Monthly Insights

24 October 2019

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Preface

Some optimism is emerging regarding Brexit and trade wars, contributing to a dialing back of risk. This is just as well as the macro environment continues to deteriorate, with recent downgrades to the IMF's global outlook, including for this region.

Global macro: Market optimism is improving on two key fronts, US-China trade and Brexit. As both issues have been the main sources of market uncertainty in 2019, signs of progress have the potential to transform sentiment in the final quarter.

GCC macro: The decline in oil production in H1 2019 has weighed on headline growth numbers. With the OPEC curb on production expected to remain in place through Q1 2020, and taking into account H1 GDP data where it is available, we have downgraded real GDP growth forecasts for 2019 in four out of the six GCC countries.

MENA macro: Lebanon's embattled government has made concessions to the thousands of protesters that spilled onto the streets in October, but questions remain over whether these measures are compatible with the long-term structural adjustments the economy needs to take to get back on a sustainable growth path.

Fixed Income: Egyptian local currency fixed income securities are the best performing ones globally with possibly more upside heading into 2020.

Currencies: The dollar has declined amid expectations of additional rate cuts from the Federal Reserve, while sterling has outperformed on a Brexit breakthrough.

Equities: At the start of Q4 2019, equities appear to be caught in a tug-of-war between easing geopolitical risks (US-China trade and over Brexit) and firm signs of an impending global economic slowdown (European recession, US manufacturing).

Commodities: Oil markets will go through a substantial change from January 2020 when new specifications governing marine fuels come into effect. As a region that produces crude oil that is high in sulphur, MENA exporters will need to adapt to a greener, lower emission world.

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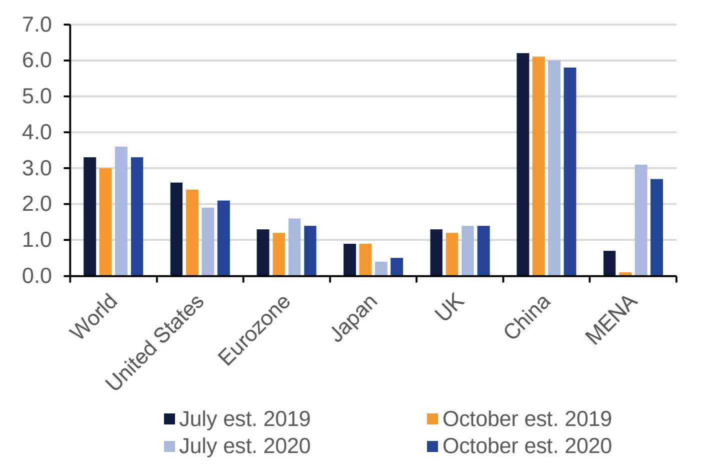
Global Macro

Market optimism is improving on two key fronts, US-China trade and Brexit. As both issues have been the main sources of market uncertainty in 2019, signs of progress have the potential to transform sentiment in the final quarter. This is just as well as the macro environment continues to deteriorate, with recent downgrades to the IMF's global outlook. On both issues there are still significant hurdles to be overcome before enduring resolutions are found however.

Promising trade developments but early days

A partial trade deal between the U.S and China was apparently agreed this month that will see China increase its purchases of U.S. agricultural commodities, agree to certain intellectual-property measures and concessions related to the Chinese yuan and financial services. In return the U.S. postponed tariff increases on USD250bn of Chinese imports which were due to come into effect, with Trump describing it as the first phase of a broader agreement that could be signed off next month.

IMF downgrades growth expectations



Source: Bloomberg, Emirates NBD Research

Trump has continued to speak positively about the prospects of a broader trade deal being reached in Chile in November, but this may be an effort to distract from the impeachment proceeding he is now facing, along with a series of foreign policy blunders. Notably officials from China have been much less effusive about the deal, and substantial issues remain to be resolved.

Additional tariffs on a further USD150bn of Chinese goods are still due to come into force in December, and solutions to the main issues of intellectual-property theft, forced technology transfers and complaints about Chinese industrial subsidies do not appear to have been found. The agreement also does not address Huawei Technologies Co., which has continued it global effort to sign 5G commercial contracts even as the U.S. seeks to persuade other countries to blacklist them. Markets got what they were hoping for in Washington this month, but this only amounts to a truce for now, with much still remaining to be done on the substance of the dispute, which will determine whether this latest news just another triumph of hope over reality.

Brexit limbo

Also adding to the sudden improvement in market sentiment was a breakthrough over Brexit, with the U.K. government striking a deal with the EU, and with the deal even getting initial support in the UK Parliament. However, this was as far as the good news went, as lacking a majority in the House of Commons the U.K. government was quickly confronted by an inability to pass the legislation required to get the deal approved in time for the October 31st deadline. With PM Johnson having sent a request to Brussels for an extension to the Article 50 deadline, Brexit is once again in a state of limbo, with legislation paused, until it gets an EU response. Markets have priced out the risk of a no-deal Brexit while pricing-in a stronger chance for there to be a delay and referendum, and/or a general election. So progress of sorts has been made but a lot still remains to be done.

Macroeconomic data remains concerning

Chinese real GDP growth continued to slow in Q3, posting just 6.0% - the weakest expansion rate in some 30 years. This followed the 6.2% seen in the second quarter, and missed expectations of 6.1%. The economy has been hit by trade war-related uncertainty, with slowing investment levels a particular worry.

Chinese growth slows

Source: Bloomberg, Emirates NBD Research

As far as the global economy is concerned, the IMF delivered a downbeat assessment at its annual meetings. In its latest World Economic Outlook the Fund now expects global GDP growth of 3.0% this year, down from 3.6% last year and a 0.3% cut from its April forecast, which would be the lowest growth rate since the financial crisis. Although the IMF still expects the global economy to rsecover by 3.4% in 2020, this is also a downgrade from the 3.6% estimated 6-months ago. The IMF sees the global monetary easing underway offsetting in part the negative impact of the U.S.-China trade conflict, but indicated that this will still reduce growth by a cumulative 0.8% by the end of 2020.

Trade tensions remain disruptive

The Eurozone is the most affected, where the leading economies are facing recession. Germany suffered the biggest downgrade being exposed to the downturn in world trade growth and to China's weakness, with its growth forecast downgraded to just 0.5% this year. Attention is increasingly turning to the possibility of fiscal policy being an alternative to the monetary policy easing that outgoing President Draghi has presided over during his 8 years at the helm of the ECB. Indeed with a hawkish minority on the ECB Governing Council unhappy about the current direction of its policy, this is likely to represent a potential hurdle for further monetary stimulus under incoming ECB President Christine Lagarde, which may encourage her to direct pressure onto governments for a fiscal response.

U.S. economy outperforms

Despite the impact of protectionism the U.S. is forecast to be the fastest growing of the G7 industrial nations this year, at 2.4%, with no other G7 economy seeing a growth rate of more than 2.0%. However, it appears likely that this could be too optimistic, with ISM non-manufacturing activity slumping to 52.6 in September, the manufacturing ISM dropping deeper into contraction territory, and with recent declines in industrial production and retail sales. Despite having cut interest rates at its last meeting in September, and despite mixed messages at that meeting about further rate cuts, the markets are now almost completely discounting another cut in the coming week. Our own view is that it would be sensible for the Fed to wait until December before making a further adjustment, to evaluate how the economy has performed since the two rate cuts made in the summer. However, with political pressure also building on the Fed to do more it is impossible to rule out another move soon, especially as the Fed is currently undergoing a review of its monetary policy framework giving it an opportunity to catch-up with market expectations.

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Key Economic Forecasts - Global

US	2014	2015	2016	2017	2018f	2019f	2020f
Real GDP %	2.5	2.9	1.6	2.4	2.9	2.3	1.7
Current A/C % GDP	-2.1	-2.2	-2.3	-2.3	-2.4	-2.5	-2.6
Budget Balance % GDP	-2.7	-2.6	-3.1	-3.4	-4.2	-4.5	-4.7
CPI %	1.6	0.1	1.3	2.1	2.5	1.8	2.0
Eurozone							
Real GDP %	1.4	2.1	1.9	2.5	1.9	1.1	1.1
Current A/C % GDP	2.5	2.7	3.1	3.2	2.9	3.0	2.7
Budget Balance % GDP	-2.5	-2.0	-1.6	-1.0	-0.5	-1.0	-1.1
CPI %	0.4	0.2	0.2	1.5	1.8	1.2	1.3
UK							
Real GDP %	2.9	2.3	1.8	1.8	1.4	1.2	1.1
Current A/C% GDP	-4.9	-4.9	-5.2	-3.3	-3.9	-4.3	-4.0
Budget Balance % GDP	-5.2	-4.1	-2.8	-1.9	-2.3	-1.5	-1.6
CPI %	1.5	0.0	0.7	2.7	2.5	1.9	2.0
Japan							
Real GDP %	0.4	1.3	0.6	2.0	0.8	0.9	0.3
Current A/C % GDP	0.8	3.1	4.0	4.2	3.5	3.3	3.2
Budget Balance % GDP	-5.4	-3.6	-3.5	-3.0	-2.5	-3.5	-3.0
CPI %	2.7	0.8	-0.1	0.5	1.0	0.7	1.0
China							
Real GDP %	7.3	6.9	6.7	6.8	6.6	6.2	6.0
Current A/C % GDP	2.3	2.8	1.8	1.6	0.4	0.6	0.0
Budget Balance %GDP	-1.8	-3.4	-3.8	-3.7	-4.2	-4.5	-4.4
CPI%	2.0	1.4	2.0	1.6	2.1	2.4	2.3
India*							
Real GDP%	6.4	7.4	8.0	8.2	7.3	6.6	6.5
Current A/C% GDP	-1.4	-1.1	-0.6	-1.5	-2.5	-2.5	-2.6
Budget Balance % GDP	-4.3	-3.5	-3.7	-3.9	-3.6	-3.5	-3.7
CPI %	6.7	4.9	5.0	3.3	4.0	3.0	3.4

Source: Bloomberg, Emirates NBD Research
**For India the data refers to fiscal year (April – March)*

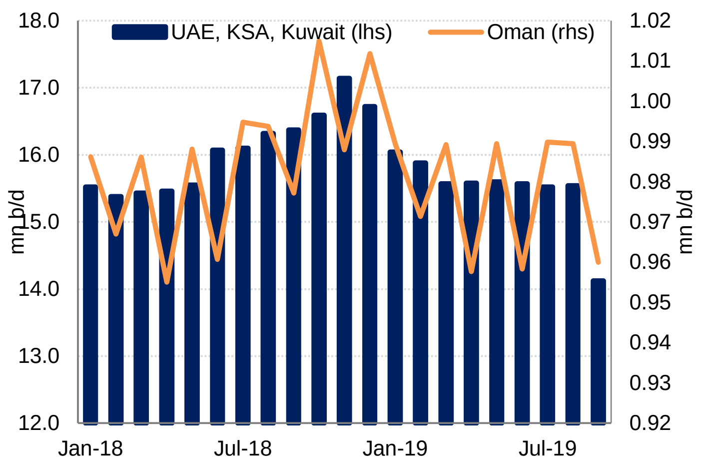
GCC Macro

Several GCC countries have now released GDP growth data for Q2 2019, allowing us to assess the performance in the first half of this year against our expectations. While there have been some bright spots (notably non-oil sector growth in Saudi Arabia), the decline in oil production in H1 2019 has weighed on headline growth numbers. With the OPEC curb on production expected to remain in place through Q1 2020, and taking into account H1 GDP data where it is available, we have downgraded real GDP growth forecasts for 2019 in four out of the six GCC countries.

The biggest change is in our forecast for Saudi Arabia, despite a strong rebound in non-oil sector growth in the first half of this year. Indeed, Q2 non-oil sector growth was the fastest since 2015. However, oil production has averaged just 9.7mn b/d in the year to September, down -5.7% on 2018 average output. Although output has recovered after the damage to Aramco's facilities in September, average crude output this year is likely to be significantly less than we had expected. As a result we now expect a -4.5% contraction in the oil sector, bringing headline GDP growth down to -0.4% this year compared with our previous forecast of 2.0%.

