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HIGHLIGHTS

- Political Developments
- Oil-Related Developments
- Non-Oil Economic Developments

Political Developments

1. Overview of on-going military conflicts

Iraq and Syria

Two raging conflicts in West Asia- in Iraq and Syria could be reaching endgame. In the case of Iraq, operations against the Islamic State (IS) "capital" at Mosul commenced from end-October, with the Iraqi coalition making quick progress and surrounding Mosul by mid-December. The forces began a pause in the military action on 21 December, described by the ranking US general on site as an "operational re-fit". There are reports of fierce engagement with IS militants and that the Iraqi military may have sustained heavy casualties.

The second phase of the fighting began on 29 December, with troops attacking Mosul from the east and southeast. While there is every likelihood that Mosul will fall in the near future, it is the aftermath that will determine the future shape of Iraq: if there is large-scale sectarian blood-letting, then Iraq in all probability will revert to the sectarian carnage that overwhelmed the country after the US invasion, with retaliatory attacks by extremist elements. Alternatively, if sectarian violence is controlled, Iraq could move on to the route to establish an accommodative political order.

In Syria, government troops, backed by heavy Russian air support, captured Aleppo on 13 December after a four-year effort that has been marked by accusations of human rights abuses on both sides. However, while this is a setback for the rebels, fighting is expected to continue in other towns, particularly Idlib. However, there are reports in the Arab media that the extent of support from the Gulf Cooperation Council (GCC) countries for the rebels has reduced considerably and is now largely confined to media support.

The complicating factor in both Iraq and Syria is the fact that the Kurds in the two countries, taking advantage of the civil strife, have expanded their territorial control over what they believe are traditional Kurdish lands. In Iraq, they have asserted a claim over Mosul once it is liberated; in Syria, they have captured most of their "Rojava", western homeland, along the Turkish-Syria border. These developments, viewed from Ankara, suggest that a contiguous Kurdish territory is being consolidated in Iraq, Syria and Turkey itself.

To thwart these Kurdish aspirations, Turkey has militarily entered both Iraq and Syria. In Iraq, it has projected itself as the champion of the Turkoman people and Sunnis in general, and has stated that it will not allow the Kurds to claim Mosul or attempt to change the demographic character of the region that has been traditionally dominated by the Turkoman and Sunnis.

In Syria, its forces have disrupted the contiguity of Kurdish lands by occupying a 90-km front at the border and then moving into Syria to about 55 km, thus creating a "buffer zone" for itself.

Turkey has also abandoned its five-year support for the rebels in Syria, in alliance with the GCC countries, and has moved close to Russia and Iran. Russia, taking advantage of the presidential transition in Washington, has initiated its own peace process by inviting Turkish and Iranian foreign and defence ministers for a peace conclave at Almaty, a meeting that does not include the US, the UN or any Arab country. This peace process is expected to support the continued leadership of Bashar al Assad in Syria and increase military and political support to the beleaguered regime.

On 29 December, President Putin announced that a nationwide ceasefire would commence from the midnight of 30 December, following talks between Russia, Turkey, the Syrian government and the opposition National Coalition, made up of "moderate" rebels, including the Salafi militia, Ahrar Al Sham; the ceasefire does not include ISIS or the Al Qaeda-affiliated Jabhat Nusra (now calling itself Jabhat Fatah Al Sham). Russia has also indicated that the ceasefire would be followed by peace talks in Astana, Kazakhstan, and that other participants such as Egypt, Saudi Arabia, Qatar and Jordan would also be invited. Russia has also clarified that the peace process would "supplement", not replace the UN process.

There are media reports that Iran is not happy about the ceasefire and the peace process. It is said that Assad and Iran, after the capture of Aleppo, had wished to fight Ahrar Al Sham, but Russia made it clear that Aleppo would be the last battle and the last victory. Russian sources are confident that Iran will be brought on board at the right time.

While there are no indications from official sources about the content of the peace plan, non-official Russian sources have said that Syria would be divided into autonomous regions in a federal structure and that Assad would step down before the next presidential elections and make way for a more acceptable Alawi candidate. Russian officials have also made clear that Russia will control the peace process, with no involvement of the Obama administration, though there would be place for the Trump government once he takes over.

Yemen

The situation in Yemen remains murky. After announcing the setting up of a Supreme Political Council, made up of adherents of the Houthis and their ally, former president Ali Abdullah Saleh, the Houthi movement at the end of November announced the installation of a government which would consist of members from "all walks of the political spectrum who are anti-aggression", a clear rejection of Hadi and his Saudi supporters. The official statement added that the new government was needed "to arrange the domestic situation and face the aggression economically, militarily and politically".

