ISSUE 002

DECEMBER 2016

MENA MARKETS REVIEW

HIGHLIGHTS

- Fed raises rates by 25 bps
- Italy's PM Renzi resigns after referendum vote
- Brent ends year at a high
- GCC markets recovered strongly during last quarter of 2016
- GCC budgets increased in 2017 while deficits are expected to shrink

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GLOBAL MACROECONOMICS

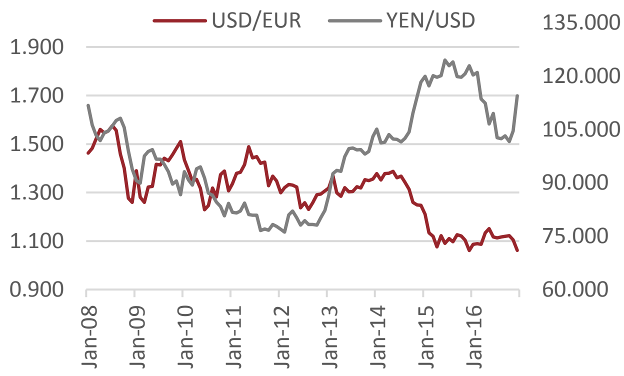
Significant changes lie ahead for the world economy. Three major events from late 2016 set the stage for 2017 and beyond, starting with the onset of a new US administration, an interest rate increase by the U.S. Federal Reserve, and an agreement by oil producers to curtail production in 2017.

The incoming Trump administration promises to be unconventional in many ways, and will likely have repercussions, both political and economic, on the world at large. We expect to see significant reductions in the US regulatory burdens (environment, finance, health…), lower taxes, increased defense, and infrastructure spending. While it is too early to quantify the impact of these actions, they will clearly improve economic growth in the US over time, provided there are no trade frictions or disruptions with major partners. It is reasonable to see US growth rising from the current 1.5-2.0% mire, and more toward 3.0%, over time. This outlook has led equities, interest rates and the USD higher, and is pointing to more of the same.

The potential Trump economic stimulus added to the Fed's and to the markets' confidence that a second policy rate hike would be needed in the current cycle. Indeed, the Fed raised the federal funds rate by 25 bps in December, to a target of 50-75 bps, and signaled it may move another three times in 2017. In response, the US 5-year note yield rose over 2.0% for the first time since 2011, and 10-year yields went above 2.5%. The USD kept rising (breaking 1.05 on the USD/EUR, and 115 on the JPY/USD), and US equities were reaching record highs, with the Dow Industrial Index near 20,000.

The US outlook is bound to somewhat support world growth, expected to improve marginally in 2017 to 3.4%, from 3.1% in 2016 (IMF). More to the point, as a trendsetter and cycle leader, the US developments may prompt similar moves toward more reliance on fiscal action in other economies, and less on monetary policy (where many suspect the limits have been reached, e.g. Japan, Europe). Also, watch the political ramifications; the Trump election (and Brexit earlier) may well embolden anti-establishment and anti EU sentiment, with important elections coming up in France and in the Netherlands (in March and May of 2017, respectively).

Chart 1: Key Exchange Rates



Source: Thomson Reuters Datastream

The positive stimulus developments above also further supported oil prices, though the recent main event there was OPEC announcing an agreement to cut production by some 4.5% (1.2 mn b/d), buttressed by an agreement with some non-OPEC producers to cut another 0.6 mn b/d. The announcement caused oil prices to shoot above, and sustain, $50 pb (Brent). This return to more "balanced" conditions in the oil market should support oil prices further, and could produce a gradual rise toward $65 pb by the end of 2018. This rise was, of course, welcome relief to the GCC countries, who will continue to post deficits and issue debt for a while, but at a more comfortable pace if oil prices improve.

We expect the MENA region to grow at about the same pace as the world economy, about 3%, virtually unchanged from 2016. While oil importers got some relief from lower oil prices, they were also held back by weaker performances in oil-exporting countries, who are major trading partners. In Egypt, growth is expected to improve towards 4-5% in 2017 and 2018 as the country implements much needed reforms and benefits from renewed confidence following the recent approval of an IMF deal.