Lower oil production is also the main reason for downgrades to Kuwait, Oman and Qatar, although in Oman and Qatar's case, we have revised our expectations for non-oil growth lower as well.

GCC oil production declines sharply in Q3



Source: Haver Analytics, Emirates NBD Research

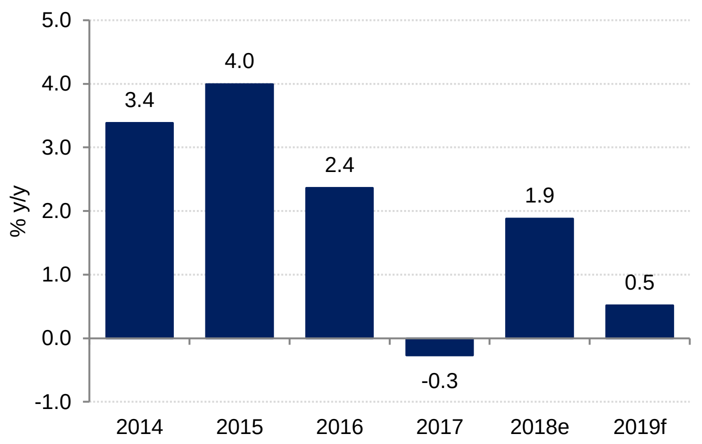
Official data showed Kuwait's GDP growth slowed to just 0.4% y/y in Q2, with the oil sector contracting by -0.4% y/y. Bloomberg estimates show that crude oil production declined a further -1.2% q/q in Q3, and this is likely to weigh on headline growth in the second half of this year. We have revised down our forecast for Kuwait's oil sector growth in 2019 to -1.5% from 0% previously. Non-oil sector growth averaged 0.8% in H1 2019, but we expect this to accelerate in H2. **Overall then, we expect real GDP growth to slow to 0.1% this year from 1.2% in 2018**.

Oman recently released official 2018 GDP figures showing growth of 1.8% last year, below our forecast of 2.1%. In particular, non-oil sector growth slowed to 2.0% from 3.3% in 2017. Consumption expenditure slowed to just 0.6% last year, while fixed investment contracted for the second year in a row. Net exports (including oil) was the main driver of Oman's growth last year. Oman's oil production has declined this year, and will likely be a drag on 2019 GDP growth. We have also revised down our expectations for non-oil GDP growth to 2.0%, the same as 2018. **We now project full year GDP growth of 1.1% in 2019, down from 1.7% previously**.

Qatar's real GDP has contracted q/q for the last three quarters, and annual GDP growth turned negative in Q2 2019 for the first time in at least seven years. Real GDP declined -1.4% y/y in Q2 with the hydrocarbon sector contracting -1.9% y/y, and the non-oil sector down -1.1% y/y. The outlook for Q3 is only a little better, with the headline PMI recovering to a six month high in September, although it remained in contraction territory at 49.0. We have revised our full year non-oil sector growth forecast down to 1%, assuming a recovery in H2 2019. We now expect a modest contraction in the hydrocarbons sector this year as well, so **2019 real GDP growth is likely to slow to 0.7% from 1.4% in 2018, well below our previous forecast of 2.4%**.

For the UAE and Bahrain, we retain our 2019 growth forecasts at 2.0% respectively. The UAE has increased oil production 2.8% this year relative to 2018, while still meeting its OPEC agreed production target. Non-oil sector growth is likely to remain lacklustre however, as PMI survey data in Q3 point to weak private sector job growth and softening external demand as well. In Bahrain, H1 GDP growth averaged 1.7%, consistent with our full year forecast. On a GDP weighted basis, average GDP growth in the region this year is likely to slow to 0.5% from 1.9% in 2018. While the headline number is soft, this is largely due to lower oil production than had been expected earlier this year.

Average* GCC GDP growth



**Weighted by nominal GDP*
Source: Haver Analytics, Emirates NBD Research

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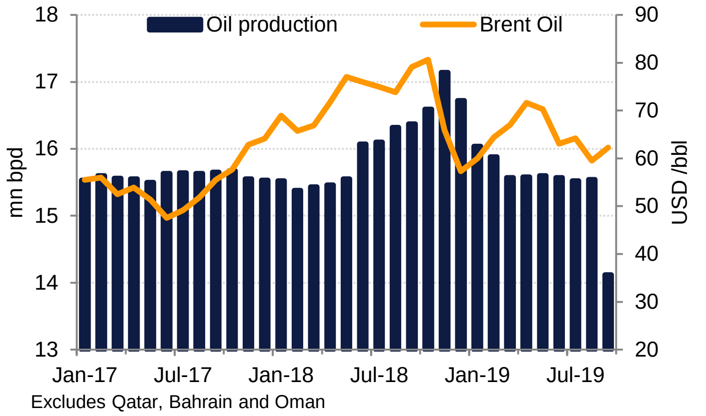
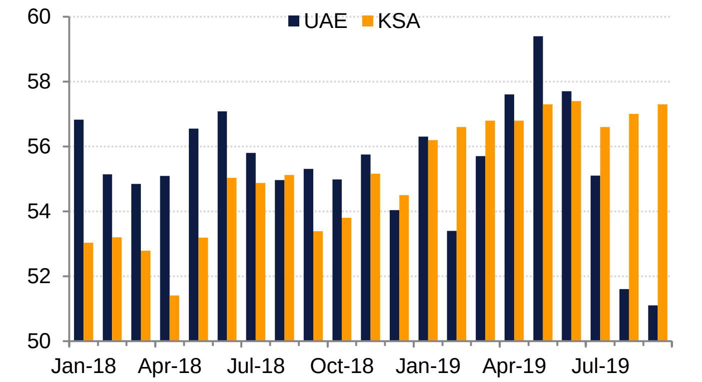
GCC in Pictures

GCC Oil Production and Oil Price



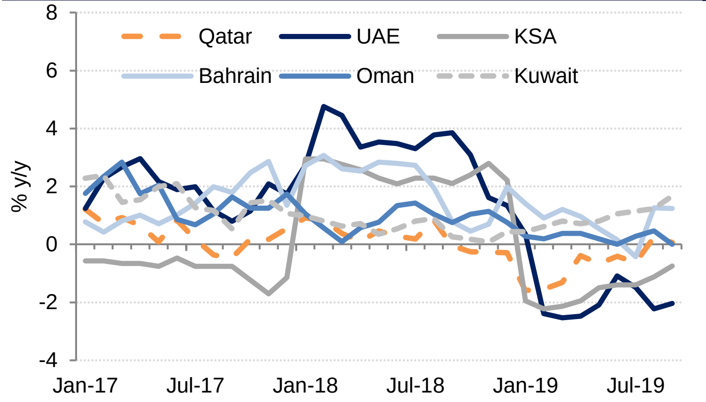
Source: Bloomberg, Emirates NBD Research

Purchasing Managers' Index



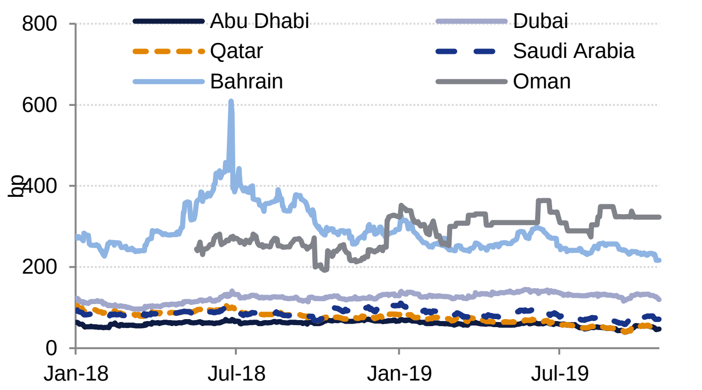
Source: IHS Markit, Emirates NBD Research

Inflation



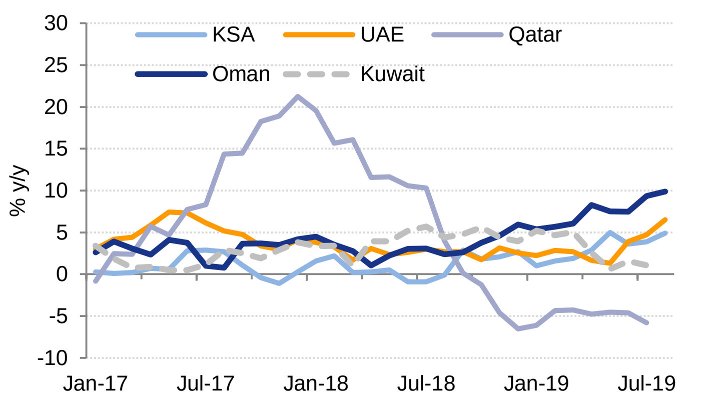
Source: Haver Analytics, Emirates NBD Research

CDS Spreads



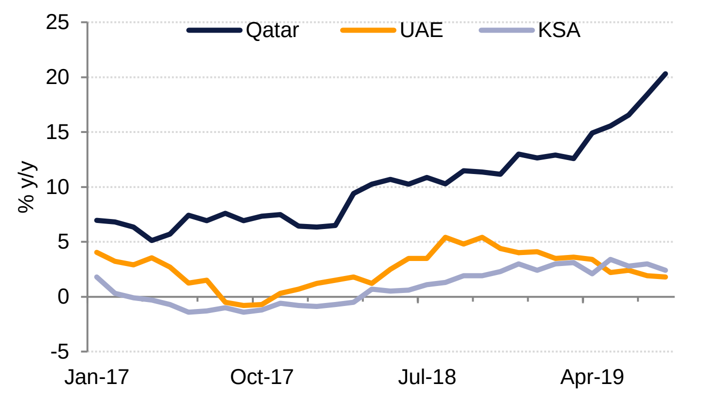
Source: Bloomberg

Money supply (ex government. deposits)



Source: Haver Analytics, Emirates NBD Research

Private sector credit*



**Qatar data is bank loan growth to private sector, not total private sector credit. Source: Haver Analytics, Emirates NBD Research*

Key Economic Forecasts - GCC

United Arab Emirates	2016	2017	2018e	2019f	2020f
Nominal GDP $bn	357.3	378.0	414.5	422.6	440.3
Real GDP %	3.1	0.5	1.7	2.0	2.6
Current A/C % GDP	3.7	7.0	7.1	4.9	4.1
Budget Balance % GDP	-2.0	-1.7	-1.6	1.8	0.3
CPI %	1.6	2.0	3.1	0.0	2.0
Saudi Arabia					
Nominal GDP $bn	644.9	688.6	782.5	777.8	810.3
Real GDP %	1.7	-0.7	2.2	-0.4	1.6
Current A/C % GDP	-3.7	1.5	9.0	4.8	5.9
Budget Balance % GDP	-12.9	-9.2	-4.6	-6.6	-6.6
CPI %	2.1	-0.8	2.5	-1.0	2.0
Qatar					
Nominal GDP $bn	151.7	166.9	191.4	188.3	196.7
Real GDP %	1.8	1.1	1.4	0.7	2.0
Current A/C % GDP	-5.5	3.8	8.7	6.1	5.4
Budget Balance % GDP	-9.2	-6.6	2.2	1.1	-1.1
CPI %	2.7	0.4	0.2	-0.5	2.0
Kuwait					
Nominal GDP $bn	109.4	119.5	141.5	139.9	145.4
Real GDP %	2.9	-3.5	1.2	0.1	1.4
Current A/C% GDP	-4.6	8.0	14.4	7.2	8.8
Budget Balance % GDP	-13.9	-9.0	-3.0	-5.6	-7.0
CPI %	3.2	1.6	0.6	1.0	1.5
Oman					
Nominal GDP $bn	65.4	70.5	79.2	79.2	81.3
Real GDP %	5.1	0.3	1.8	1.1	1.7
Current A/C % GDP	-19.2	-15.6	-5.5	-6.0	-5.4
Budget Balance % GDP	-20.9	-13.8	-6.6	-8.1	-7.2
CPI %	1.1	1.6	0.9	1.0	2.5
Bahrain					
Nominal GDP $bn	32.3	35.4	37.7	39.0	40.6
Real GDP %	3.5	3.8	1.8	2.0	2.4
Current A/C % GDP	-4.6	-4.5	-5.9	-6.3	-7.1
Budget Balance % GDP	-13.5	-10.0	-6.3	-6.6	-5.8
CPI %	2.8	1.4	2.1	1.5	2.0
GCC (Nominal GDP weighted avg)					
Nominal GDP $bn	429	456	515	514	536
Real GDP %	2.4	-0.3	1.9	0.5	1.9
Current A/C % GDP	-2.8	2.8	7.9	4.4	4.8
Budget Balance % GDP	-10.1	-7.2	-3.1	-3.6	-4.2
CPI %	2.1	0.4	2.1	-0.4	2.0

