Weekly Market Summary

26th of May 2017

Is the Fed's June Rate Hike a Done Deal ?! Only Trump, Comey and Jared Kushner Could Provide That Confirmation Next Week!

Fadi Nasser - Head of Treasury Sales

As the auspicious month of Ramadan will soon start, I also wish our valuable readers peace, serenity and utmost happiness!! Ramadan Kareem and "Kul 3Am Wa Entom Bi-Khair"!

June is set to be a very busy month despite little price movements in past days. The last 48 hours did witness an important meeting and key central bank minutes, though investors – let down by lack of surprises from OPEC's decision and the US FOMC May 3th discussions – have fast turned their attention to the latest breaking news in the Trump Russia inquiry, as well as renewed US-Chinese tensions in the South China sea.

To start with yesterday's meeting, the world's largest oil producers agreed – as widely expected - to hold back oil production for another nine months (*the initial deal had been hammered out last November*) – with members of the Organization of Petroleum Exporting Countries (OPEC) pledging to cuts 1.8 million barrels of oil a day until March 2018. The meeting was held at OPEC's headquarters in Vienna between members of the cartel and non-OPEC producers including Russia. Saudi Arabia's oil minister Khalid al Falih said the goal of rebalancing the market's supply with demand was already in hand. "*In the absence of that agreement the market would have been aimless*," he said in reference to the original November deal. Falih also predicted that the market would make "*a full recovery*", but that more time was needed. Analysts at Wood MacKenzie said OPEC would in the future face "*a tricky balancing act*" over how best to reintroduce higher output while avoiding more oversupply, which would bring a sharp fall in oil price. The oil consultancy said a nine-month extension would have little impact on its price forecast of a US$ 55 a barrel for the rest of 2017.

After all, the deal to maintain the cut another nine months will expire in March 2018 with a return to OPEC's pump-at-will policy that prevailed between 2014 and 2016 and pushed prices below US$ 30 a barrel; Or the organization could keep adjusting production. "*What concerns me is that there is no clear messaging around the exit strategy*," Ebele Kemery, head of energy investing at JPMorgan Asset Management, told Bloomberg TV. "*The way we look at the market going forward, there is going to be oversupply in 2018. They are talking about price stability. To get price stability we need to know what the end-game is*." Kemery's concern over a lack of strategy appeared to be widespread and shared by commodity traders: Brent crude fell 5% yesterday - the most in three weeks - to US$ 51.24 a barrel on the decision, and the price slide continued initially overnight with Brent falling for a time to below US$ 51 per barrel and July WTI to US$ 48.20 per barrel before a slight recovery and stabilization in prices in past hours. Still, the extension to March prolongs a rare period of collaboration between the Organization of Petroleum Exporting Countries and some of its biggest rivals. The last time both sides worked together was 15 years ago. Back then, the agreement fell apart soon after it was made. Alexander Novak, Russia's energy minister, said the relationship between OPEC and non-members of the cartel was at a "*pivotal moment*.'' Both Saudi Arabia and Russia also confirmed after the meeting that they could take further action if the market situation warranted. Novak told Bloomberg TV that the cuts could be increased or reduced if the market needed. Al-Falih reiterated his promise do "*whatever is necessary*", including potentially extending the cuts beyond March 2018. "*We'll cross that bridge when we get to it*," he said. If Al-Falih's optimistic outlook is correct, OPEC may not need a clear exit strategy after all!

Moving to the US, most Federal Reserve officials judged "*it would soon be appropriate*" to tighten monetary policy again and backed a plan that would gradually shrink their US$ 4.5 trillion balance sheet. "*Most participants judged that if economic information came in about in line with their expectations it would soon be appropriate for the committee to take another step in removing some policy accommodation*," according to minutes from the Federal Open Market Committee's May 2-3rd gathering released last Wednesday.