The GCC countries are poised in our view to grow near 2.0% overall (real GDP) in 2017 and 2018, held back by oil production cuts. Non-oil growth however should be a decent 3.0% on average in 2017-18, led by Qatar, the UAE, and Kuwait, as the non-oil sector shows some resilience amid continued governmental efforts to control spending and waste, and raise revenues (fees and taxes). We see GCC regional non-oil growth rising gradually from 2017 to 2018, 2.5% to 3.3%, as the economies gradually digest the new reforms and measures. The consumer sector has in general retrenched, particularly in KSA, while public projects and government investments have been maintained, in particular in Kuwait and in Qatar.

Table 1: GCC Economic Indicators

		2015	2016e	2017f	2018f
Nominal GDP	USD tn	1.4	1.4	1.5	1.6
Real GDP growth	%y/y	3.5	2.0	1.7	2.5
Oil	%y/y	2.7	2.2	0.6	1.4
Non-oil	%y/y	3.8	2.0	2.6	3.3
Inflation	%y/y	2.8	3.0	2.8	3.6
Budget balance	% of GDP	-10.0	-9.9	-5.8	-4.5

Source: National Sources, NBK estimates

Not surprisingly, the region will continue to grapple with deficits for another while, though these deficits should start to shrink in 2017. Deficits averaged 10% of GDP in 2015-16; they should shrink to 5.2% in 2017-18. Countries are financing the gap by drawing down reserves, but also with debt issuance, including international issuance. Among others, KSA was a large borrower overseas in 4Q16, taking in USD 17.5 billion, while Kuwait is readying to go international in 2017. Borrowing abroad diversifies the sources of funds, and relieves the pressure on domestic liquidity. The latter has been under some pressure, but remained very manageable. Moreover, of course, GCC central banks followed the Fed's lead, pretty much like in 2016, by raising their official rates by 25 bps, following the December Fed hike.

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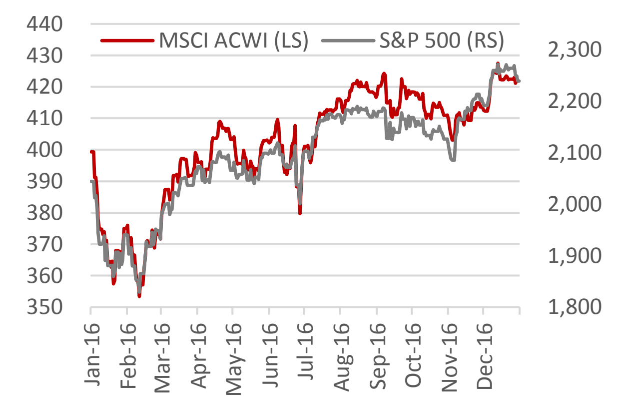
Global Equities

Global equities improved following last month's poor performance, as measured by the MSCI All Country World Index, which was up 2.0% for the month of December and up 5.6% for the full year of 2016. Following the same trend, U.S. stocks, as measured by the S&P 500, ended the month of December and full year 2016 up 1.8% and 9.5%, respectively. The Dow Jones Industrial Average reached a record level of near 20,000 during the month of December and ended the year up 13.4%. The Federal Reserve raised rates for the second time in the last 12 months; one year after the first rise came in December 2015. The Fed raised its target federal funds rate from 25-50 bps to 50-75 bps, a move that was fully priced and anticipated by markets. With inflation moving toward policy makers' 2 percent target and unemployment strengthening further, this has secured the case behind the Fed's interest rate hike.

Chart 2: MSCI ACWI ex US & S&P 500 Performance

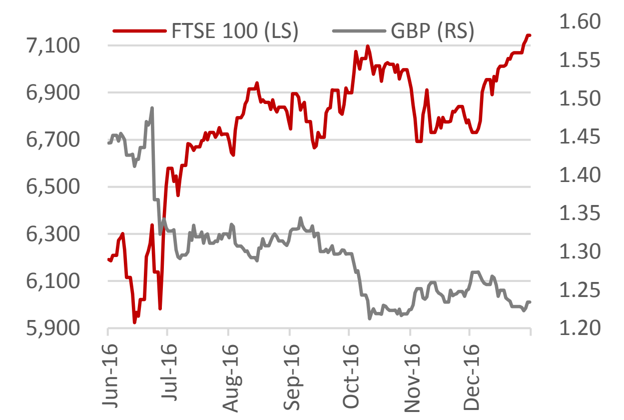


Source: Bloomberg

Across the Atlantic, European equities performed very well, as measured by the Euro Stoxx 600 Index, up 5.7% for the month despite Italy's referendum, which saw PM Matteo Renzi resign. Supporting the rally was the ECB's announcement extending its QE program until the end of 2017 and reducing the amount to 60 billion euros a month from 80 billion euros. Overall, the index closed the year in the red down 1.2%, but recovered from its low in February gaining approximately 19%.

