

BANKING ON KNOWLEDGE



Geopolitical issues, Fed action swing financial markets

By Dr R Seetharaman

Brent crude had gone up close to \$115/barrel by the end of last week on account of geopolitical issues in Middle East and is at a yearly high. WTI was above \$106/barrel by the end of last week. Oil prices can rise further if geopolitical issues escalate on account of Iraq.

Iraq produces about 3.3mn bpd, making it the second biggest producer in Opec. It is also sitting on the world's fourth largest proven reserves. Recently natural gas prices surged after US stockpiles of the fuel increased at a slower rate than expected and natural gas price is above \$4.5/MMBTU by end of last week.

The Gulf Co-operation Council financial markets were also impacted on account of geopolitical issues in Middle East. The GCC Capital markets such as Qatar and UAE, which rallied on account of MSCI upgrade, are now witnessing sell-off on account of geopolitical issues. The other GCC capital markets are also affected. After the beginning of geopolitical issues and till end of last week Qatar stock market had fallen by 3%, Saudi Arabia by 2%, Dubai by 5%, Abu Dhabi by 2% and Kuwait had fallen by 4% respectively. Oman market was flat. Some of the GCC Sovereign yields such as Qatar, Saudi and Bahrain also surged. By the end of last week, Qatar's five-year CDS - 46.84 basis points, Saudi five-year CDS - 47.5 basis points, Dubai five-year CDS - 137.715 basis points, Abu Dhabi five-year CDS - 40.5 basis points and Bahrain five-year CDS - 167.5 basis points.

Gold prices went above \$1300/ounce by end of last week on account of geopolitical issues in Middle East and the likelihood of a steady US interest rates for a while. It went up by close to 3% last week. Silver prices also went up above \$20/ounce on account of geopolitical issues in Middle East and the Fed action. It had gone up by close to 6% last week. Last week the Fed cut its bond-buying to \$35bn a month from \$45bn, starting on July 1 and is expected to raise short-term interest rates a bit faster in 2015



and 2016 than previously forecast. The Fed now sees the key fed funds rate closer to 1.25% at the end of 2015, up from a prior forecast of 1%. The Fed also expects the rate to move up to around 2.5% by the end of 2016 instead of 2.25% as previously projected. The US Fed still thinks the economy will expand rapidly in the next two years. The economy is seen growing at a 3%-3.2% range in 2015 and 2.5%-3% in 2016, unchanged from the bank's prior forecast.

The Fed slashed its growth projection for 2014 to a 2.1%-2.3% range - down from 2.8%-3% on account of harsh winter and they don't think the contraction in GDP in the first quarter will have a lasting effect.

Stronger growth will lower the unemployment rate a little faster to as low as 6% by the end of 2014; as low as 5.4% by 2015; and as low as 5.1% by 2016.

The dollar was weak after following a reassurance from the Fed of steady US interest rates for a while. It had fell dur-

ing the week and by the end of the week was at 80.372. A weaker greenback tends to raise the appeal of dollar-priced commodities underpinning prices. Aluminium has risen to its highest level in nine months after investors cut bearish wagers and it is getting support from softer dollar. Aluminium is above \$1800/tonne. Copper, which had received support from a softer dollar, had earlier fallen this month amid an investigation into warehousing at China's Qingdao port and is above \$6700/tonne. Nickel price was above \$18000/tonne and had received support from softer dollar; however it had also surged earlier on account of the Indonesian ban. Global financial markets witnessed swings last week mainly on account of geopolitical issues in Middle East and Fed action.

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