Source: Haver Analytics, National sources, Emirates NBD Research

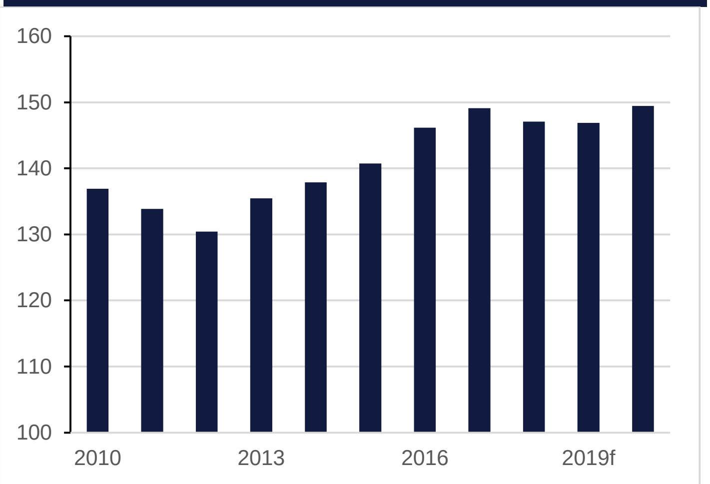
MENA Macro : Lebanon's government comes under pressure

Lebanon's embattled government has made concessions to the thousands of protesters that spilled onto the streets in October, but questions remain over whether these measures are compatible with the long-term structural adjustments the economy needs to take if it is to get back on a sustainable growth path.

New government concessions

Following five days of significantly large and bipartisan street protests all over Lebanon, Prime Minister Saad al-Hariri announced a number of measures aimed at appeasing the protester's concerns on October 21. The protesters have been railing against corruption and economic mismanagement in the country, where financial stresses are starting to have a real impact on daily lives as apparent dollar shortages are coming to the fore. According to Hariri, ministers would take a 50% pay cut, and a new tax on banks would also be introduced. At the time of writing on October 22 it is as yet unclear as to whether these have been sufficient to curb the unrest, given the fairly disparate demands being made with regards the government. Indeed, Hariri acknowledged in his announcement that these reforms might not meet all demands and recognised the legitimacy of the protests, but maintained that the government actions were a step in the right direction.

Action required to bring down debt/GDP



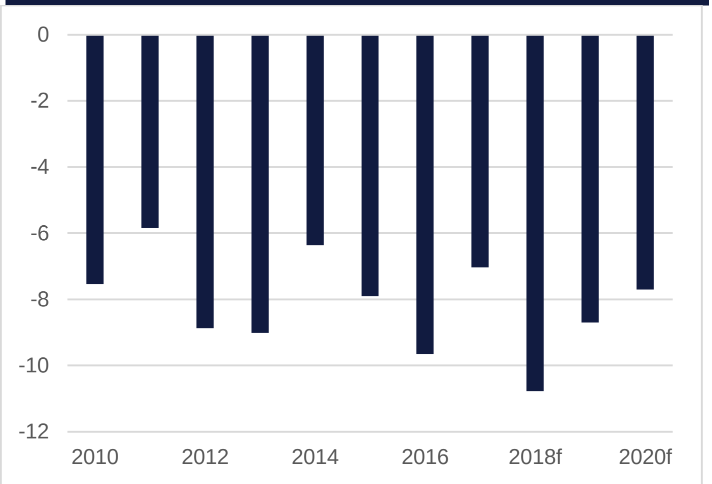
Source: Haver Analytics, Emirates NBD Research.

The problem for the Lebanese government is that a drawdown of its fiscal deficit is essential for it to get back on an even keel, but it is hard to do this given its current lack of political capital. Any significant challenge to elements of parliament and their control of certain sectors will run up against pushback, while these protests have illustrated that austerity measures will be met with a similar response; one of the sparks which ignited these demonstrations was a plan to tax calls on Voice over Internet Protocol service WhatsApp.

Unrealistic fiscal consolidation targets

Alongside the pay cuts and bank tax, part of the emergency plan announced by the government encompassed setting a fiscal deficit target for 2020. This is somewhat reassuring given that the 2019 budget was only passed by parliament over halfway through this year, extending the policy paralysis which has blighted fiscal consolidation efforts. A concrete spending plan is crucial to reassure investors, multilateral agencies, and CEDRE contributors that the government is serious about implementing meaningful reforms and drawing down its eye-watering debt levels (around 150% of GDP). However, the somewhat unrealistic objective of hitting a deficit equivalent to just -0.6% of GDP in 2020 could prove to be more of a hindrance than a help as it is almost certain to be missed.

Fiscal balance/GDP will narrow slowly



Source: Haver Analytics, Emirates NBD Research

For 2019, reported aims of revenues of LBP 19tn and spending of LBP 23tn would result in a fiscal shortfall equivalent to 6.4% of GDP. However, our expectations of LBP 17tn and LBP 24tn respectively would see the deficit more in the region of 8.7%, following 10.8% in 2018. In light of this, and the government's post-protest plans to boost spending on the poor while curbing new taxes, the 2020 target looks rather farfetched – we forecast a deficit of 7.7% – and the markets did not respond positively to the news. Yields on government dollar-denominated bonds continued to rise, with the 2021 eurobond spiking from 21% to 24% over the course of the day – compared to under 10% earlier this year. The country's CDS spreads also rose again and while the currency is pegged to the dollar, there have been concerns regarding the peg's durability as dollar shortages have been reported in recent weeks. The black market rate for the pound has reportedly risen to 1,650 to the dollar, compared to the official rate of 1,500.

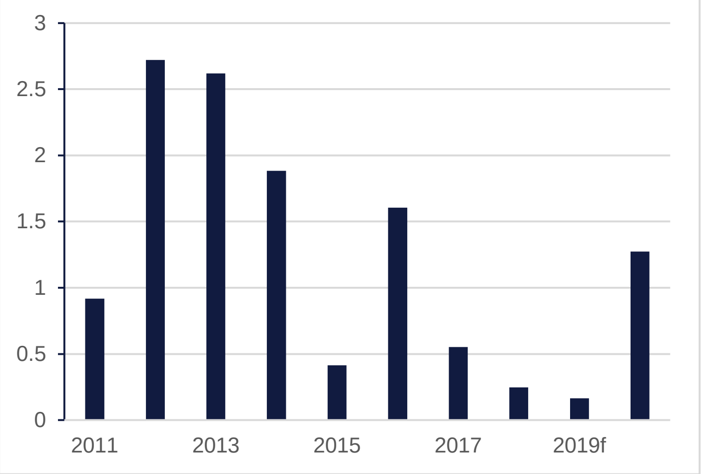
Markets unconvinced (Eurobond 2028 %)

Source: Haver Analytics, Emirates NBD Research

Growth looks weak this year

Aside from difficulties in bringing down the nominal fiscal shortfall, the GDP denominator is unlikely to see any major gains this year. Growth in 2019 is unlikely to exceed the 0.2% seen in 2018, and the risks to our growth projection are to the downside, especially in light of recent events. High-frequency indicators including cement sales, PMI surveys, coincident indicators and new building permits all indicate an economy under pressure, and this unrest will have done nothing to boost activity. Making progress on hitting fiscal targets would start the release of the USD 11bn of CEDRE funding pledged in Paris last year, enabling the government to embark on its Capital Investment Plan, but in the absence of this for the time being, growth will remain lacklustre.

Real GDP growth will pick up in 2020



Source: Haver Analytics, Emirates NBD Research

There is one bright spot, in that the tourism sector has been robust in 2019, and the removal of a travel ban on UAE citizens in October should ensure it remains a bright spot in 2020, when we forecast an acceleration in real GDP growth to 1.3%.

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Key Economic Forecasts – Non-GCC Oil Importers

Egypt*	2016	2017	2018e	2019f	2020f
Nominal GDP $bn	332.4	225.8	241.6	300.7	377.1
Real GDP %	4.3	4.1	5.3	5.6	5.8
Current A/C % GDP	-6.0	-6.4	-2.5	-2.7	-2.9
Budget Balance % GDP	-12.05	-10.83	-9.83	-8.22	-7.13
CPI %	13.7	29.6	14.4	10.4	8.0
Jordan					
Nominal GDP $bn	39.2	40.7	41.7	43.2	44.6
Real GDP %	2.1	2.1	2.0	2.3	2.3
Current A/C % GDP	-9.4	-10.6	-6.8	-6.3	-6.1
Budget Balance % GDP	-3.2	-2.7	-2.6	-2.3	-2.4
CPI %	-0.8	3.3	4.5	0.8	1.9
Lebanon					
Nominal GDP $bn	51.1	52.1	62.3	66.1	70.5
Real GDP %	1.6	0.6	0.2	0.2	1.3
Current A/C % GDP	-20.5	-23.3	-19.9	-19.8	-19.4
Budget Balance % GDP	-9.6	-7.0	-10.8	-8.7	-7.7
CPI %	-0.8	4.5	6.1	2.9	2.9
Morocco					
Nominal GDP $bn	103.3	109.6	117.9	119.2	124.2
Real GDP %	1.1	4.2	3.0	2.7	3.0
Current A/C % GDP	-4.1	-3.4	-5.5	-5.3	-3.7
Budget Balance % GDP	-4.2	-3.4	-3.4	-4.2	-3.8
CPI %	1.6	0.8	1.8	0.4	0.8
Tunisia	103.3	109.6	117.9	119.1	123.7
Nominal GDP $bn	41.7	36.8	34.5	31.9	33.5
Real GDP %	1.0	1.7	2.5	1.5	2.3
Current A/C % GDP	-8.9	-11.1	-12.9	-12.0	-10.3
Budget Balance % GDP	-6.2	-6.7	-5.5	-5.1	-4.6
CPI %	3.7	5.3	7.4	6.8	6.3
Oil Importers (GDP weighted avg)					
Nominal GDP $bn	223.8	147.8	158.8	199.4	255.0
Real GDP %	3.05	3.38	3.66	3.85	4.35
Current A/C % GDP	-7.4	-8.3	-6.4	-6.1	-5.4
Budget Balance % GDP	-9.4	-7.6	-7.5	-6.8	-6.1
CPI %	8.5	15.8	9.1	6.4	5.6

Source: Haver Analytics, National sources, Emirates NBD Research
**Egypt data refers to fiscal year (July-June)*