In the UK, one of the defining moments of 2016 was Brexit and the sharp drop in the pound thereafter. The FTSE 100 was able to recover after the unexpected vote in June gaining 19.4% by year-end. For the month of December, the index was up 5.3% and the full year was up 14.4%.

Chart 3: FTSE 100 & GBP



Source: Bloomberg

In Asia, Japan's Nikkei continued to post gains, up 4.4% in December, as the yen weakened. The BOJ maintained the minus 0.1 percent interest rate and held the 10-year government bond yield target at around zero. The index closed the year flat posting a minimal gain of 0.4%.

Emerging Markets, on the other hand, closed the month almost flat, down 0.1%, as measured by the MSCI EM Index; this is mainly attributed to outflows from emerging markets given the continued post-US election positive market sentiment. Yet, for the year 2016, the index closed in the green 8.6%, lifted by stronger commodity prices. For the year, gold (down 2.2% in December) and oil (up 12.6% in December) posted positive numbers of 8.1% and 52.4%, respectively.

Specifically, oil prices have enjoyed a steady rise throughout the year, ending 2016 with a high of $56.82/bbl. This can be mainly attributed to the optimism surrounding the upcoming production cuts to come in effect in January by both OPEC and non-OPEC producers. The reduction goal of roughly 1.8

million barrels will be carried out in phases over a period of six months, with an option to roll it over for another six months. Saudi Arabia will bear a big part of the reduction, agreeing to cut output by 486,000 barrels per day.

Chart 4: Oil Prices Development - USD per Barrel (BRENT)

Source: Bloomberg

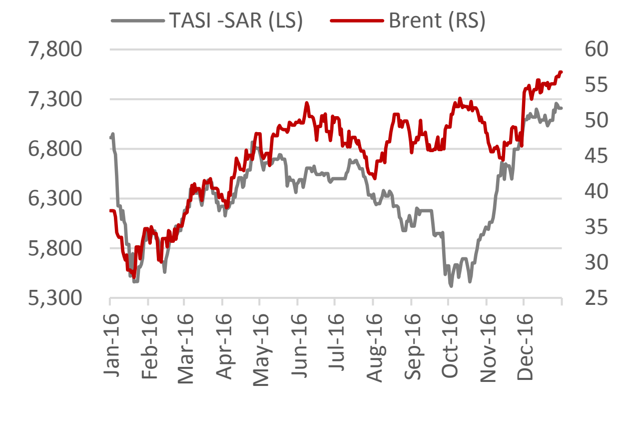
Regional Equities

MENA equities continued to generate positive returns, as measured by the S&P Pan Arab Composite, up 4.2% in December, driven up mainly by the solid performance of the Saudi equity market and the rally in oil prices. For the year, the index was up 3.7% boosted by the performance of both Saudi Arabia and the United Arab Emirates.

Following the announcement of the Fed rate hike, all GCC members raised their benchmark interest rates by 0.25% with the exception of Oman, which chose not follow suit for the second time during the current tightening cycle.

The Saudi Tadawul All Share Index generated the lowest, yet still positive, return among the GCC countries, ending the month up at 3%. This gain was mainly led by the banking, petrochemical, and real estate sectors. The increase in the country's main interest rate and the continued positive sentiment from the bond sale earlier have helped propel bank valuations. For petrochemical companies, the OPEC/Non-OPEC deal continues to provide support. The index returned for the full year 4.3%, recovering well from a turbulent year of low oil prices and subsidy cuts.