The initiative of the Houthis has come in the background of the rejection of the proposal of the UN special envoy, Ismail Ould Cheikh Ahmed, to set up a national unity government by the Hadi group, though it had been accepted by the Houthis and appeared to enjoy US and Saudi support. This has put a set back to the nascent peace initiative and condemned Yemen to continued fighting in which about 10,000 people have already been killed. According to UN sources, several million Yemenis are facing starvation.

Expressing its displeasure with Saudi attacks in Yemen which have led to numerous civilian casualties, the US block the sale to Saudi Arabia of 16,000 precision munitions kit, valued at $ 350 million. US officials have criticised the Saudi military for poor targeting which caused a "high rate of civilian casualties", including the bombing of a funeral hall in October in which over a hundred people had been killed. Partly to assuage western concerns, Saudi Arabia announced on 19 December that it would not use British-made cluster bombs in Yemen.

In order to assert his credibility, President Abd Rabbo Mansour Hadi at end-December paid a visit to the southern Hadhramout province from where Al Qaeda militants had been evicted earlier this year by UAE and US Special Forces. Hadi declared that this "liberation" would be the model followed by his forces to liberate the rest of the country from the Houthi-Saleh alliance. He also laid the foundation stone of a natural gas power plant to ease the power situation in the region.

Amidst the political and military uncertainty, the Islamic State proclaimed its presence in Yemen with a suicide bombing in Aden in which 48 people, mainly security personnel, were killed.

2. Implications of the Trump presidency

During the election campaign, president-elect Donald Trump had been very hostile to the nuclear agreement, even saying that his first as president would be to rip up the deal and renegotiate better terms. After his election victory, he appointed senior officials who have a long record of hostility to Iran. However, both Trump and his officials have also not been flattering about Saudi Arabia either, with the national security adviser, General Michael Flynn even voicing severe criticism of Islam itself.

The Kingdom, while deeply concerned about the implications of the Trump presidency for its interests, has taken comfort from Trump's visceral animosity for Iran which, they believe, will shape a new US approach to West Asia which will exhibit far greater understanding of the security concerns of the GCC countries vis-à-vis Iran, concerns that are shared by large sections of the US political establishment.

Besides the Iran factor, two other reasons that could form the basis for improved US-Saudi ties are: (a) the country's ambitious economic reform programme, as envisaged in the "Vision-2030" document, and (b) the view in the Kingdom that, given his business background, Trump is less likely to be concerned about Saudi religious and cultural practices.

Oil-Related Developments

Oil prices

The OPEC agreement of 30 November to cut output by 1.2 million barrels per day (mbd) and the associated pledge that non-OPEC producers led by Russia would also cut production by another 600,000 b/d from 1 January, 2017, has led to a price rise of over 15%: at end-December, Brent was at $ 55.59, while WTI was $ 53.73. Oil prices received a boost when the OPEC and selected non-OPEC members met in Vienna on 10 December and were able to agree on a non-OPEC production cut of 562,000 b/d, only slightly less than the ball-park figure envisaged earlier at the 30 November meeting. Russia re-affirmed its own production cut of 300,000 b/d. At the 10 December meeting of OPEC and non-OPEC producers, besides Russia, other countries announcing cuts were: Mexico (100,000 b/d), Oman (40,000 b/d), Azerbaijan (35,000 b/d) and Kazakhstan (20,000 b/d).

Oil ministers said that these cuts would re-balance the market, and added that OPEC was ready to take further action if prices did not stabilize. The Saudi Energy Minister, Khalid al Falih also indicated that the Kingdom could effect cuts below the 30 November agreement when he said: "I can tell you with absolute certainty that effective January 1 we're going to cut and cut substantially to be below the level that we have committed to on November 30." He added that his country could even go below the level of 10 mbd, depending on market conditions.

The 30 November meeting had three unique features: (a) non-OPEC producers joined in the cut agreement for the first time in 15 years; (b) OPEC approved differentiated cuts for its members: Iran was allowed to raise output to its pre-sanctions level, while Libya and Nigeria were excluded from the proposed cuts due to on-going civil conflicts, and (c) Iraq, which had resisted the idea of cuts, also agreed to a cut of 210,000 b/d.

Not surprisingly, analysts have projected a wide range of prices for 2017: OPEC and non-OPEC oil ministers have said they expect prices of about $ 70/ barrel in the first half of 2017, with a slight fall thereafter as US shale oil production increases. Goldman Sachs is more cautious: it projects Brent at $

59 in the second half of next year and WTI at $ 57.5.

