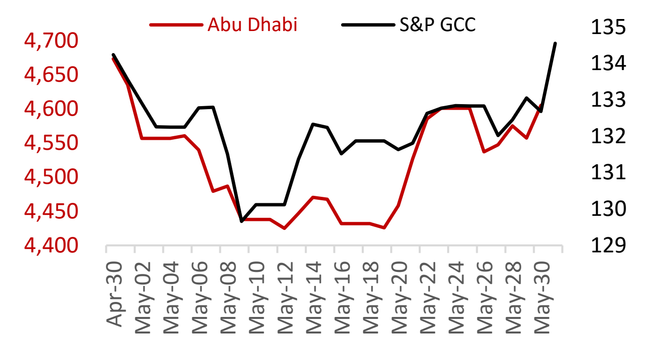
Kuwait



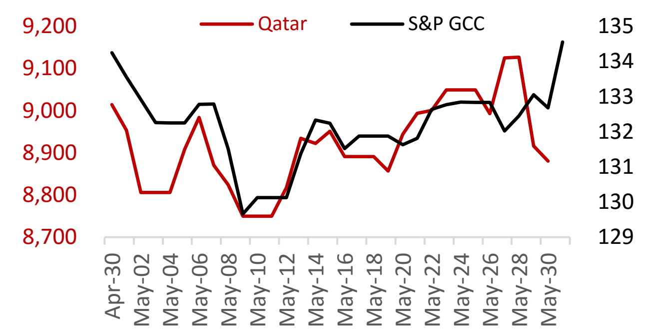
Dubai



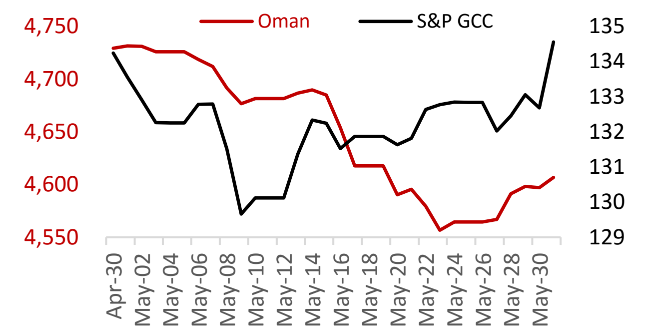
Abu Dhabi



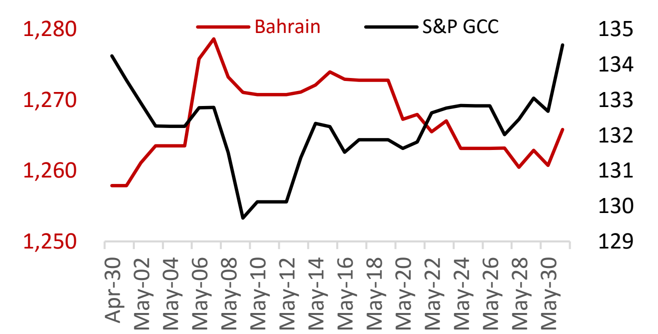
Qatar



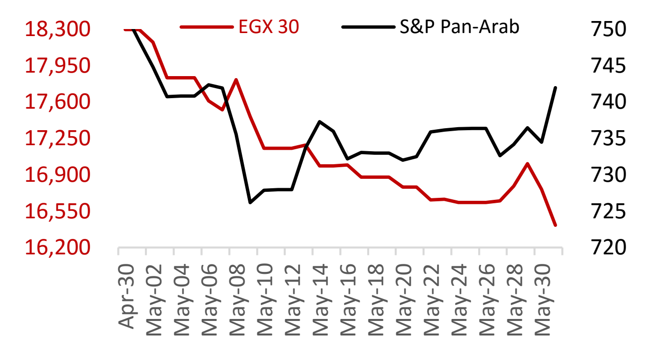
Oman



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

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Market Data – *as of May 31, 2018:*