Chart 5: TASI & Oil Price

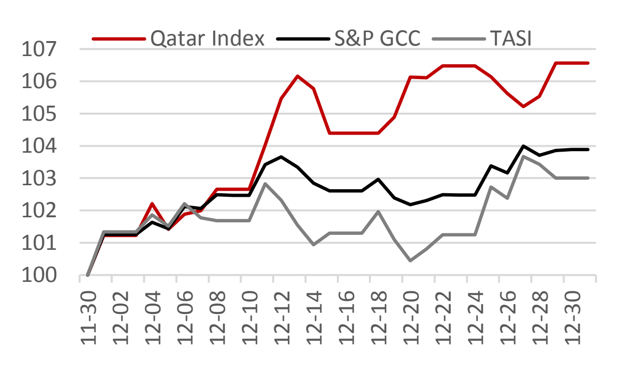


Source: Bloomberg

Following the 2017 budget announcement, Saudi Arabia plans to increase spending to 890 billion riyals from 840 billion riyals budgeted in 2016. The increased budget will allow for additional state expenditure on infrastructure in order to promote economic growth. The 2017 deficit is expected to shrink to 198 billion riyals, down from 297 billion in 2016, due to higher oil prices and non-oil revenues.

The Qatar Exchange Index proved to be the best performing GCC index in December, up 6.6% for the month; supporting the rally is a potential $44 billion merger between three Qatari banks. Furthermore, the index was lifted by November's OPEC production cut deal; however concerns remain regarding weaker corporate earnings and banking sector liquidity. On an annual basis, the index ended the year almost flat returning 0.07%. Qatar published its 2017 budget, estimating an expenditure of QR198.4bn and a deficit of 28.3 billion riyals, the latter coming down from QR46.5bn in 2016. Qatar aims to continue spending in 2017, approximately 43% of its budget, on key sectors including health, education, infrastructure and transportation which should positively affect the equity market.

Chart 6: Rebased Relative Performance of Qatar, Saudi, & GCC



Source: Bloomberg *(figures normalized)*

Dubai ended the month up 5.1%, as measured by the DSM General Index, lead mainly by the real estate and construction and banking sectors. Similar to its neighbors, the increase in the interest rates along with the 2017 budget announcement has helped increase valuations. On an annual basis, the index returned 12.1%, making it one of the best performers for the year. Dubai approved an AED 47.3bn budget for 2017 with a projected deficit of 0.6% of GDP, amounting to Dh2.5bn. Infrastructure expenditures are expected to increase by 27% when compared to 2016 while expenditures on health, education, housing and community represents 34% of the budget.

Abu Dhabi ended the month and the year up 5.5% and 5.6%, respectively, as measured by the ADSM General Index. Similar to Dubai, the sectors leading the rally for the month of December were banks and real estate.

The Kuwait Weighted Index added 3.5% for the month, while remaining overall flat during 2016 with a slight drop of 0.42%. As is the case for most oil producers, especially those from the GCC, the oil cut deal fueled equity market rallies that allowed them to recover losses sustained over most of 2016. (See charts on following page)

Oman's MSM 30 index closed December with a gain of 5.4% for the month and 7% for the year.

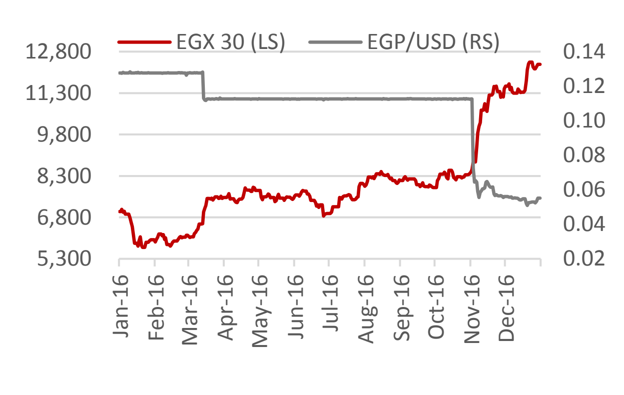
Following the OPEC meeting in November, Oman, the biggest non-OPEC member in the Middle East, committed to a reduction of 45,000 bpd of its oil output along with other non-OPEC member such as Russia.

Bahrain Bourse All Share Index posted a net return of 4% for the month while posting a minimal gain for the year of 0.4%.

Egypt's EGX 30 generated positive returns for the month, up 7.8%. The index generated the highest annual return of 76.2% due to the sharp devaluation of the Egyptian pound.

The World Bank approved the second $1 billion tranche from a $3 billion loan to Egypt to promote its economic reform program, with the third tranche to arrive in late 2017. Fitch Ratings has also affirmed Egypt's Long-Term Foreign- and Local- Currency Issuer Default Ratings (IDRs) at 'B' with a Stable Outlook.