Analysts are looking at two areas of uncertainty that would impact on the price outlook: the first is whether the proposed will be truly effective in removing the surplus in the market, and linked with this is the matter of producers actually complying with the agreed cuts; the second issue pertains to the quantum and speed with which US shale oil will enter the market.

In regard to the first issue, analysts have pointed out that the cuts have been proposed at a time when major producers have been indulging in record production levels. Thus, in October 2016, OPEC produced 33.82 mbd; a reduction of 1.2 mbd will yield an output of 32.6 mbd, the same as what OPEC had produced in January 2016. Similarly, Russia will be cutting 300,000 b/d from its peak production of 11.2 mbd to reach 10.9 mbd, which would still be higher than its production of 10.88 mbd in January 2016.

Bloomberg has estimated that the proposed cuts could reduce the market glut by half of the stockpile of about 300 million barrels, subject to full compliance by the producers. On the other hand, IEA believes that re-balancing will occur early next year as oil stocks decline by about 600,000 b/d in the first six months of 2017.

The other source of uncertainty is US shale oil production. Oil rigs in use in the US had plunged from a high of 1609 rigs in October 2014 to 316 in May this year, as prices had fallen from $ 107/ barrel in June 2014 to $ 26 in February 2016; the number of rigs in operation now is 510. As prices rise due to production cuts, analysts estimate that rigs in use could rise to 723 in 2017 and 933 in 2018, as against an average rig use of 978 in 2015. Goldman Sachs has projected a boost in US shale oil production which would bring oil prices to $ 55 in the first of next year. They believe that with oil at $ 55, US production could reach annual production of 800,000 b/d. Financial analyst Mohammed El-Erian says that prices of even $ 70/ barrel are quite unlikely, and the best OPEC will be able to achieve will be a range of $ 50-60.

Non-Oil Economic Developments

1. Saudi budget: On Thursday, 22 December, Saudi Arabia unveiled its first budget after the announcement of the “Vision-2030" in April 2016, which is aimed at reducing dependence on oil revenues and boosting the role of the private sector in taking the national economy forward in coming years. Its most striking feature was that the national deficit of SR 297 billion ($ 79 billion) for 2016 was 16% less than what had been budgeted, i.e., SR 367 billion ($ 97.8 billion). The budget also reflected reduced government spending: actual spending was SR 825 billion ($ 220 billion) as against the budgeted figure of SR 840 billion ($ 224 billion); revenues were marginally higher at SR 528 billion ($ 140 billion) as against the budgeted figure of SR 514 billion ($ 137 billion).

The budget for 2017 indicates increased government spending of SR 890 billion ($ 237 billion), but a lower deficit of SR 198 billion (52.7 billion), reflecting anticipated higher oil prices. The deficit will then be 7.7% of the GDP as against 11.5% in 2016. The budget expects to obtain considerable sums from foreign investors: the country plans to issue international bonds valued at $ 10-15 billion in 2017, after having raised $ 17.5 billion in bond sales in October this year.

The budget envisages reduced energy subsidies, with direct cash support for “needy” citizens from a fund of SR 25 billion ($ 6.6 billion); this programme will increase to SR 60 billion ($ 16 billion) by 2020. The government has reiterated its commitment to promoting public-private partnerships by stating that 17 government departments have identified 87 projects for joint implementation by the public and private sectors.

Analysts have noted that while the budget continues to depend on oil revenues to promote national growth, there has been some increase in non-oil revenues as well.

The Kingdom has also boosted its sovereign wealth fund, the Public Investment Fund, with a fresh injection of $ 27 billion. In 2016, the fund has been actively investing abroad in order to increase foreign investments to 50% of its portfolio as against 5% at present. It has put in $ 3.5 billion in

Uber Technologies and $ 45 billion in a global technology fund of $ 100 billion formed by Japan's SoftBank group.

2. Saudi Arabia develops its mining sector: King Salman of Saudi Arabia heralded his country's commitment to diversifying the economy by inaugurating the $ 35 billion mining and minerals processing complex at Ras al Khair on the east coast. This project includes a phosphate complex and a $ 10 billion aluminium facility. The complex has a 1400-km railway line, a port, and desalination and power plants. The construction of a ship-building and repair complex at Ras al Khair is expected to start in 2018 and begin commercial operations by 2022.

It is planned that the mining sector's contribution to the national GDP will go $ 64 billion by 2030, as against $ 17 billion today.

(The views expressed are personal)