Key Economic Forecasts – Non-GCC Oil Exporters

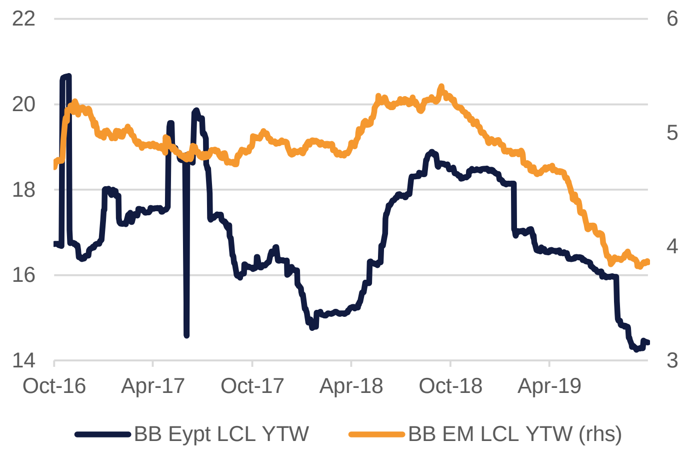
Algeria	2016	2017	2018e	2019f	2020f
Nominal GDP $bn	160.2	167.6	165.5	164.4	169.0
Real GDP %	3.2	0.4	1.6	1.0	2.0
Current A/C % GDP	-12.3	-13.2	-9.0	-7.6	-6.5
Budget Balance % GDP	-13.0	-6.5	-9.2	-9.4	-10.3
CPI %	5.8	6.0	3.5	3.2	4.5
Iran					
Nominal GDP $bn	441.8	446.9	422.4	465.0	535.5
Real GDP %	12.4	3.3	-4.2	-7.6	0.5
Current A/C % GDP	3.7	3.5	3.7	-0.2	-1.4
Budget Balance % GDP	-4.8	-5.1	-4.2	-4.4	-3.9
CPI %	8.7	10.0	21.0	38.7	25.0
Iraq	441.8	446.9	433.4	494.1	586.2
Nominal GDP $bn	165.2	166.2	215.5	243.3	250.7
Real GDP %	9.6	1.0	0.3	4.2	4.1
Current A/C% GDP	1.3	9.0	16.3	11.4	10.9
Budget Balance % GDP	-15.0	-1.8	8.3	-3.8	-3.4
CPI %	1.3	0.7	0.4	0.0	0.6
Libya					
Nominal GDP $bn	43.6	63.3	76.1	88.2	104.2
Real GDP %	-6.9	34.8	7.6	5.4	10.4
Current A/C% GDP	-10.2	-9.5	-2.1	-2.6	-2.9
Budget Balance % GDP	-18.1	-10.6	-7.1	-6.3	-5.9
CPI %	9.5	25.0	11.5	10.0	8.5
Oil Exporters (GDP weighted avg)					
Nominal GDP $bn	312.4	307.4	293.2	322.9	367.4
Real GDP %	8.7	5.3	-0.7	-2.0	2.5
Current A/C % GDP	0.5	0.4	3.4	0.2	0.2
Budget Balance % GDP	-8.0	-6.9	-3.0	-4.8	-4.8
CPI %	6.1	8.2	12.3	20.6	14.2

Fixed Income

Egyptian bonds best performing in 2019

A trade which gathered steam in 2016 has regained its allure in 2019 following a period in 2018 which was dominated by outflows. It is no surprise that the dovish shift in monetary stance of developed market central banks at the start of 2019 played an important part in pushing investors towards a country where yields in local currency bonds are among the highest in the emerging market space. Despite a 350 bps cut in interest rate by the Central Bank of Egypt over the past year, the yield-to-worst remains at 14.41%. While this is a decline from 18.50% at the start of the year, it still is at a substantial spread to the wider EM local currency yield of 3.86% (versus 4.96% end-2018).

Yield gap between EM and Egypt local currency bonds (%)

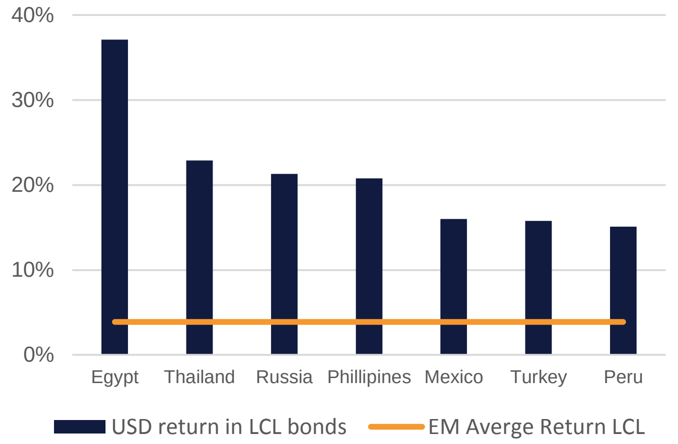


Source: Bloomberg

The yield becomes more attractive when juxtaposed against a very stable currency. The EGP has traded in a very narrow range of 16.13 and 17.98 over the last one year. In fact, since the start of the year, EGP has gained +10.7% against the USD to currently trade at 16.175. The stability in EGP and high yield has resulted in a total unhedged return of 38.4% ytd in USD terms. This is nearly six times that of the total return in USD terms of emerging market local currency government bonds.

All yields and total returns are based on Bloomberg Barclays indices.

Total Returns



Source: Bloomberg

The buyers

Foreign investors have increased their exposure over the last three years. As per data from the Central Bank of Egypt, the share of foreign investors as a percentage of total T-Bill outstanding has increased from almost zero at the end of June 2016 to 17.3% at the end of August 2019.

In absolute number, the foreign ownership of T-Bills has increased from EGP 176bn at the end of June 2017 to EGP 248bn at the end of August 2019. Interestingly, as a share of total T-Bill outstanding, foreign ownership has dropped from 20.5% to 17.3% over the same period. However, that is primarily because the central bank issued EGP 578bn worth of T-Bills between July 2017 and August 2019 (26 months). This is a sharp increase from EGP 386bn issued between July 2014 and June 2017 (36 months).

It is also worth noting that the share of shorter-dated T-Bills in total issuances has increased from c.20% at the end June 2015 to c.25% at the end of August 2019. From the data available, it can be inferred that foreign investors are putting their money more at shorter-term paper i.e., with maturity of less than 1 year.

Egyptian local currency fixed income securities athe best performing one globally with possibly more room for growth heading into 2020.

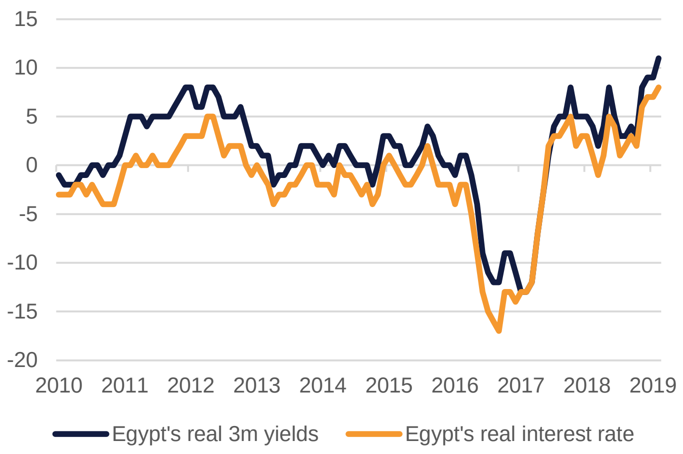
Foreign ownership of Egypt T-bills (USD bn)

Source: Haver Analytics, Emirates NBD Research

The road ahead

Following a sub-5% inflation print in September 2019, Egypt's real interest rate at c.8.5% is now among the highest in the world. This singular feature is likely to drive foreign investor interest in local currency bills even more. More so at a time when fixed income investors are grappling with negative yields in major economies. However, lower inflation also allows the central bank to be more aggressive in lowering interest rates which could weigh on yields and curb the enthusiasm of foreign investors. According to our forecasts, the Central Bank of Egypt is likely to cut rates by as much as 400 bps over the next 12 months. Having said that, even in that scenario the real interest rate is likely to among the top quartile of emerging market economies even after assuming a slight pick-up in inflation from lower base going forward which in turn should keep investors interested.

Egypt real interest rates among highest in the world



Source: Bloomberg

There is also a growing possibility that the government might look to push foreign inflows in longer-dated securities. It would be interesting to see if there is an appetite from investors for the same. If the outflow following a political protest at the end of last month is anything to go by then it appears developing investor interest could be challenging. However from a fundamental perspective, the Egyptian economy is relatively well-placed compared to its peers and that could help persuade investors. The economy expanded at the fastest rate in the region at 5.6% for the fiscal year ending June 2019. The fiscal deficit has also improved from 9.8% of GDP in FY 2018 to 8.2% in FY 2019. Importantly, FX reserves have increased from USD 15bn in 2016 to USD 45bn at the end of September 2019. This should help the central bank minimize volatility in the EGP which is a critical component of investor returns.

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Interest Rate Forecasts

US Treasuries Forecasts				
	Current	**3M**	**6M**	**12M**
2y	1.59	1.65	1.75	1.80
10y	1.76	1.90	2.00	2.00
2s10s (bp)	17	15	25	20
3M Libor				
3m	1.93	2.00	2.00	1.85
3M Eibor				
3m	2.15	2.25	2.25	2.00
Policy Rate Forecasts				
	Current %	**3M**	**6M**	**12M**
FED (Upper Band)	2.00	1.75	1.50	1.50
ECB (deposit rate)	-0.50	-0.50	-0.50	-0.50
BoE	0.75	0.75	0.75	0.75
BoJ	-0.10	-0.10	-0.10	-0.10
SNB	-0.75	-0.75	-0.75	-0.75
RBA	1.00	1.00	0.75	0.75
RBI (repo)	5.15	4.90	4.75	4.75
SAMA (reverse repo)	2.00	1.75	1.50	1.50
UAE (Repo rate)	2.25	2.00	1.75	1.75
CBK (o/n repo rate)	2.50	2.50	2.50	2.50
CBB (o/n depo)	2.00	1.75	1.50	1.50
CBO (o/n repo)	2.77	2.52	2.52	2.25
CBE (o/n depo)	13.25	11.25	10.25	9.25

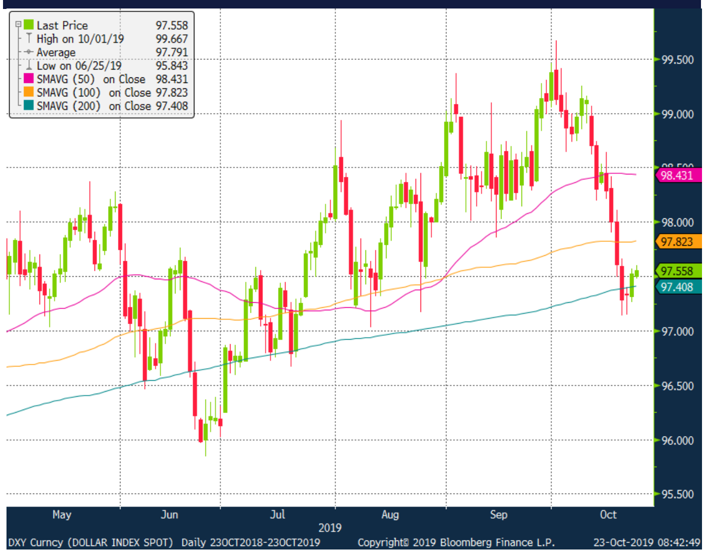
Source: Bloomberg, Emirates NBD Research
As at 22 October 2019

Currencies

Dollar underperforms

Over the last month, the dollar has been the second worst performing major currency, with only the Japanese yen being weaker. This underperformance was based on a combination of continued dovishness from the Fed as well as signs of optimism that a trade deal with China might be in sight. The Fed cut interest rates for a second time in 2019 at their September meeting, lowering the Fed Funds Target Rate by 25bps to 1.75-2.00. While the Fed communicated that this remains a supportive mid-cycle adjustment rather than the start of an easing cycle, the OIS shows a 90.4% chance of a third rate cut at the policy meeting later this month, indicating that the market has different expectations. While the USD has held up relatively well overall since the Fed started cutting rates in the summer, we would expect it to fare less well the more it continues to ease monetary policy going into 2020. Increasing risk appetite related to optimism over the U.S.-China trade dispute and Brexit were also a feature of the last few weeks, having the effect of seeing currencies like sterling strengthen at the dollar's and yen's expense. While 2020 is also likely to see both of these key issues ultimately resolved, other risk factors are likely to emerge related to the US election and the impeachment process, moderating the pace of dollar declines.