Chart 7: EGX 30 Index & EGP/USD



Source: Bloomberg

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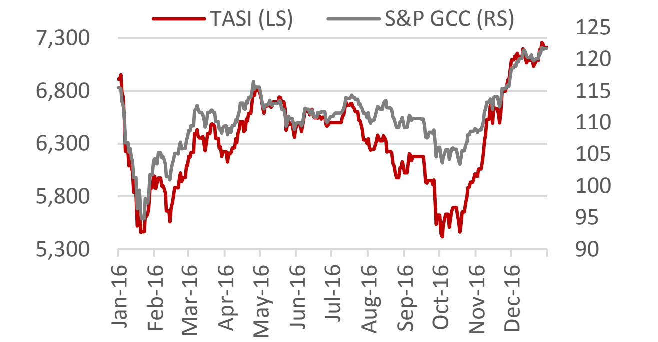
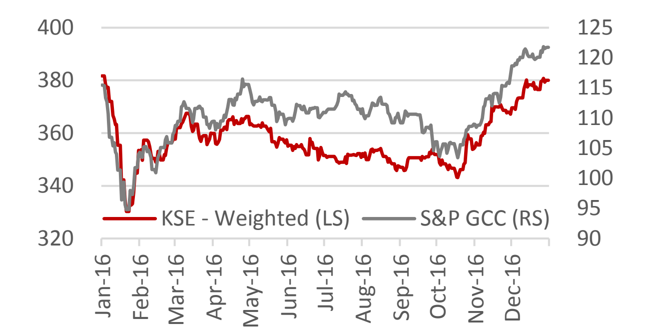
Stock Market Performance – *as of December 31, 2016:*