The statement points toward a hike as soon as the Fed's meeting on June 14th (markets currently assign an 85% probability for such outcome), though FOMC voters added the caveat that "*it would be prudent*" to wait for evidence that a recent slowdown in economic activity had been transitory. As a reminder, The Fed left the target range for their benchmark lending rate unchanged at 0.75% to 1% in May, and kept their projected three rate increases in 2017, including the hike they made in March. Policy makers also added that they would like to start shrinking their bloated balance sheet by year-end, a move that may lift longer-term borrowing costs and dampen growth. At the May meeting, nearly all officials "*expressed a favourable view*" of a staff-presented general approach to shrinking the balance sheet that would involve gradually increasing run-off caps (i.e. a cap on the size of maturing bonds that would be sold each month) every three months. The caps would eventually reach fully phased-in levels, which would then be held in place until the size of the balance sheet is normalized. Policy makers agreed that they should provide additional details of the plan "*soon*" and nearly all said it would be appropriate to start the process later this year, provided their expected path for rate hikes stays on track. Market reaction was muted, with the US Dollar weakening slightly against peer currencies and US 10-year benchmark rates dropping by 2-3 basis points (last EUR/USD @ 1.1214 and UST 10-year yield at 2.24%).

Last, but surely not least, a look at two significant developing stories that will surely continue making the headlines in coming days/weeks:

- **South China Sea Tensions**: China's government warned a U.S. warship to leave waters around a reef it claims in the South China Sea, saying the vessel was invading its territory and undermining security in the region. The U.S. warship entered waters adjacent to the Spratly islands, an area where China has "*indisputable sovereignty*," defence ministry spokesman Ren Guoqiang said at a briefing in Beijing on Thursday. China "*identified, tracked, verified and warned off the ship*." The so-called freedom of navigation operation in the South China Sea was the first under President Donald Trump. The guided-missile destroyer USS Dewey made the patrol on Wednesday near Mischief Reef, where China has built an artificial outpost equipped with an airfield, the Wall Street Journal reported. China claims most of the South China Sea, one of the world's busiest shipping routes. In recent years it has increased its military presence in the waters by reclaiming thousands of acres of land to build artificial outposts on reefs. "*The Chinese military is resolutely opposed to U.S. behaviour which boosts regional militarization and makes accidents more likely*," Ren said. Earlier this week, Moody's Investors Service surprisingly decided to cut its rating on China's debt for the first time in almost three decades, although stocks, bonds and the currency remained little changed (surely helped by government intervention). The Moody's downgrade to A1 from Aa3 comes at an awkward time for China's authorities, who called the cut "*absolutely groundless*." A campaign to reduce risk in the financial sector had caused local investors to desert the equity and bond markets, while traders have been pushing back against the central bank's efforts to shore up the currency. Moody's justified its latest move by citing the likelihood of a "*material rise*" in economy-wide debt and the burden that it will place on the state's finances.

- **Trump, Comey and Jared Kushner**: A Trump-free week has reminded Washington of calmer times, but the president's problems will surely be waiting for him as soon as he returns back home. Former FBI Director James Comey has agreed to testify in open session before the Senate Intelligence Committee about the bureau's probe into Russian meddling with the 2016 U.S. election, and that is expected to intensify Donald Trump's troubles (not to mention other battles relating to his travel ban, health care bill and budget cuts!). The announcement late last Friday from committee Chairman Richard Burr, of North Carolina, and Vice Chairman Mark Warner, the Virginia Democrat, came hours after the Washington Post reported that the FBI's Russia investigation had identified a senior White House adviser close to the president as a significant person of interest.

And whilst the Post did not initially name the official, it has now been confirmed that this important individual is Jared Kushner, the president's son-in-law (best known in the GCC as Ivanka's lucky husband!) and one of his senior advisers. FBI investigators believe that Kushner has significant information relevant to their inquiry, though it does not mean yet they suspect him of a crime or intend to charge him. Kushner met at least once in December with the Russian ambassador, Sergey Kislyak, and he also met last year with a Russian banker, Sergey Gorkov. "*Mr. Kushner previously volunteered to share with Congress what he knows about these meetings,*" Kushner's lawyer, Jamie Gorelick, told NBC News. "*He will do the same if he is contacted in connection with any other inquiry*." Also last Friday, the New York Times reported that Trump had told top Russian diplomats who visited the Oval Office the previous week that firing Comey relieved "*great pressure*" on him. The report, which cited a U.S. official who has seen a document summarizing the meeting, said Trump also told the Russians the FBI director "*was crazy, a real nut job*." Comey - expected to testify after the May 29th Memorial Day holiday - is sure to face pointed questions from the Committee about whether Trump directly asked him to squash the Flynn investigation and whether he thinks he was fired for refusing. His answer to those questions will carry significant weight with lawmakers, who have already asked for copies of that memo. Fingers crossed; surely a hearing not to be missed!!