DXY to break 200-day moving average



Source: Bloomberg

From the October and 2019 highs of 99.667, the Dollar Index has declined as to its current levels of 97.579. During this movement, there have been several key technical developments. Firstly, the index has broken below the 50-day moving average (98.431). Having acted as a support level since July 2019, this key level has now provided resistance on four occasions since the start of October. In addition, the price has broken below the 100-day moving average (97.823) with further losses only halted when support was found near the 200-day moving average (97.408). A break of the 200-day moving average may result in a test of the 50-week moving average (97.232). Should the index realize a weekly close below this level, it may catalyze a larger decline towards 96.

EUR rally remains vulnerable

Soft economic data out of the Eurozone has triggered fears of a new recession. With manufacturing in contraction (the Eurozone Manufacturing PMI remaning below 50 since February 2019), and few signs of inflationary preassures the EUR has only managed to rally on the coattails of the dollar's sell-off. Furthermore the European Central Bank's benchmark deposit rate cut further into negative territory, from -0.4% to -0.5% combined with its pledge to renew quantitative easing is a potential handicap to further EUR gains. With the ECB pledging to continue the asset purchase program by buying EUR20bn of assets a month from November 1, for as long as necessary, the expectation is that monetary policy will remain accommodative for the foreseeable future. Against this, however, some signs of division on the ECB's governing council are emerging, fueling speculation that the ECB will be less inclined to ease further under incoming Presdient Lagarde, and setting up a potential tussle between bulls and bears that could see the EUR tread water for some time.

EURUSD maintains downside risks

Source: Bloomberg

A 0.83% gain over the last 30 days has taken the price of EURUSD to 1.1122. This move has resulted in a break of the 50-day moving average (1.1035) which has provided resistance since July 2019, and a test of the 100-day moving average (1.1135). However, analysis of the weekly candle chart shows that the downtrend that has been in effect since February 2018, remains intact. In order to break out of this downtrend and hold onto further gains, the price needs to realize a weekly close above the 1.1210, the resistive cap of this downtrend and not far from the 200-day moving average of 1.1206.

GBP outperforms

The announcement that UK Prime Minister Boris Johnson had secured a deal with the European Union helped GBP outperform rival currencies and be the last month's best performing currency. Some of these gains have unwound, however, following the failure of Parliament to agree to Johnson's timetable to meet the October 31st deadline. Renewed uncertainties concerning a possible delay to Brexit have emerged, with attendant risks of a general election and/or a second referendum, causing the pound to retreat from above the 1.30 level as investors have locked in profits.

GBPUSD breaks 200-day MA

Source: Bloomberg

GBPUSD climbed by 4.68% since the start of the month, rising from 1.2290 to 1.2865. The price had reached as high as 1.3013 on October 21st before paring some of these gains. This move has taken the price above many key levels. The formerly resistive 50% one-year Fibonacci retracement (1.2670) has been broken and is now providing support for the cross. Furthermore, technical analysis of the weekly candle chart shows that the 50-week moving average (1.2733) and the 61.8% one-year Fibonacci retracement (1.2838) have been broken for the first time since May 2019. Most importantly though, the price was able to break above the 200-day moving average (1.2715). While the price stays above this level, further gains seem to be the path of least resistance. We have revised our GBP forecasts to reflect the probability that Brexit will be resolved early next year, giving rise to a sharp improvement back towards pre-2016 referendum levels.

INR immune to slowdown

The INR has been largely immune to signs of protracted economic slowdown in India. Over the last one month it has remained largely flat to contain its year-to-date losses to -1.7%. On a ytd basis, the movements are broadly in line with that of broader emerging market currencies. The JP Morgan EM Currency index has dropped -2.1% ytd.

The reason behind the moves are more global in nature than domestic. The weakness in oil prices has helped ease fears of a blow-out in fiscal and current account deficits. Along with that, the easing of rhetoric on the trade front has renewed risk appetite in emerging market assets as has the firm tilt dovish tilt in developed market monetary policy. One trend which has been evident over the past quarter has been the positive correlation between the CNY and INR. In the last three months, the CNY has depreciated -2.7% compared to -2.9% move in the INR.

Looking forward, we believe that most of positive strands have been accounted for and hence the outlook heading into the year-end is fraught with greater volatility. More so considering that greater detail would emerge over the extent of fiscal slippage and whether growth has bottomed out or not. We expect the INR to end 2019 at 72.0.

As we go to print, the NZD is trading at 0.6296, not far from the 2019 lows 0.6255 seen in the last week. With the OIS currently implying a 78.6% chance of further cuts this year, the price may decline towards new 2019 lows in the medium term.

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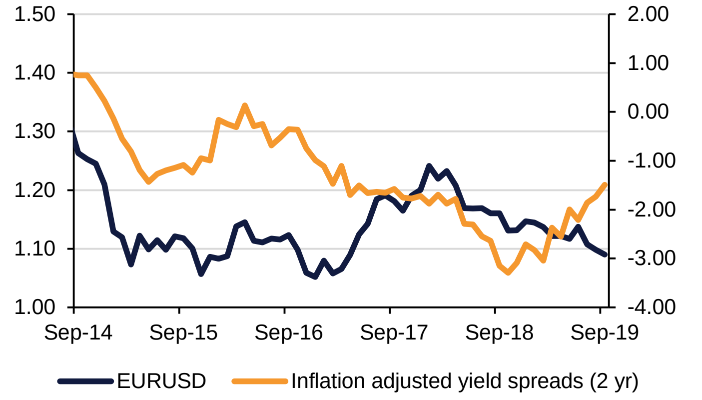
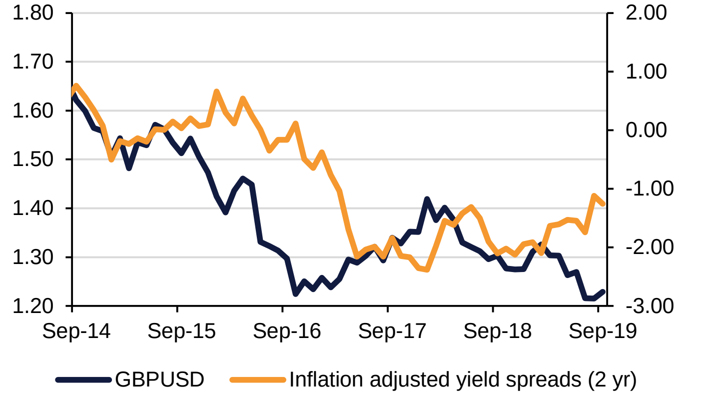
FX–Major Currency Pairs & Real Interest Rates

Interest Rate Differentials–EUR



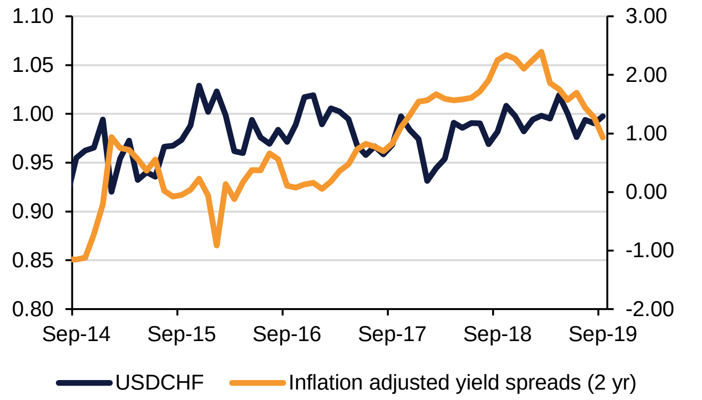
Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-GBP



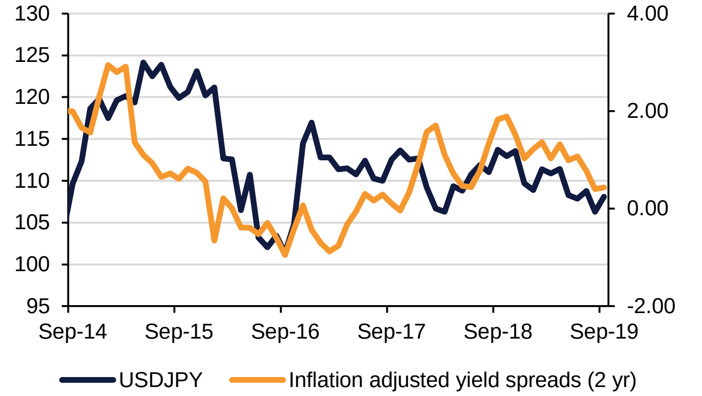
Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-CHF



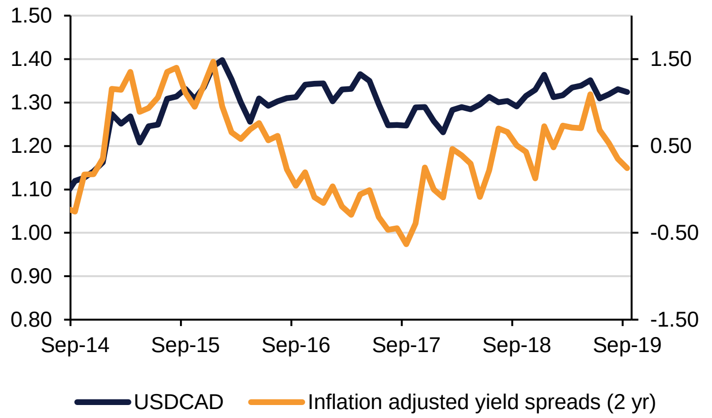
Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-JPY



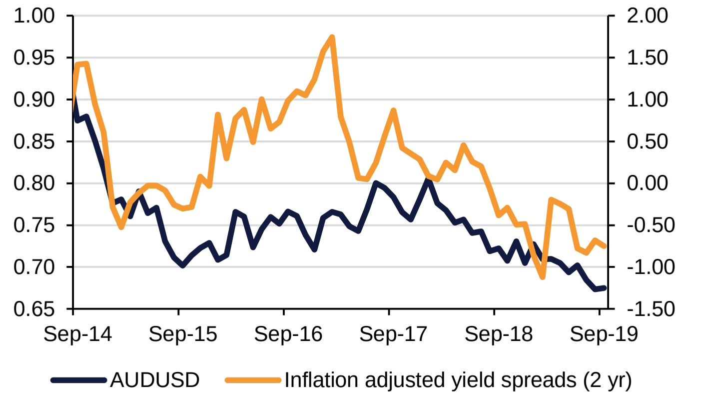
Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-CAD



Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-AUD



Source: Bloomberg, Emirates NBD Research

FX Forecasts

FX Forecasts - Major						Forwards		
	23-Oct	Q4 2019	Q1 2020	Q2 2020	Q3 2020	3m	6m	12m
EUR/USD	1.1125	1.1000	1.1200	1.1500	1.1800	1.1205	1.1268	1.1390
USD/JPY	108.49	110.00	110.00	108.00	107.00	108.00	107.43	106.32
USD/CHF	0.9895	0.9700	0.9500	0.9400	0.9300	0.9830	0.9767	0.9647
GBP/USD	1.2872	1.2700	1.3300	1.3600	1.4000	1.2954	1.2984	1.3037
AUD/USD	0.6855	0.7000	0.7100	0.7200	0.7300	0.6870	0.6884	0.6908
NZD/USD	0.6405	0.6300	0.6500	0.6600	0.6700	0.6436	0.6446	0.6462
USD/CAD	1.3095	1.2800	1.2600	1.2400	1.2400	1.3062	1.3064	1.3074
EUR/GBP	0.8643	0.8661	0.8421	0.8456	0.8429	0.8650	0.8678	0.8737
EUR/JPY	120.69	121.00	123.20	124.20	126.26	120.98	120.98	120.98
EUR/CHF	1.1009	1.0670	1.0640	1.0810	1.0974	1.1014	1.1004	1.0986

