Weekly Market Summary

30th of December 2016

2016 Coming to an End .... The Year of Shocking Surprises !!
Fadi Nasser - Head of Treasury Sales

Merry Xmas & Happy New Year to all our valuable clients!

When history looks back at 2016, a couple of words will stick out most prominently: Trump, Brexit and Surprise!

Donald Trump, real estate mogul and reality TV star, surprised everyone - reportedly even himself - by winning the 2016 US presidential elections after polls and experts tipped Hillary Clinton for the job. But even before that, there were other "*I-don't-believe-this*" moments over the past 12 months, all the way through to this week (and December is not finished yet). Most significant would be the UK vote - on June 23rd – to quit the European Union after more than four decades, in a stunning rejection of the continent's postwar political and economic order (repercussions to be felt next year when Article 50 is triggered).

Still, markets learned to get over things fast and pretty much kept rolling! Faced with anemic global growth, terror attacks, humanitarian crisis and natural disasters, they barely blinked an eye. Surely Brexit surprised everyone, and market panic ensued – though for about few days only. A week after the vote, markets, even in the U.K., had recovered lost ground, and then some. Donald Trump's surprise presidential win last month was much the same story, only in a highly compressed time frame. The Trump-inspired losses, which some market watchers had predicted would be in the double-digit percentages and long lasting, all occurred before US markets opened on November 9th and were rapidly reversed.

Maybe algorithmic trading has made markets that much more efficient. Maybe investors are getting better at spying opportunities in crisis (the rise of financials in the wake of Trump's victory might be an example). Maybe they have just become so accustomed to central banks' support and bull equity runs (now more than seven years old) that they just do not believe anything can go that wrong! Or maybe traders have come to the conclusion that "*nobody knows anything*" and therefore one is always better off "*selling the rumor and buying the fact*"! But buoyant sentiment to my mind is most likely leading many in the market place to a false conclusion - that surprises don't really matter - and as such leaving them exposed to unpleased shocks if and when undesirable outcomes materialize (that is in large contrast to the early 2016 period, when investors were seeing nothing but bad times ahead).

As we head into 2017, I would also caution our valuable clients against holding mainstream views on financial markets (such as the USD continuing to strengthen, oil heading much higher on the back of OPEC's latest oil production cut agreement, gold remaining depressed and stuck in a tight range, the ECB implementing additional quantitative easing that will weaken the Euro, volatility returning with a vengeance, geopolitical risks persisting, etc..).

I mention that to provide a clear reminder that what "*everyone knows or assume to know*" is usually unhelpful at best and wrong at worst! And what CFOs/Finance Officers should worry most about & really focus on are the risks/things that other market participants haven't considered. After all, forecasters usually stick too closely to current levels in markets (2.05% on UST 5-year yield and $55 on WTI oil today, but those levels were much lower at 1.00% & $30 respectively, just 9 months back!), and on those rare occasions when they call for change, they often underestimate the potential magnitude!

Last – but not least – I will end this last economic piece for the year by reproducing a concise, though comprehensive Bloomberg update covering the main features of Saudi Arabia's recently unveiled 2017 Budget (versus 2016 performance). It also outlines key features to end the Kingdom economy's dependence on oil.

Deficit

- 2017 budget deficit projected at 7.7% of gross domestic product (GDP), or 198 billion riyals
- 2017 budget deficit is expected to be 33% lower than 2016
- Deficit to be financed by issuing debt and drawing from reserves
- 2016 deficit estimated at 11.5% of GDP, or 297 billion riyals, compared with expected 13%. Deficit was 362 billion riyals in 2015
- The 2016 number "*sends a strong message that fiscal discipline is taken seriously and on the path to a balanced budget by 2020*," said John Sfakianakis, director of economic research at the Gulf Research Center Foundation.

Spending

- 890 billion riyals in 2017
- Spending in 2016 is estimated at 825 billion riyals, 1.8% below budget
- Military spending expected at 191 billion riyals in 2017 versus 205 billion in 2016
- Kingdom to spend 268 billion riyals on National Transformation Plan through 2020; of which 42 billion are allocated in 2017
- "*This seems to be a broadly neutral budget,*" said Jason Tuvey of Capital Economics in London. "*The government will take a break from austerity in 2017 to resume it in 2018.*"

Revenue

- 692 billion riyals in 2017
- Revenue for 2016 estimated at 528 billion riyals, 2.7% above target
- "Realized returns from other sources" led to revenue increase of 15 billion riyals over 2015, the budget document said, without giving details
- Oil revenue projected at 480 billion versus 329 billion in 2016
- 2017 oil revenue "*looks a bit optimistic especially in light of the production cuts that Saudi Arabia would have to implement as part of the OPEC agreement*," said Monica Malik, chief economist at Abu Dhabi Commercial Bank.

Non-oil economy

- Non-oil revenue in 2017 expected to be 212 billion riyals, up from estimated 199 billion in 2016
- Non-oil revenues in 2016 were boosted by the growth in transfers from the Saudi Arabian Monetary Authority -- 62.2 billion riyals versus 35.4 billion in 2015
- Government is focused on increasing non-oil revenue, expects it to account for 50% of total by 2020
- "*I am surprised that the non-oil economy expanded this year given the squeeze in government spending*," said James Reeve, the London-based deputy chief economist at Samba Financial Group. "It may be that some relatively autonomous sectors, such as petrochemicals, had a better year than we were anticipating."

Oil Prices

- Government is "very optimistic" about oil-price recovery in 2017, Oil Minister Khalid Al-Falih said.
- 2017 budget based on conservative oil-price assumptions, Al- Falih added
- Kingdom to link fuel prices to global costs in 2017-2020

Subsidies

- Government will launch cash-transfer program for low- and middle-income households; citizens can register from February and program will start before energy increasing energy prices in 2017
- Cash-transfer program to cost 25 billion riyals in 2017, rising to 60 billion by 2020, Deputy Labor and Social Development Minister Ahmed al-Humaidan said
- Saudi industries, mines, energy to get more government support in 2017

Taxes

- "Selective taxes" on tobacco, soft and energy drinks to be imposed during 2017
- Government to introduce 5% value-added tax in 2018
- Government has no plans to impose taxes on nationals and residents or to tax Saudi companies
- Government to introduce a "small" fee on foreign residents, Finance Minister Mohammed Al-Jadaan said

Debt

- Public debt estimated at 12.3% of GDP in 2016. Total debt reached 316.5 billion riyals, including 213.4 billion in domestic debt
- Debt service in 2016 estimated at 5.4 billion riyals, to increase to 9.3 billion in 2017
- Spending plan envisions three scenarios. "Base scenario" sees public debt at 419 billion riyals in 2020, while the "very conservative" scenario sees it at 737 billion. A third "conservative" scenario sees it at 590 billion
- Public debt ceiling set at 30% by 2020

GDP

- Saudi GDP estimated to grow 1.4% in 2016; oil economy by 3.37%
- Public sector GDP growth seen at 0.51% in 2016; private sector GDP growth at 0.11%
- "*The 2017 spending number should be pro-growth and will add to market confidence*," said Sfakianakis at the Gulf Research Center Foundation.

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.