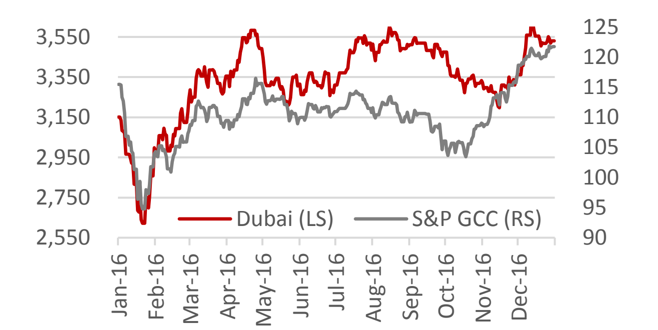
Saudi Arabia



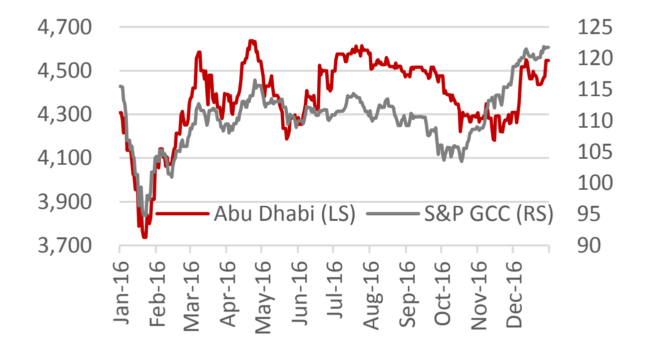
Kuwait



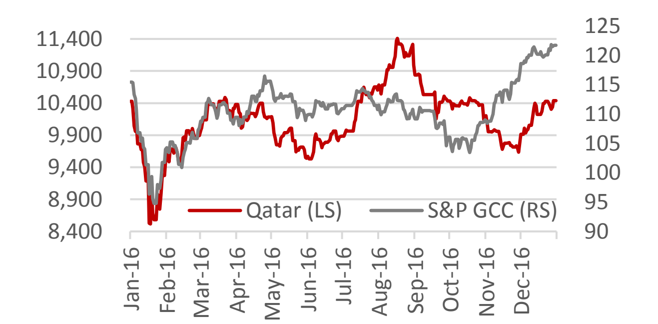
Dubai



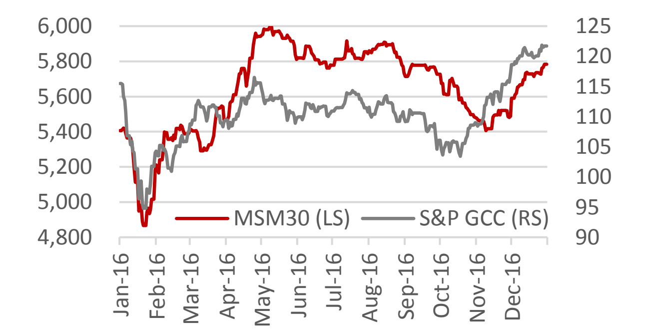
Abu Dhabi



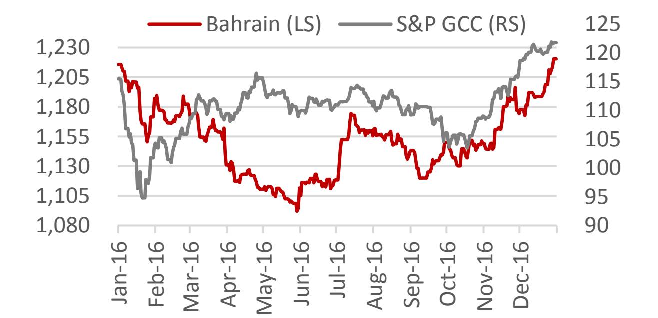
Qatar



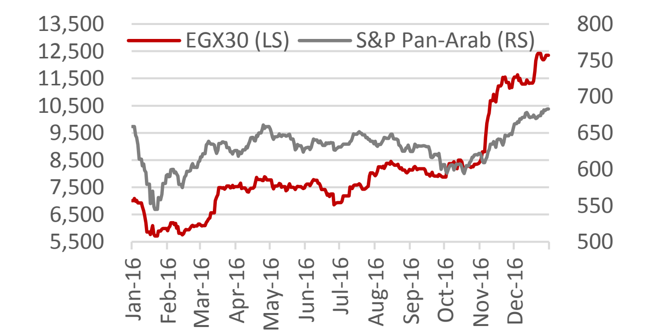
Oman



Bahrain



Egypt



LS: Left-side
RS: Right-side
All indices are in local currencies, except for the S&P GCC and S&P Pan Arab which are denominated in USD.

Market Data – *as of December 31, 2016:*

Equity*	Last Price	% Change			
		Monthly	Quarterly	YTD	1Yr Trailing
Global					
MSCI AC World Index (USD)	421.84	2.0%	0.8%	5.6%	5.6%
MSCI EAFE (USD)	1,684.00	3.3%	-1.0%	-1.9%	-1.9%
MSCI EM (USD)	862.27	-0.1%	-4.6%	8.6%	8.6%
US					
S&P 500 Index	2,238.83	1.8%	3.3%	9.5%	9.5%
Dow Jones Industrial Average	19,762.60	3.3%	7.9%	13.4%	13.4%
NASDAQ Composite Index	5,383.12	1.1%	1.3%	7.5%	7.5%
Russell 2000 Index	1,357.13	2.6%	8.4%	19.5%	19.5%
Developed					
Euro Stoxx 600	361.42	5.7%	5.4%	-1.2%	-1.2%
FTSE 100 Index	7,142.83	5.3%	3.5%	14.4%	14.4%
DAX Index	11,481.06	7.9%	9.2%	6.9%	6.9%
CAC 40 Index	4,862.31	6.2%	9.3%	4.9%	4.9%
Nikkei 225	19,114.37	4.4%	16.2%	0.4%	0.4%
Hang Seng Index	22,000.56	-3.5%	-5.6%	0.4%	0.4%
Emerging Markets					
Russia Stock Exchange	2,232.72	6.1%	12.9%	26.8%	26.8%
Turkey - Borsa Istanbul 100 Index	78,138.66	5.6%	2.2%	8.9%	8.9%
MSCI Asia ex Japan	514.34	-2.3%	-6.6%	2.9%	2.9%
Shanghai Composite	3,103.64	-4.5%	3.3%	-12.3%	-12.3%
India - NIFTY 50	8,185.80	-0.5%	-4.9%	3.0%	3.0%
Taiwan Stock Exchange	9,253.50	0.1%	0.9%	11.0%	11.0%
Brazil Ibovespa Index	60,227.29	-2.7%	3.2%	38.9%	38.9%
Mexico Stock Exchange	45,642.90	0.7%	-3.4%	6.2%	6.2%
MENA					
S&P Pan Arab (USD)	682.90	4.2%	12.6%	3.7%	3.7%
S&P GCC Composite (USD)	121.72	3.9%	14.8%	5.4%	5.4%
KSA - Tadawul All Share Index	7,210.43	3.0%	28.2%	4.3%	4.3%
Dubai - DFM General Index	3,530.88	5.1%	1.6%	12.1%	12.1%
Abu Dhabi - ADX General Index	4,546.37	5.5%	1.6%	5.6%	5.6%
Qatar Exchange Index	10,436.76	6.6%	0.0%	0.1%	0.1%
Kuwait Weighted Index	380.09	3.5%	8.0%	-0.4%	-0.4%
Oman - Muscat Securities Market 30 Index	5,782.71	5.4%	1.0%	7.0%	7.0%
Bahrain Bourse All Share Index	1,220.45	3.9%	6.1%	0.4%	0.4%
Egypt - EGX 30	12,344.89	7.8%	56.6%	76.2%	76.2%
Morocco - MADEX	9,547.25	9.2%	16.2%	31.6%	31.6%
Jordan - ASE Index	2,170.29	0.0%	2.3%	1.6%	1.6%