FX Forecasts - Emerging						Forwards		
	23-Oct	Q4 2019	Q1 2020	Q2 2020	Q3 2020	3m	6m	12m
USD/SAR*	3.7506	3.7500	3.7500	3.7500	3.7500	3.7504	3.7508	3.7539
USD/AED*	3.6728	3.6730	3.6730	3.6730	3.6730	3.6740	3.6754	3.6781
USD/KWD	0.3035	0.3020	0.3020	0.3020	0.3020	0.3040	0.3046	--
USD/OMR*	0.3848	0.3850	0.3850	0.3850	0.3850	0.3854	0.3860	0.3880
USD/BHD*	0.3770	0.3770	0.3770	0.3770	0.3770	0.3761	0.3761	0.3779
USD/QAR*	3.6619	3.6400	3.6400	3.6400	3.6400	3.6605	3.6570	3.6510
USD/EGP	16.1975	16.0000	15.7500	15.7500	15.500	16.5350	16.9350	17.8300
USD/INR	70.940	72.000	71.000	70.000	68.000	71.7200	72.5500	74.1000
USD/CNY	7.0769	7.1000	7.2000	7.2000	7.2000	7.0862	7.1045	7.1395
USD/SGD	1.3627	1.3000	1.2900	1.2900	1.2900	1.3619	1.3606	1.3591

FX Forecasts - MENA					
	23-Oct	Q4 2019	Q1 2020	Q2 2020	Q3 2020
USD/MAD	9.6154	9.7000	9.8500	9.9000	9.9000
USD/TND	2.8305	2.8500	2.8500	2.9000	2.9000
USD/TRY	5.8089	5.8000	6.1000	6.2000	6.2000

Data as of 23 October 2019
Source: Bloomberg, Emirates NBD Research

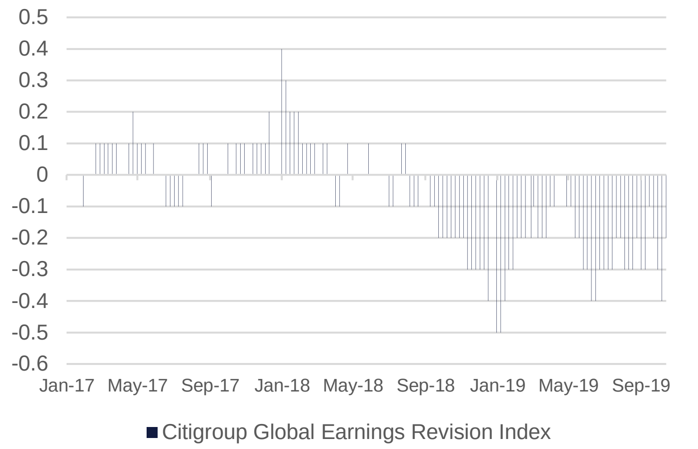
Equities

At the start of Q4 2019, equities appear to be caught in a tug-of-war between easing geopolitical risks (US-China trade and over Brexit) and firm signs of an impending global economic slowdown (European recession, US manufacturing). The counterbalancing factors, so far, has allowed major equity indices to hold their ground and trade near all-time highs. With central banks across economies proactively trying to sustain and/or chase economic expansion, the current strength in equities may have more legs than earlier anticipated.

Overall, the MSCI All Country index gained +0.4% 1m to take their year to date gains to +15.8%. Gains were primarily driven by emerging and frontier market equities as a probable resolutions of key issues lowered risk premium for riskier assets. The MSCI Emerging Markets index and the MSCI Frontier Markets index gained +1.3% 1m and +1.9% 1m respectively. Within developed markets, an interesting trend is developing over the last three months wherein European equities are outperforming US equities. The Euro Stoxx 600 index has rallied +1.1% 1m and +0.7% 3m relative to +0.1% 1m and -0.3% 3m move in the S&P 500 index. However, on a ytd basis, the S&P 500 index has rallied +19.5% compared to +16.7% gain in the Euro Stoxx 600 index. The recent outperformance can be potentially putdown to the fact that European equities were under-owned for better part of last twelve months. Within the MENA region, Egyptian equities outperformed as political protests were contained at a very early stage. The EGX 30 index added +2.5% 1m. Elsewhere, the region the focus remained on the potential IPO of Saudi Aramco and probable impact on liquidity and flows should the transaction be completed and listed on the Tadawul.

One pillar of support for global equities has been a resilient start to Q3 2019 corporate earnings. So far 15% of companies in the S&P 500 index have reported earnings. According to FactSet, 84% of those companies have reported a positive earnings surprise and 64% have reported a positive revenue surprise. The blended earnings growth for Q3 2019 is -4.7% relative to expectations of -4.0% at the end of Q3 2019. In Europe, 33 companies in the Euro Stoxx 600 index have reported earnings so far and 64% of those companies have reported a positive earnings surprise and 56% have reported a positive revenue surprise. The blended earnings growth for Q3 2019 is -5.3% decline in earnings. However, more importantly earnings forecasts for global equities have been downgraded by 0.6% over the last month and that could potentially weigh on investor sentiment as we move deeper into the earnings season.

Earnings revised lower



Source: Bloomberg

With a resolution to trade tensions between the US and China on the horizon, it is probable that positive sentiment over the issue gives way to more pressing worries over strength of global economy in the final months of this year. While equities are taking comfort from the return of a 'central bank put', it does appear that they are too optimistic with regards to their expectations from monetary policies. However, the chances of a disappointment in the short-term remain remote and could well be more of an issue for 2020. Having said that, the failure of the US and China in closing out the deal or a deeper than anticipated slowdown in economic activity could still upend risk appetite.

Bull-run age check

The current bull-run in equities is considered by some parameters as the longest in the history. In some markets it has lasted for more than a decade. Inevitably, the length raises the question over its longevity. We look at some of many factors considered to gauge how far it can run.

Market breadth

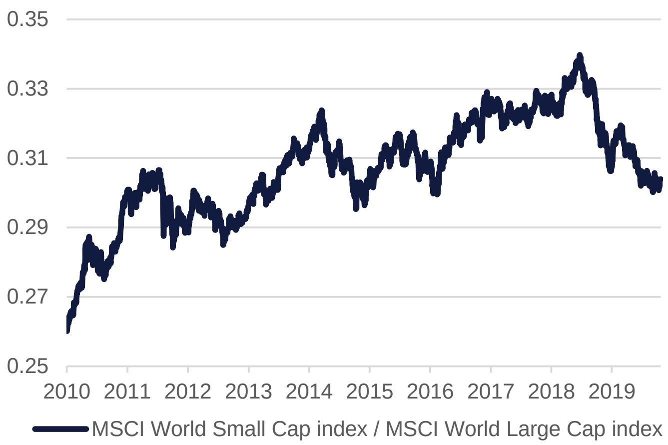
The market breadth in literal terms shows the ratio of total number of stocks rising to a total number stocks falling, a simple but effective indicator of the spread of strength in markets. As a general rule, the early and late cycle bull-run is marked by a narrower market breadth.

At the start of Q4 2019, equities appear to be caught in a tug-of-war between easing geopolitical rhetoric and firm signs of an impending global economic slowdown

More so at the latter stages as investors become wary of riskier assets. Another way of looking at market breadth includes performance of various sectors and the difference in performance between large cap and small cap stocks.

For example, the total return breakdown of the S&P 500 index indicates that fewer sectors are now driving gains on the broader index compared to returns from the start of the year. The year to date return from the S&P 500 index saw all sectors clocking positive returns with seven out of 10 sectors giving returns within a narrow range of each other. However, over the past three months returns have been driven by only two out of 10 sectors with five sectors giving negative returns. A similar trend is observed with the Euro Stoxx 600 index.

Large caps outperforming small caps



Source: Bloomberg

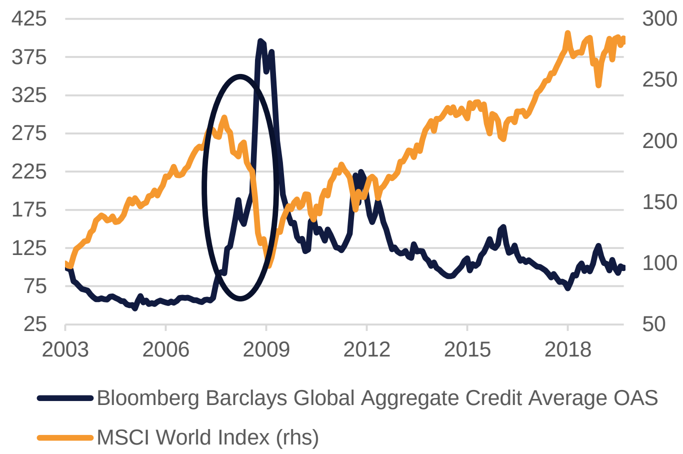
Similarly, the outperformance of large cap stocks relative to that of small cap stocks indicates a late stage of the bull-run. This is because of the presumption that small cap stocks have limited ability to withstand turns in economic cycles compared to that of large-cap stocks. The ratio of the MSCI World small cap index to the MSCI World large cap index has dropped to 0.30 from the highs of 0.34 seen in the middle of 2018.

Credit spreads

Generally, credit spreads are considered as an early-warning indicator of equity market performance wherein a widening of credit spreads forewarns a bear market and a tightening suggests continuation of the broader rally. It should also be noted that a short-term spike in credit spreads owing to various factors does not necessarily warrant caution as much as a sustained rise. For example, credit spreads started widening as much as 15 months before the stock market peak in 2007.

Even during the current bull-run we have had episodic increases in credit spreads, such as in October 2018, which have broadly resulted in pullbacks rather than deeper corrections. Though it is comforting to note that credit spreads have largely remained within a tight range so far, it could also be a function of global central banks tilting sharply towards easy monetary policy at the start of 2019. Further, there are levels generally considered to be a tipping point in spreads and/or yields. In the current environment, most market participants argue that 1.50% yield on 10y USTs could be that level as it was not breached in 2012 or 2016 when fears over economic weakness were at its peak.

Credit Spreads as a leading indicator



Source: Bloomberg

There have been counter-arguments that credit spreads may not necessarily be as reliable as in the past given the unorthodox tools in the current monetary policy framework of various central banks. However, the evidence during 2017-2018 when divergence in credit spread between the US and Eurozone was also accompanied by relative underperformance of Eurozone equities to US equities suggest that it still remains an important indicator.

IPOs

According to data from Ernst & Young, global IPO activity slowed in Q3 2019. As many as 256 companies raised USD 40.2bn which marked a decline of 24% y/y in terms of volume and 22% y/y in terms of proceeds. The trend is similar in the first nine months of 2019 where IPO volumes dropped 26% y/y and money raised by 25% y/y. Based on year-to date proceeds, the EMEA region saw a decline of 41% y/y, Asia Pacific 27% and the Americas 10%.

Generally, the IPO activity is a lagging indicator of broad equity performance as promoters and/or founders prefer to cash in when the sentiment is at its strongest. Based on that assumption, the IPOs in 2019 should have increased considering that major indices have delivered double digit returns and are trading near to all-time highs. It does appear that pockets of geopolitical tensions through 2019 has weighed on new issues as has investors wariness on valuations amid broad views over the length of this bull-run. It is also likely that the underperformance of new issuances, with the exception of those in Asia Pacific, could have also played a part. For example, in the Americas IPOs have returned +13.9% since listing compared to +21.0% rally in the S&P 500 index (as of 30 September 2019).

Overall, a euphoric IPO market is seen to mark the near-peak of the rally. However, a weak IPO market so far in 2019 despite resilient strength in returns from broader equity indices suggest that perhaps we have not seen the peak yet. Alternatively, it may also be suggesting that the peak is behind us and that investors are becoming increasingly risk-averse.

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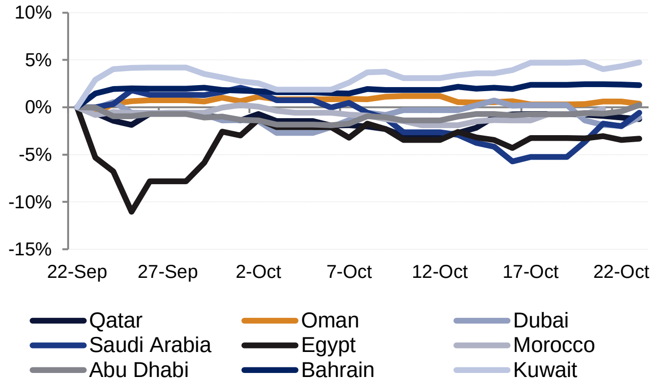
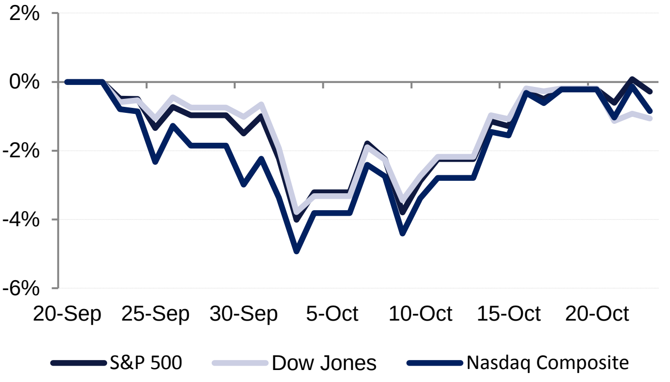
Major Equity Markets

MENA Equity Markets



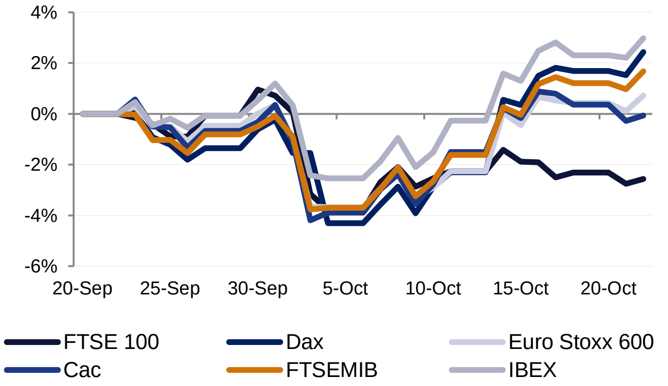
Source: Bloomberg, Emirates NBD Research

US Equity Markets



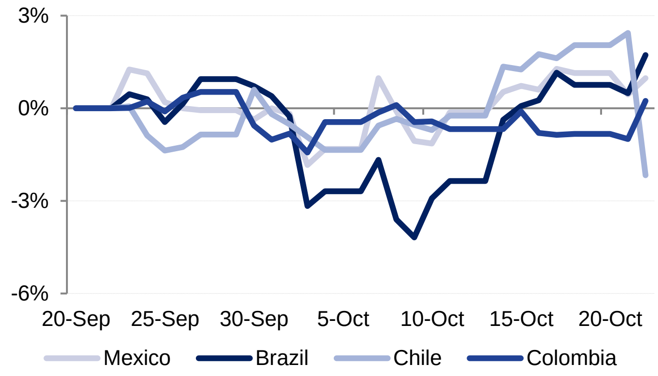
Source: Bloomberg, Emirates NBD Research

European Equity Markets



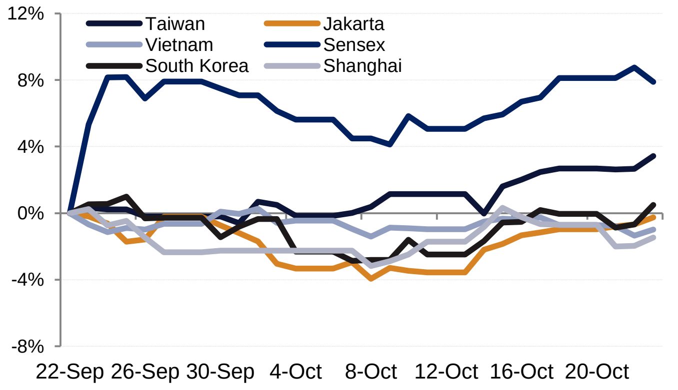
Source: Bloomberg, Emirates NBD Research

Latin American Equity Markets



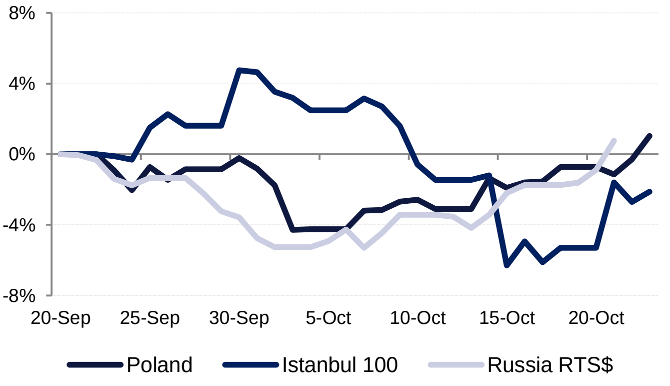
Source: Bloomberg, Emirates NBD Research

Asian Emerging Equity Markets



Source: Bloomberg, Emirates NBD Research

Emerging Europe Equity Markets

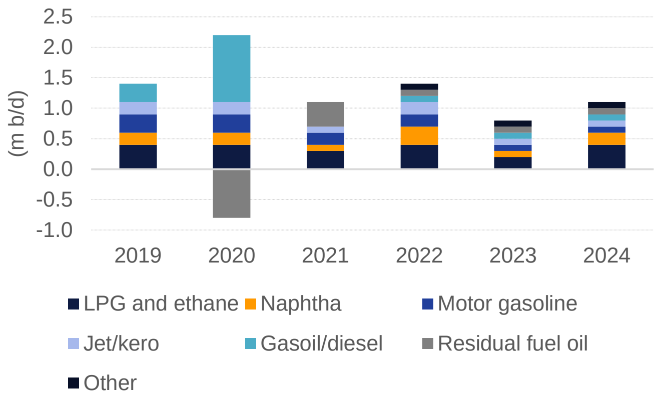


Source: Bloomberg, Emirates NBD Research

Commodities

Oil markets will go through an enormous transformation from January 1, 2020 as new regulations covering the sulphur content of marine fuels take effect. The IMO 2020 rules have been estimated to affect as much as 3.5m b/d of demand for high sulphur fuel oil, the shipping industry's traditional fuel. Substantial industry attention has focused on how refiners, traders, ports and the shipping industry will adjust but the sulphur content of refined fuels is largely a function of the content in the original crude oil. For a region that produces a relatively sour barrel the Middle East could face changes in the demand profile for its crude exports post 2020.

Fuel oil demand to collapse in 2020



Source: IEA, Emirates NBD Research.

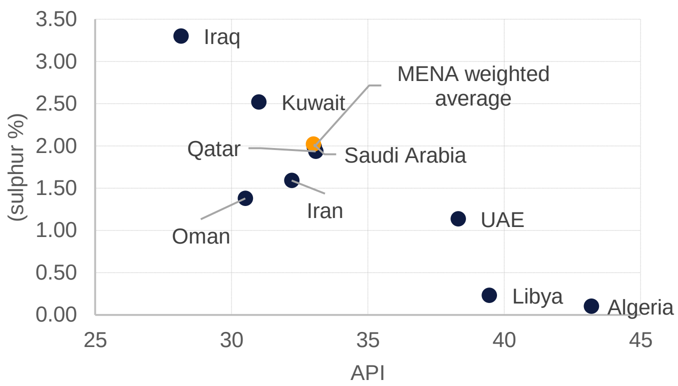
As of January 2020, ship operators will only be able to use fuel that has less than 0.5% sulphur by mass as per regulations from the International Maritime Organization, a UN agency. Getting fuel down to this sulphur spec can be achieved in several ways. One is to run a low sulphur fuel oil (LSFO), although consistent availability across ports is an uncertainty. A second is to directly use marine gasoil, a lighter (lower viscosity) grade of fuel that will pull diesel out of availability for trucking and other industrial uses. Shippers can continue to run high sulphur fuels (HSFO) if they install scrubbers, a device which removes sulphur from ship emissions but incurs high capital costs and time out of service while the scrubbers are installed. Finally, shipping companies could switch to using LNG as a marine fuel in engines. Of all the options available, using lower sulphur fuels—whether gasoil or LSFO—appear to be the choice most refiners and shippers are turning toward.

With a market that will be moving toward lighter and sweeter (lower sulphur content) fuels, refineries will be increasingly stratified with respect to what kind of grades of crude they can run. Lower complexity refineries that don't possess upgrading facilities that can process fuel oil into lighter, sweeter—and higher value-added—products will place a premium on light, sweet crudes. These crudes generally yield more gasoil and light ends relative to residual products like fuel oil. Hence there has been a persistent premium for light sweet and medium sweet crudes this year: Tapis, a Malaysian grade had a peak premium of USD 8/b over Brent, given its very low sulphur content (0.04%) and relatively large share of gasoil yield (47%). Meanwhile, Mars Blend, a medium sour grade from the US has seen its value over benchmark WTI consistently decline throughout the year, moving from more than USD 8/b in Q1 to just USD 1/b over WTI currently.

MENA crude generally high in sulphur

Crude oil exported from the Middle East and North Africa is generally of medium to heavy gravity and sour, although there is a wide variation by country. North Africa—Libya and Algeria—produces crudes that are light, nearing on condensates, and with relatively low levels of sulphur. Both producers would be well suited to meet higher marginal demand from refiners to accommodate fuel switching although production levels are impacted by political developments in both countries. In the GCC, however, most crudes are classified as sour and yield a relatively larger share of fuel oil, precisely the opposite of what markets will be looking for as baseload crudes to meet IMO rules. On a weighted average production basis, the UAE's main grades come in at an API of 38 and sulphur content of 1.1%. For export markets, the UAE's crude quality is likely to become lighter as Murban (39.7, 0.8% sulphur) takes up more of the share of exported barrels as grades such as Upper Zakum (33.9, 1.8% sulphur) are fed into an upgraded and expanded refinery at Ruwais.

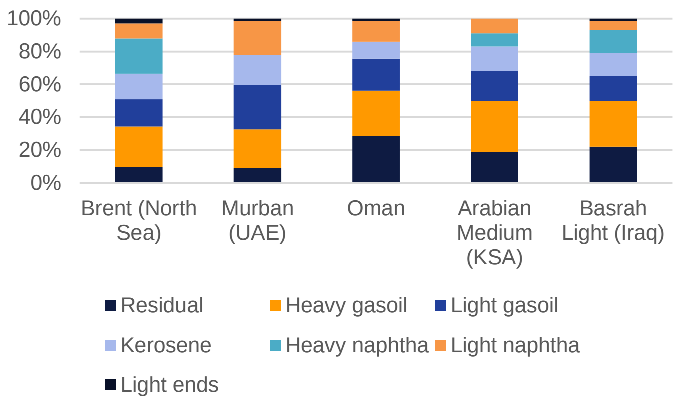
MENA crudes are sour and medium/heavy



Source: BP, Exxon, Equinor, Emirates NBD Research.

As MENA grades are on average heavier and sour, their long-term demand will be a function of the appetite of highly complex refineries, mainly located in Asian markets. Most of the world's hydrocracking (breaking heavier products such as fuel oil into middle distillates like gasoil) or desulphurization capacity additions will be taking place in Asia and the Middle East, locking Middle East exporters further into their dependency on Asian oil demand trends. China in particular is seeing a significant shift away from 'industrial' fuels like gasoil or fuel oil and increasingly toward more 'consumer' oriented products such as jet, gasoline and petrochemical feedstocks. Crude grades that yield relatively more of these lighter components are likely to be the main beneficiary of sustained oil demand in China. Of note among MENA grades is Murban, one of the UAE's flagship grades, which has a relatively large share of lighter products with comparatively lower yield of residuals (such as fuel oil).

Refinery yield by crude



Source: BP, Exxon, Equinor, Emirates NBD Research.

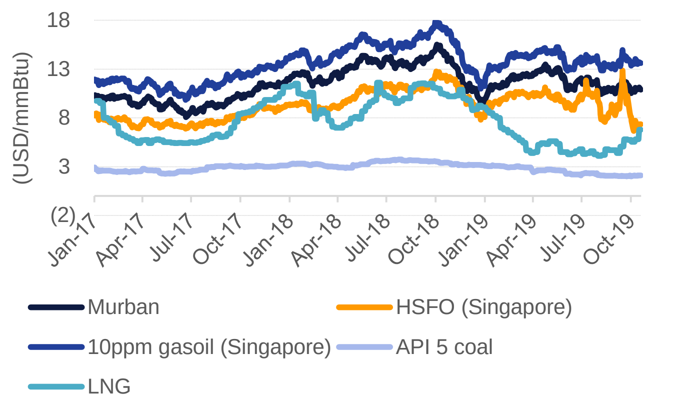
Dubai crude prices impacted by OPEC cuts

Dubai crude prices, as a benchmark for medium/heavy, sour barrels have traditionally priced at a discount to Brent given it yields relatively more lower value products such as fuel oil. In a context of tightening emission standards and waning demand for HSFO, markets would be expecting to price crudes which yield a relatively higher amount of sour fuel oil at a widening discount. However, with most of the crude in the Middle East impacted by OPEC production decisions, 2019 has actually seen the opposite. The discount for Dubai against Brent narrowed significantly in Q1 and actually traded at times at a premium as the market grew exceptionally short on heavy, sour barrels as OPEC+ cuts and sanctions on Iran and Venezuela tightened the market. Even as the deadline for IMO 2020 has neared, the value for Dubai has held up, trading at a discount of only around USD 1/b in mid-October.

With little apparent change in OPEC production policies expected in 2020, the tightness of the medium/heavy sour market will persist and likely help to keep discounts for high sulphur crudes contained. Additionally, substantial investments into refineries across the UAE and Saudi Arabia in recent years should help to minimize the impact of the fuel specification change. Regional refineries are optimized to produce substantial volumes of gasoil/diesel as their economic rationale focused on meeting Asian demand. However, a declining share of gasoil in the Asian demand mix, and substantial investment in Chinese refineries, has limited flows of middle distillates from the Middle East to Asia, particularly to China. A change to greater use of gasoil in marine applications could help to soak up some of this excess gasoil supply from Middle East producers.

But some HSFO will still be produced by refineries running MENA crude even though it will have limited demand. One destination for the 'unwanted' HSFO may be into power generation: fuel oil has a higher specific energy than coal and emits lower levels of carbon (675g C02/kWh compared with 870g CO_2/kWh for bituminous coal). On an USD/mmBtu basis, HSFO remains substantially more expensive than coal and diversion into power generation would mean prices correcting downward by as much as USD 5.25/mmBtu (around USD 85/tonne) from current prices. Moreover, fuel oil power generation is limited, accounting for just over 3% of total electricity generation in 2018. Faced with a relatively narrow market then on which to offload the HSFO, refiners and traders may react by discounting HSFO-rich crudes.

Scope for HSFO to correct lower



Source: EIKON, Platts, Emirates NBD Research.

The full impact of IMO 2020 on Middle East exporters will be clouded so long as OPEC production cuts remain in place. However, emission and fuel quality standards around the world are only moving in one direction: greener not browner. China, for example, has introduced rules requiring sulphur content of just 0.1% in its inland waters for freight ships, bringing it in line with standards in Europe and North America. MENA exporters of sour crude grades will need to maintain their investment in upgrading refineries or targeting export markets capable of processing their crude in order to remain competitive in a post IMO world.

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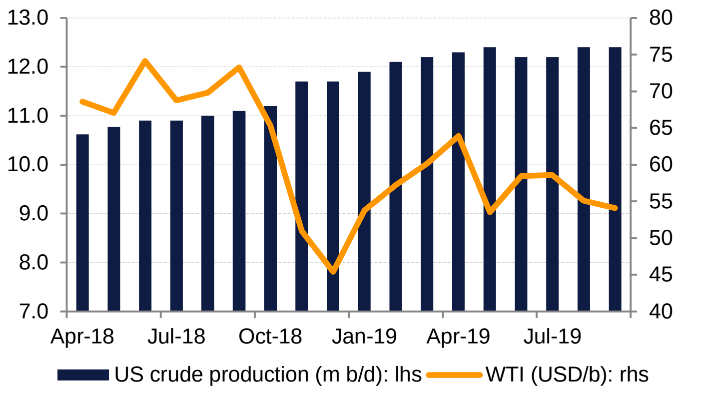
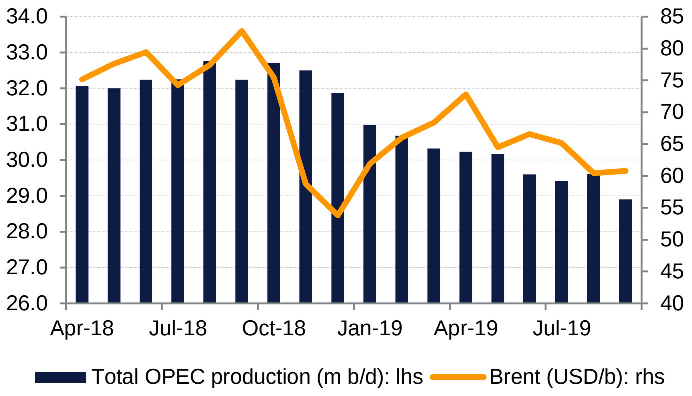
Major Commodities Markets

US oil production and price



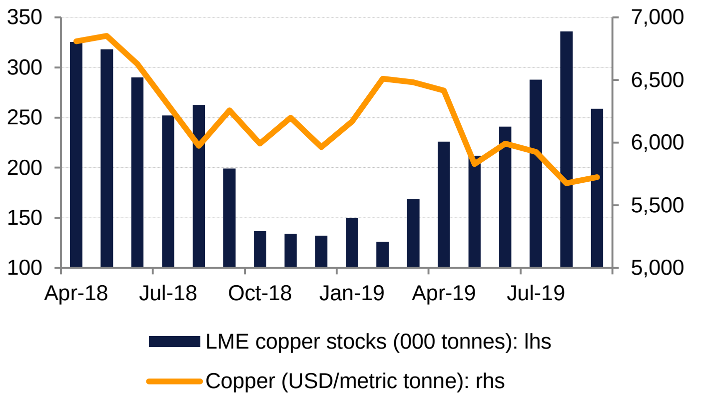
Source: EIKON, Emirates NBD Research

International oil production and price



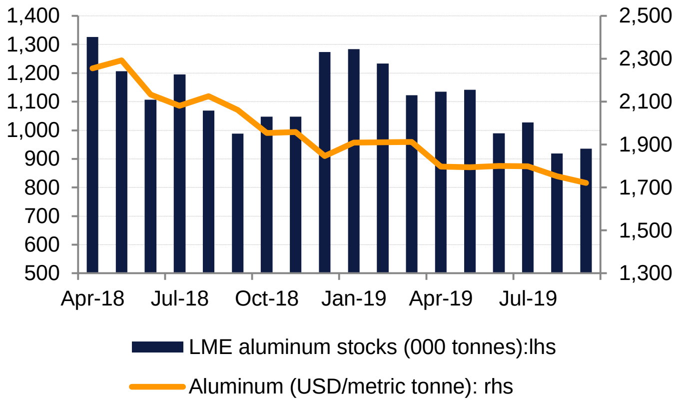
Source: EIKON, Emirates NBD Research

Copper stocks and price



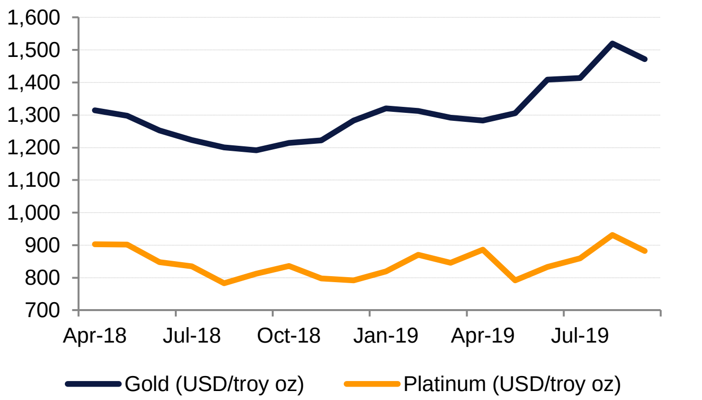
Source: EIKON, Emirates NBD Research

Aluminum stocks and price



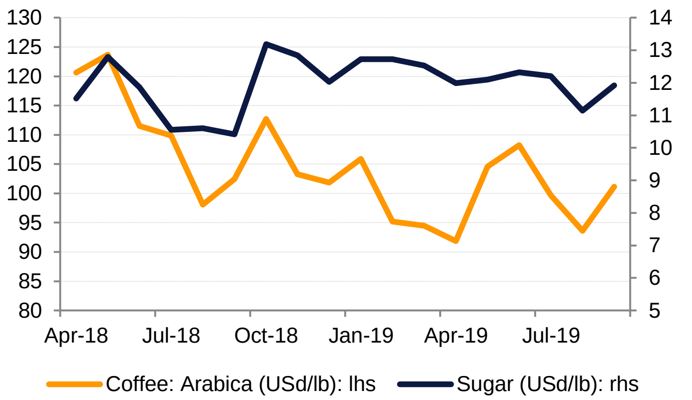
Source: EIKON, Emirates NBD Research

Precious metals prices



Source: EIKON, Emirates NBD Research

Agriculture prices



Source: EIKON, Emirates NBD Research

Commodity Forecasts

Global commodity prices							
	Last	2019Q4	2020Q1	Q2	Q3	2019	2020
Energy							
WTI	55.51	60.00	58.50	56.00	57.50	57.81	56.50
Brent	60.84	63.00	63.00	60.00	58.00	64.33	59.63
Precious metals							
Gold	1,492.32	1,450.00	1,450.00	1,475.00	1,450.00	1,384.00	1,456.25
Silver	17.56	17.00	16.50	16.00	15.50	16.11	15.75
Platinum	918.13	950.00	1,000.00	900.00	950.00	872.59	956.25
Palladium	1,752.62	1,450.00	1,400.00	1,400.00	1,375.00	1,450.25	1,387.50
Base metals							
Aluminum	1,728.00	1,775.00	1,800.00	1,850.00	1,900.00	1,816.95	1,875.00
Copper	5,875.00	6,000.00	6,250.00	6,500.00	6,500.00	6,044.30	6,500.00
Lead	2,221.50	2,084.79	2,161.23	2,237.31	2,237.31	2,014.47	2,237.22
Nickel	16,750.00	17,500.00	17,500.00	16,000.00	15,000.00	14,457.82	15,750.00
Tin	16,745.00	17,000.00	16,500.00	16,500.00	17,750.00	18,688.90	17,187.50
Zinc	2,477.50	2,405.13	2,488.31	2,570.92	2,570.92	2,520.74	2,570.78
Iron ore	90.45	90.00	90.00	85.00	75.00	93.32	80.00

Prices as of 24 October 2019. Note: prices are average of time period unless indicated otherwise.
Source: EIKON, Emirates NBD Research

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