Disclaimer

It is important that you only use this report if you are the intended recipient of this report and you have satisfied yourself that you are eligible to receive such information. This report is provided to you because you are one of our esteemed customers and have previously shown interest in receiving the type of information contained in this report.

The Treasury and Investment Management department of Gulf International Bank B.S.C. ("GIB") have compiled the information in this report. GIB is incorporated in the Kingdom of Bahrain and is licensed by the Central Bank of Bahrain (the "CBB") as a conventional wholesale bank. GIB's head office is located at Al-Dowali Building, P.O. Box 1017, 3 Palace Avenue, Manama, Kingdom of Bahrain.

This report is intended for the accredited investors, as defined in the Investment Business Code of Conduct published by the CBB. This information has not been reviewed by the CBB or any other regulatory authority in any jurisdiction and neither CBB nor any other regulatory takes any responsibility for the correctness or accuracy for the information contained in this report.

The information contained herein is not directed at or intended for use by any person resident or located in any jurisdiction where (1) the distribution of such information is contrary to the laws of such jurisdiction or (2) such distribution is prohibited without obtaining the necessary licenses or authorizations by the relevant branch, subsidiary or affiliate office of GIB and such licenses or authorizations have not been obtained. The recipient of such information is responsible for ensuring that this information has not been received by it in breach of laws and regulations of any jurisdiction.

This report contains publicly available information only, which has only been complied by GIB. The information provided herein is on "as is" and "as available" basis and without representation or warranty of any kind. GIB hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall GIB or its subsidiaries, affiliates, shareholders or their directors, officers, employees, independent contractors, agents and representatives (collectively, "GIB Representatives") be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting there from, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of information or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of GIB or any GIB Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. The information here is, and must be construed solely as, compilation of information (unless expressly stated otherwise) and not statements of fact as to credit worthiness or recommendations or opinions of GIB.

This report does not provide individually tailored investment advice. Any materials contained herein have no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. The document is provided for information purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. GIB makes every effort to use reliable, comprehensive information, but we do not represent that it is accurate or complete. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the materials, nor are they a complete statement of the securities, markets or developments referred to herein. Recipients should not regard the materials as a substitute for the exercise of their own judgement. Any opinions are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of GIB as a result of using different assumptions and criteria. GIB is not under any obligation to update or keep current the information contained herein.

The value of, and income from, your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realised.

The information contained in this report is just for informational purposes. Information does not constitute a solicitation, an offer, or a recommendation to buy or sell any investment instruments, to effect any transactions, or to conclude any legal act of any kind whatsoever. GIB does not intend to provide investment, legal or tax advice through this report and does not represent that any securities or services discussed are suitable for any investor. When making a decision about your investments and business, you should seek the advice of professional advisors.

The report may contain statements that constitute "forward looking statements". While these forward looking statements may represent GIB's judgment and future expectations, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from GIB's expectations. GIB is under no obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise. The historical information is provided for information purposes only. Performance figures are calculated before tax (if any) and after deducting ongoing fees and expenses. The performance figures are historical and past performance is not necessarily an indication of future results. Certain amounts (including %ages) included in this document may have been subject to rounding adjustments. Accordingly, figures may not be an exact arithmetic aggregation of the figures to which they relate. The values and forecasts shown represent our current indicative valuations and forecasts of the relevant transactions, currencies, interest rates, commodities or securities as at the date shown. Any value or forecast shown herein is not an indicative price quotation. We expressly disclaim any responsibility for the accuracy of the values or forecasts shown, any errors or omissions in the report

With the exception of information regarding GIB and save as otherwise specifically indicated, the information set out in this report is based on public information. We have, where possible, indicated the primary source of information. We strongly recommend the recipients consult the primary source of information. Facts and views in this report have not been reviewed by, and may not reflect information known to, professionals in other GIB business areas.

This Report, and the information contained herein (save to the extent that such information is publicly available) is confidential and may not be disclosed by you to any other person outside of your organization without our consent.