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

Market Data – *as of December 31, 2016:*

Fixed Income	Last Price	% Change			
		Monthly	Quarterly	YTD	1Yr Trailing
Bond Indices					
J.P. Morgan Global Agg Bond (USD)	532.42	-0.3%	-6.6%	2.2%	2.2%
Barclays US Agg Bond	1,976.37	0.1%	-3.0%	2.6%	2.6%
Bloomberg US Gov Bond Index	123.55	-0.1%	-3.7%	1.0%	1.0%
Bloomberg Barclays US Corp Bond Index	2,726.78	0.7%	-2.8%	6.1%	6.1%
Bloomberg Barclays US Corp High Yield Bond Index	1,813.85	1.8%	1.8%	17.1%	17.1%
Bloomberg Global Dev Gov Bond Index ex - US (USD)	101.03	-1.2%	-11.3%	2.0%	2.0%
Bloomberg Global Corp Bond Index ex US (USD)	123.93	0.4%	-4.6%	4.4%	4.4%
JPM Emerging Market Bond Index (USD)	739.08	1.4%	-4.2%	10.2%	10.2%
Bloomberg Barclays EM High Yield Bond Index (USD)	1,197.28	1.9%	-1.4%	15.9%	15.9%
US Treasury Yields (%)	**Current**		**3 M ago**	**6 M ago**	**12 M ago**
3 Month Yield	0.50		0.27	0.25	0.16
2 Year Yield	1.19		0.76	0.59	1.05
5 Year Yield	1.93		1.15	0.99	1.76
10 Year Yield	2.44		1.59	1.44	2.27
30 Year Yield	3.07		2.32	2.23	3.02
Global Treasury Yields (%)	**Current**		**3 M ago**	**6 M ago**	**12 M ago**
British 10 Year Gilt	1.24		0.75	0.83	1.96
German 10 Year Bund	0.21		-0.12	-0.14	0.63
Japan 10 Year Treasury	0.05		-0.09	-0.24	0.27

Commodities	Last Price	% Change			
		Monthly	Quarterly	YTD	1Yr Trailing
Precious Metals					
Gold Spot	1,147.50	-2.2%	-12.8%	8.1%	8.1%
Silver Spot	15.93	-3.5%	-16.9%	15.0%	15.0%
Energy					
WTI Crude	53.72	8.7%	11.4%	45.0%	45.0%
Brent Crude	56.82	12.6%	15.8%	52.4%	52.4%
Natural Gas	3.72	11.1%	28.1%	59.3%	59.3%

Currencies	Last Price	% Change			
		Monthly	Quarterly	YTD	1Yr Trailing
EUR-USD X-RATE	1.05	-0.7%	-6.4%	-3.2%	-3.2%
GBP-USD X-RATE	1.23	-1.3%	-4.9%	-16.3%	-16.3%
USD-JPY X-RATE	116.96	2.2%	15.4%	-2.7%	-2.7%
KWD-USD X-RATE	3.27	-0.1%	-1.4%	-0.7%	-0.7%

Interbank Rates (%)	1M	3M	6M	12M
London Interbank	0.77	1.00	1.32	1.69
Kuwait Interbank	1.19	1.44	1.75	2.06
Emirates Interbank	0.95	1.48	1.72	2.10
Qatar Interbank	1.54	1.78	1.97	2.36
Saudi Interbank	1.80	2.04	2.22	2.42

Source: Bloomberg

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