Equity*	Last Price	% Change			
		Monthly	Quarterly	YTD	1Yr Trailing
Global					
MSCI AC World Index (USD)	508.77	-0.18%	0.59%	-0.83%	9.70%
MSCI EAFE (USD)	1,986.17	-2.81%	-0.97%	-3.15%	5.09%
MSCI EM (USD)	1,120.71	-3.75%	-4.28%	-3.26%	11.48%
US					
S&P 500 Index	2,705.27	2.16%	2.44%	1.18%	12.17%
Dow Jones Industrial Average	24,415.84	1.05%	1.30%	-1.23%	16.22%
NASDAQ Composite Index	7,442.12	5.32%	5.36%	7.80%	20.06%
Russell 2000 Index	1,633.61	5.95%	6.81%	6.39%	19.22%
Developed					
Stoxx Europe 600	383.06	-0.59%	3.29%	-1.57%	-1.78%
FTSE 100 Index	7,678.20	2.25%	8.81%	-0.12%	2.10%
DAX Index	12,604.89	-0.06%	4.20%	-2.42%	-0.08%
CAC 40 Index	5,398.40	-2.21%	4.47%	1.62%	2.17%
Nikkei 225	22,201.82	-1.18%	3.48%	-2.47%	12.98%
Hang Seng Index	30,468.56	-1.10%	1.25%	1.84%	18.74%
Emerging Markets					
Russia Stock Exchange	2,302.88	-0.18%	1.40%	9.15%	21.18%
Turkey - Borsa Istanbul 100 Index	100,652.30	-3.48%	-12.42%	-12.73%	3.19%
MSCI Asia ex Japan	709.10	-1.63%	-1.04%	-0.61%	14.65%
Shanghai Composite	3,095.47	0.43%	-2.32%	-6.40%	-0.70%
India - NIFTY 50	10,736.15	-0.03%	6.15%	1.95%	11.59%
Taiwan Stock Exchange	10,874.96	2.04%	-0.29%	2.18%	8.31%
Brazil Ibovespa Index	76,753.62	-10.87%	-10.09%	0.46%	22.39%
Mexico Stock Exchange	44,662.55	-7.64%	-3.17%	-9.51%	-8.46%
MENA					
S&P Pan Arab (USD)	741.93	-1.35%	1.36%	8.08%	10.89%
S&P GCC Composite (USD)	134.55	0.23%	3.38%	10.50%	13.06%
KSA - Tadawul All Share Index	8,161.08	-0.58%	3.69%	12.94%	18.77%
Dubai - DFM General Index	2,964.13	-3.32%	-4.65%	-12.05%	-11.24%
Abu Dhabi - ADX General Index	4,605.04	-1.38%	0.43%	4.70%	4.01%
Qatar Exchange Index	8,880.51	-2.54%	3.57%	4.19%	-10.31%
Boursa Kuwait All Share Index	4,735.72	-1.32%	-5.29%	-5.29%	N/A
Oman - Muscat Securities Market 30 Index	4,606.68	-2.59%	-3.49%	-9.66%	-15.04%
Bahrain Bourse All Share Index	1,265.80	0.63%	-3.99%	-4.95%	-4.09%
Egypt - EGX 30	16,414.53	-10.28%	-5.93%	9.31%	23.05%
Morocco - MADEX	10,005.75	-5.59%	-5.71%	-0.94%	5.97%
Jordan - ASE Index	2,095.98	-4.36%	-6.15%	-1.70%	-3.64%

**All Indices are in local currency, unless otherwise noted.*
Source: Bloomberg

Market Data – *as of May 31, 2018:*

Fixed Income	Last Price	% Change Monthly	Quarterly	YTD	1Yr Trailing
Bond Indices					
J.P. Morgan Global Agg Bond (USD)	562.76	-0.73%	-2.19%	-1.26%	1.42%
Barclays US Agg Bond	2,015.76	0.71%	-0.04%	-1.50%	-0.37%
US Government Total Return Value Unhedged (USD)	2,142.23	0.89%	0.08%	-1.07%	-0.80%
Bloomberg Barclays US Corp Bond Index	2,823.29	0.54%	-0.40%	-2.70%	0.06%
Bloomberg Barclays US Corp High Yield Bond Index	1,945.28	-0.03%	0.62%	-0.24%	2.35%
Global Treasury ex US Total Return Index Value Unhedged	640.57	-1.66%	-4.06%	0.22%	3.30%
Global Agg Corporate Total Return Index Value Unhedged	252.00	-0.76%	-1.89%	-2.71%	1.33%
JPM Emerging Market Bond Index (USD)	773.46	-1.08%	-2.53%	-4.27%	-1.71%
Bloomberg Barclays EM High Yield Bond Index (USD)	1,258.36	-2.06%	-3.14%	-4.05%	-1.34%
US Treasury Yields (%)	**Current**		**3 M ago**	**6 M ago**	**12 M ago**
3 Month Yield	1.895		1.639	1.259	0.971
2 Year Yield	2.427		2.242	1.772	1.282
5 Year Yield	2.696		2.628	2.113	1.752
10 Year Yield	2.859		2.864	2.362	2.203
30 Year Yield	3.025		3.140	2.762	2.863
Global Treasury Yields (%)	**Current**		**3 M ago**	**6 M ago**	**12 M ago**
British 10 Year Gilt	1.230		1.474	1.233	1.046
German 10 Year Bund	0.341		0.651	0.305	0.304
Japan 10 Year Treasury	0.040		0.068	0.035	0.049

Commodities	Last Price	% Change Monthly	Quarterly	YTD	1Yr Trailing
Precious Metals					
Gold Spot	1,298.51	-1.28%	-2.03%	-0.33%	2.33%
Silver Spot	16.43	0.59%	0.36%	-3.01%	-5.20%
Energy					
WTI Crude	67.04	-2.23%	3.23%	10.96%	38.74%
Brent Crude	77.59	3.22%	10.42%	16.03%	54.22%
Natural Gas	2.95	6.84%	8.01%	-0.03%	-3.87%

Currencies	Last Price	% Change Monthly	Quarterly	YTD	1Yr Trailing
EUR-USD	1.169	-3.19%	-5.12%	-2.60%	3.99%
GBP-USD	1.330	-3.38%	-5.12%	-1.59%	3.17%
USD-JPY	108.820	-0.48%	2.39%	-3.43%	-1.77%
KWD-USD	3.309	-0.38%	-0.86%	-0.13%	0.43%

Interbank Rates (%)	1M	3M	6M	12M
London Interbank	2.001	2.321	2.474	2.718
Saudi Interbank	2.126	2.439	2.626	2.844
Emirates Interbank	2.090	2.558	2.704	3.048
Qatar Interbank	2.379	2.633	2.793	3.000
Kuwait Interbank	1.750	2.000	2.188	2.438

Source: Bloomberg

Disclaimer: