IMPACT OF CRISIS ON FINANCIAL MARKETS

MARCH 2022

INTRODUCTION

The current geopolitical environment on the global front amid the Russia – Ukraine conflict has presented economies and financial markets with another crisis event. This has prompted us to look back in history towards some key events related to similar crisis events in the past, and understanding market dynamics and trends across various asset classes such as equities, commodities and currency markets. Financial markets have reacted in various patterns across similar events, and this study aims to ascertain the following aspects:

- Magnitude of Market reaction across various asset classes
- Triggers for market downturn during such events
- Recovery catalysts driving a reversal in trend
- Overall Impact on Global and KSA markets
- Key Learnings and takeaways
- Expectations and insights in the current environment

The study is conducted using broad market indicators such as the S&P 500 index, Dollar Index, Gold and Crude prices

Key Events Covered:

1973	1990	2008	2020	2022
Arab Oil Embargo	Gulf War	Mortgage Crisis	COVID - 19	Russia – Ukraine War

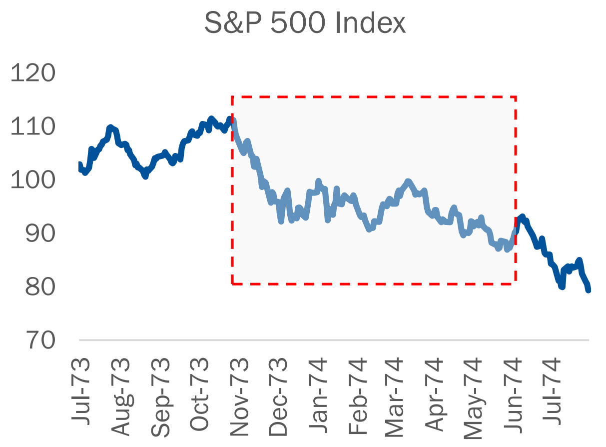
ARAB OIL EMBARGO 1973…(1/2)

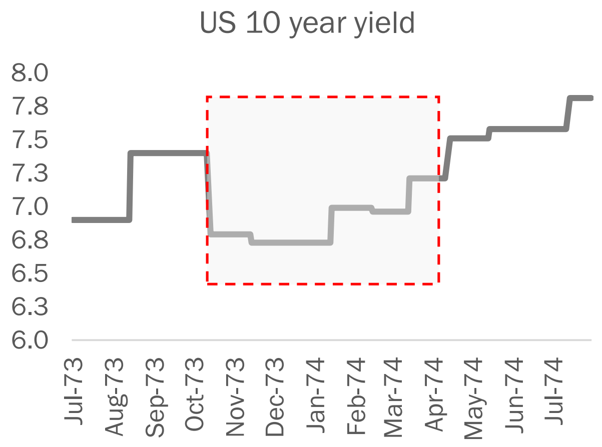
The Event:

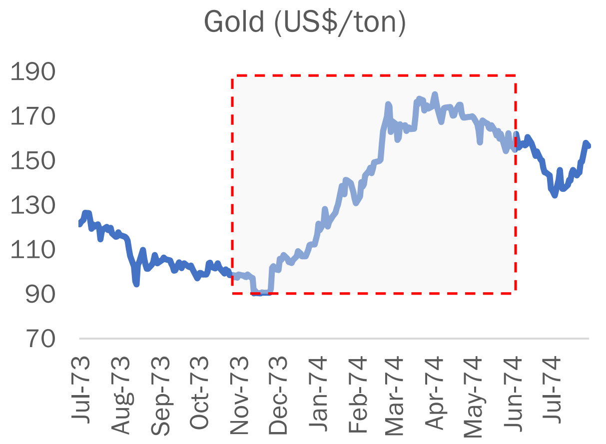
Temporary cessation of oil shipments from the Middle East to the United States, the Netherlands, Portugal, Rhodesia, and South Africa was imposed by oil-producing Arab countries in October 1973 in retaliation for support of Israel during the Yom Kippur War. This embargo on the United States was lifted in March 1974, though in other countries it remained in place for some time afterward. This was the first oil crisis, an oil-supply disruption leading to major price increases and a worldwide energy crisis.

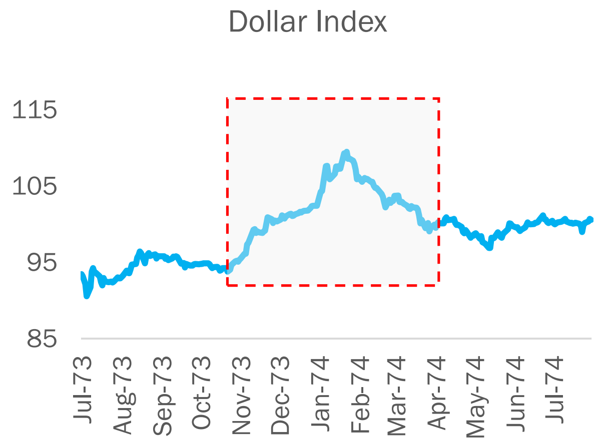
Global Impact:

Far reaching changes in domestic energy policy, increased domestic oil production in the United States and a greater emphasis on improving energy efficiency. In October 1973, OPEC raised oil prices by 70 percent and two months after the Yom Kippur War, prices were raised by an additional 130 percent. As OPEC continued to raise prices through the rest of the decade (prices increased 10-fold from 1973 to 1980), its political and economic power grew.









Source Market Data from Refinitiv Eikon

ARAB OIL EMBARGO 1973...(2/2)

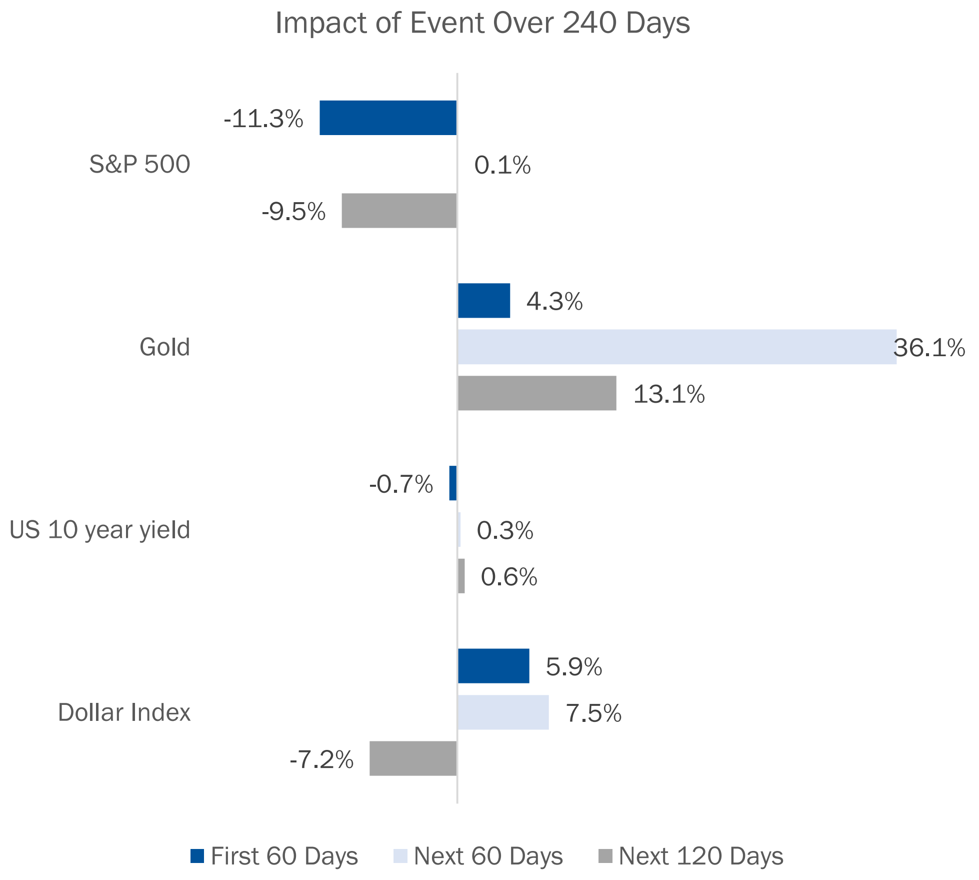
Impact on KSA:

The oil embargo saw oil prices increase to more than three folds from $4.08 in 1973 to $12.52 in 1974. During the same period, Saudi GDP increased to $45.4bn ($6.4k per capita) in 1974 from $14.95bn ($2.2k per capita) in 1973. Inflation, however, reached unprecedented levels at 16.5% and 21.4% in 1973 and 1974, respectively, peeking at 34.6% in 1975.

Production and prices continued to fall in the 1980s. The brunt of the production cuts was borne by Saudi Arabia, whose oil revenues shrank by some four-fifths by 1986, the revenues of all producers, including non-OPEC countries, fell by some two-thirds in the same period as the price of oil dropped to less than $10/bbl. The decline in revenues and the ruinous Iran-Iraq War (1980–88), which pitted two OPEC members against each other, undermined the unity of the organization and precipitated a major policy shift by Saudi Arabia, which decided that it no longer would defend the price of oil but would defend its market share instead.

Further Reactions:

Oil-importing countries reacted slowly to the price increases, but eventually reduced their overall energy consumption, found other sources of oil (e.g., in Norway, the United Kingdom, and Mexico), and developed alternative sources of energy such as coal, natural gas, and nuclear power. In response, OPEC members, particularly Saudi Arabia and Kuwait reduced their production levels in the early 1980s in what proved to be have a limited impact to defend their posted prices.



Start Date considered as Oct 1, 1973

Source Market Data from Refinitiv Eikon, WorldBank, Bp

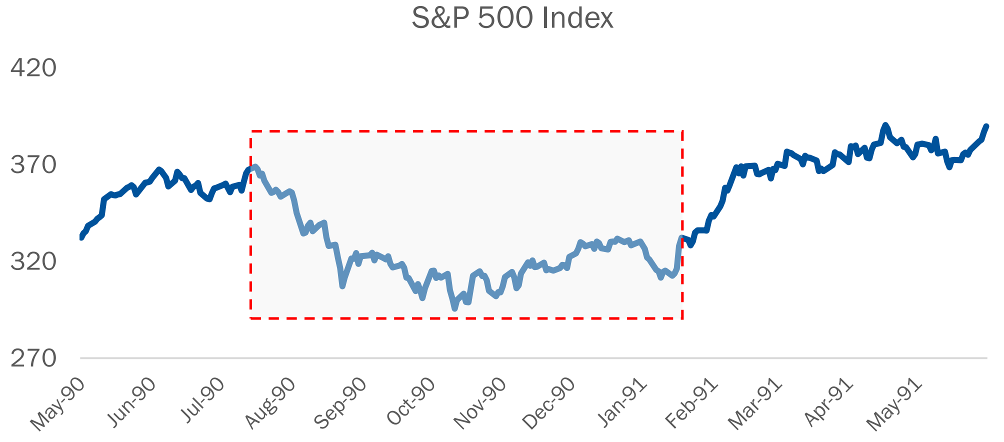
GULF WAR 1990-1991…(1/3)

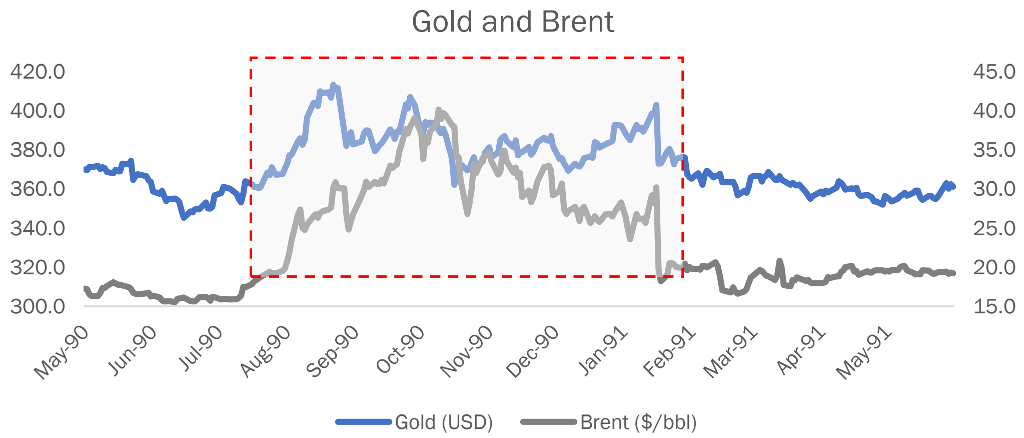
The Event:

Iraq ordered an invasion and occupation of Kuwait. The United Nations Security Council passed Resolution 661 on August 6, 1990, requiring member nations to impose economic penalties on Iraq. Several countries came to aid Kuwait on the 24th of February 1991. By February 28, Iraqi soldiers had evacuated Kuwait after a four-day ground assault in which hundreds of oil wills were set on fire. President Bush announced a cease-fire, thereby ending the Gulf War.

Global Impact:

The Gulf crisis intensified the American recession as it was fought with American inventories, therefore, impacting both, the budget and the economy. The Iraqi invasion of Kuwait resulted in a geopolitical oil crisis, rising from a pre-invasion average of roughly $18/bbl to slightly more than $40 by late October. However, they fell back to around $21 when more supply from other producers arrived and global oil demand lagged.





Source Market Data from Refinitiv Eikon

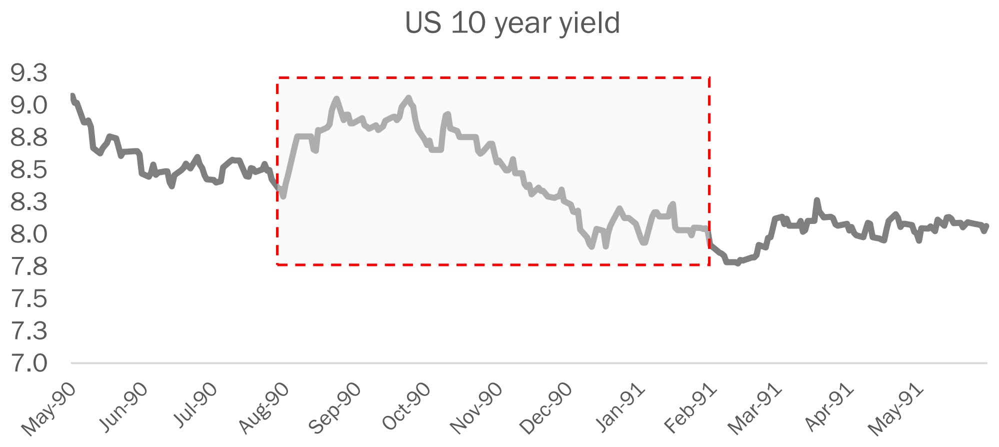
GULF WAR 1990-1991...(2/3)

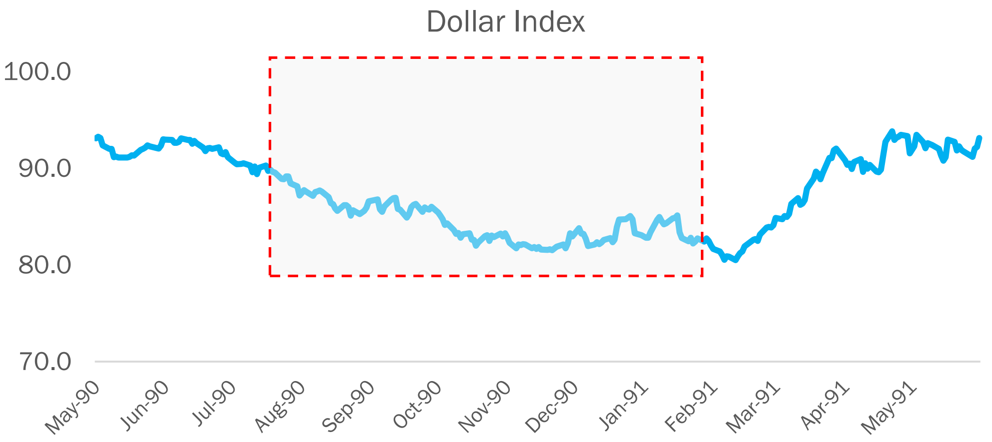
Global Impact:

The cost of jet fuel, which had been 60 cents a gallon before the invasion, had risen to $1.40 a gallon by mid-October. Even as fuel costs began to fall, the advent of ground and air conflict posed a significant financial crisis for airlines due to decreased traffic.

Consumer staples and utilities, both generally stable sectors of the economy, increased by 14% and 2%, respectively, due to increased supply among militants and migrants. During the Gulf War (red highlight in the below chart), gold and crude oil prices rose to new highs, while the S&P 500 and dollar index fell to record lows.

Post the war period we notice that there in normalization in financial performance wherein S&P 500 and dollar index strengthened and established new highs from its record lows during the Gulf war period.





Source Market Data from Refinitiv Eikon

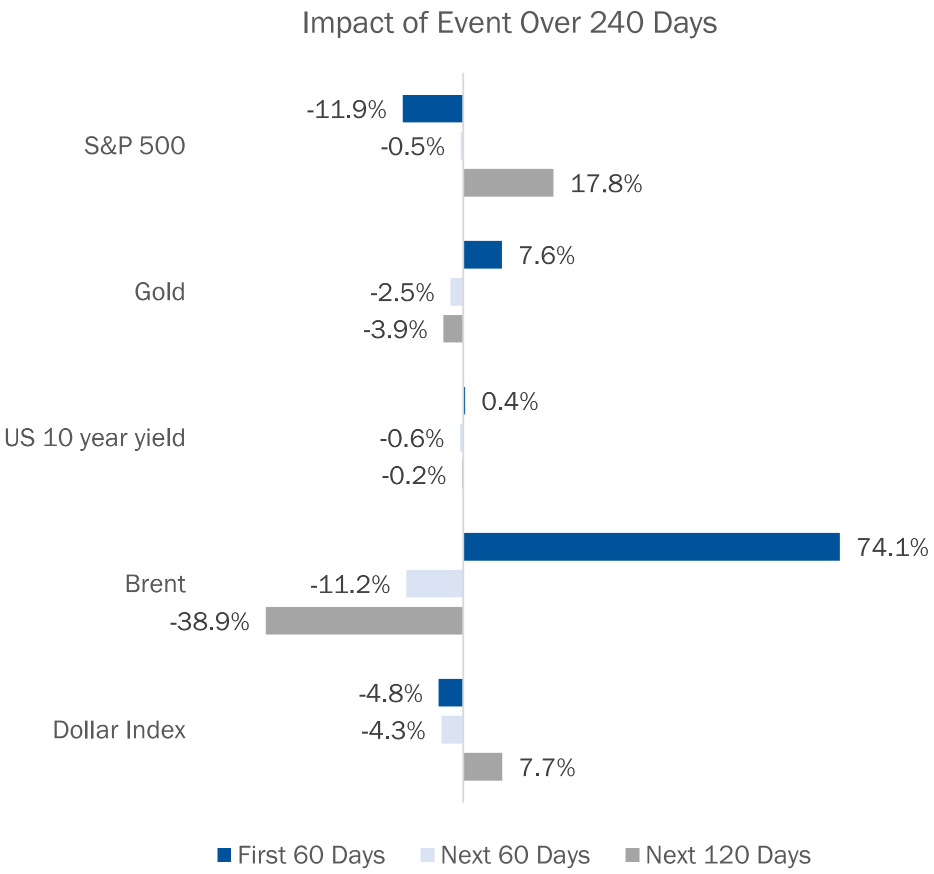
GULF WAR 1990-1991...(3/3)

Impact on KSA:

Saudi Arabia acquired new weaponry from other countries, expanded its military forces, and provided financial assistance to several foreign states. Higher Saudi oil output and much higher global oil prices gave some relief to the Saudi economy. However, GDP per capita rose only modestly through the 1990s, and in certain years declined in real terms.

Further Reactions:

After the re-establishment of Kuwaiti sovereignty in February 1991, the government opened the doors to all Kuwaiti citizens. In January 1992, Kuwait's oil minister claimed that the country had already spent $1.5 Bn putting out fires and intended to spend another $8 to $10 Bn to fix future damage and increase production by 2 Mn BPD by the end of 1993. Overall demand returned by mid-1992, with many products such as autos and consumer durables, were in surplus supply.



Start Date considered as July 20, 1990

Source Market Data from Refinitiv Eikon

MORTGAGE CRISIS 2008…(1/4)

The Event:

Severe contraction of liquidity in global financial markets that originated in the United States as a result of the collapse of the U.S. housing market. This began with the FED, having anticipated a mild recession that began in 2001, reduced the federal funds rate 11 times between May 2000 and December 2001, from 6.50% to 1.75%. This enabled banks to extend consumer credit at a lower prime rate and encouraged lending to high-risk customers.

As a result, the share of subprime mortgages among all home loans increased from about 2.5% to nearly 15.0% per year from the late 1990s to 2004–07. Contributing to the growth of subprime lending was the widespread practice of securitization, whereby banks bundled together hundreds or even thousands of subprime mortgages and other, less-risky forms of consumer debt and sold them.

Lehman was the fourth-largest investment bank in 2008, had $639 Bn in assets and $613 Bn in liabilities. The bank became a symbol of the excesses of the 2007-08 Financial Crisis, cost an estimated $10 Tn in lost economic output. The company branched into mortgage-backed securities and collateral debt obligations. In February 2007, Lehman's stock price reached a record $86.18 per share, giving it a market capitalization of nearly $60 Bn. But by the first quarter of 2007, cracks in the U.S. housing market were already becoming apparent. On March 17, 2008, due to concerns that Lehman would be the next Wall Street firm to fail following Bear Stearns' near-collapse, its shares plummeted nearly 48%. Later, facing a $3.9 Bn loss, which included a $5.6 Bn write-down, the firm announced an extensive strategic corporate restructuring effort.

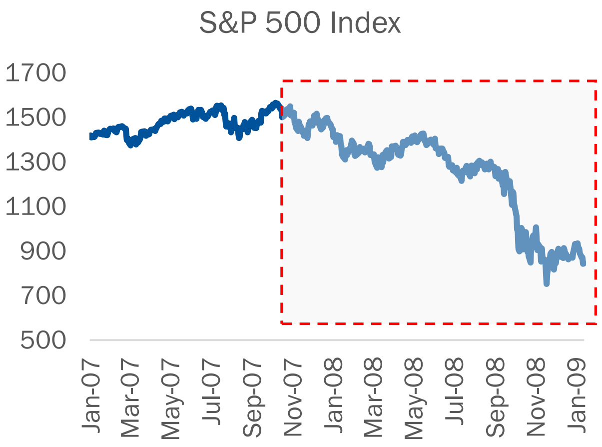
With only $1 Bn left in cash by the end of that week, Lehman was quickly running out of time. Over the weekend of September 13, Lehman, Barclays, and Bank of America (BAC) made a last-ditch effort to facilitate a takeover of the former, but they were ultimately unsuccessful. On Monday, September 15, Lehman declared bankruptcy, resulting in the stock plunging 93% from its previous close on September 12.

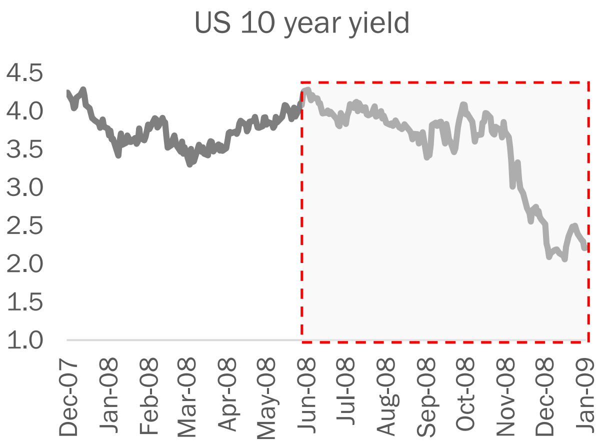
Source Market Data from Refinitiv Eikon

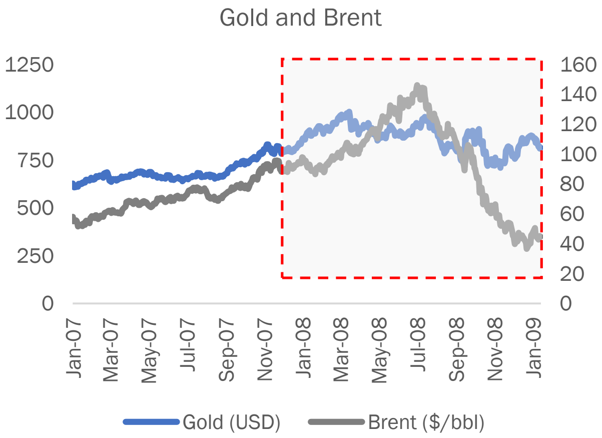
MORTGAGE CRISIS 2008…(2/4)

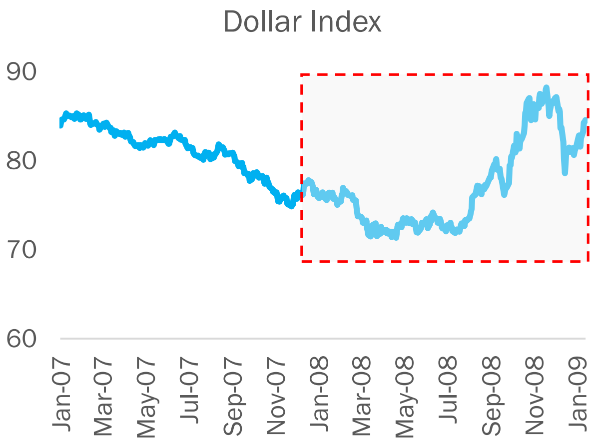
Global Impact:

Sub-prime lending inevitably resulted in more defaults from borrowers holding adjustable-rate mortgages (ARMs). This was partially due to the rate increase, but also because the housing market had reached a saturation point. Home sales, and thus home prices, began to fall in 2005. By 2007 the steep decline in the value of MBSs (Mortgage-Backed Securities) had caused major losses at many banks, hedge funds, and mortgage lenders, forcing some large and prominent firms to liquidate, or to appeal to the government for loans, to seek mergers with healthier companies, or to declare bankruptcy. Banks stopped lending to subprime customers, causing home sales and prices to decline further, which discouraged home buying even among consumers with prime credit ratings, further depressing markets. In 2012 the St. Louis Federal Reserve estimated that during the financial crisis, the net worth of American households had declined by about $17 Tn in inflation-adjusted terms, a loss of 26%. GDP contraction represented a loss of $70,000 in lifetime income for every American. ~7.5 Mn jobs were lost between 2007-2009, representing a doubling of the unemployment rate, which stood at nearly 10% in 2010.









Source Market Data from Refinitiv Eikon

MORTGAGE CRISIS 2008...(3/4)

Impact on KSA:

While many economies around the globe, especially developed countries were severely and negatively affected by the crisis in 2008 and 2009, the Saudi economy continued to show resilience and strong economic growth. Consequently, the Saudi Arabian experience of international banking and domestic financial intermediation during this tumultuous period was a key positive. Although Saudi banks were moderately affected by the deteriorating conditions in the global financial markets, domestic financial markets continued to function effectively and efficiently without any hiccups.

Real GDP grew by 4.5% in 2008 (3.3% in 2007), on the back of strong oil sector growth of 4.8%. The non-oil private sector, which represents 47% of GDP, also grew at a healthy rate of 4.7%. In addition, the quality of Saudi banks' assets remained strong, with non-performing loans (NPLs) amounting to 1.4% of total loans and advances at end-2008, while provisions coverage was at 153%. NPLs remained below 3% at September 2009. Financing by international banks of banking and non-banking counterparties in Saudi Arabia grew strongly in 2007 but, due to the deteriorating conditions in the global financial markets, they tapered off in 2008 and 2009.

On the supply side, following the collapse of Lehman Brothers, international banks became reluctant to fund even the strongest emerging market banks due to their own need to build up liquid assets. The need for international funding was in turn affected by the fact that Saudi banks had excess liquidity due to high levels of government expenditure, as well as by the slowing down of growth in domestic credit extension and the few opportunities for Saudi banks to invest in turbulent international markets.

These factors led to a significant increase in bank funds placed with the SAMA. There was also a slowdown in certain industrial sectors such as steel, transport and consumer products due to lower consumer demand in the domestic and regional markets

Source Market Data from Refinitiv Eikon

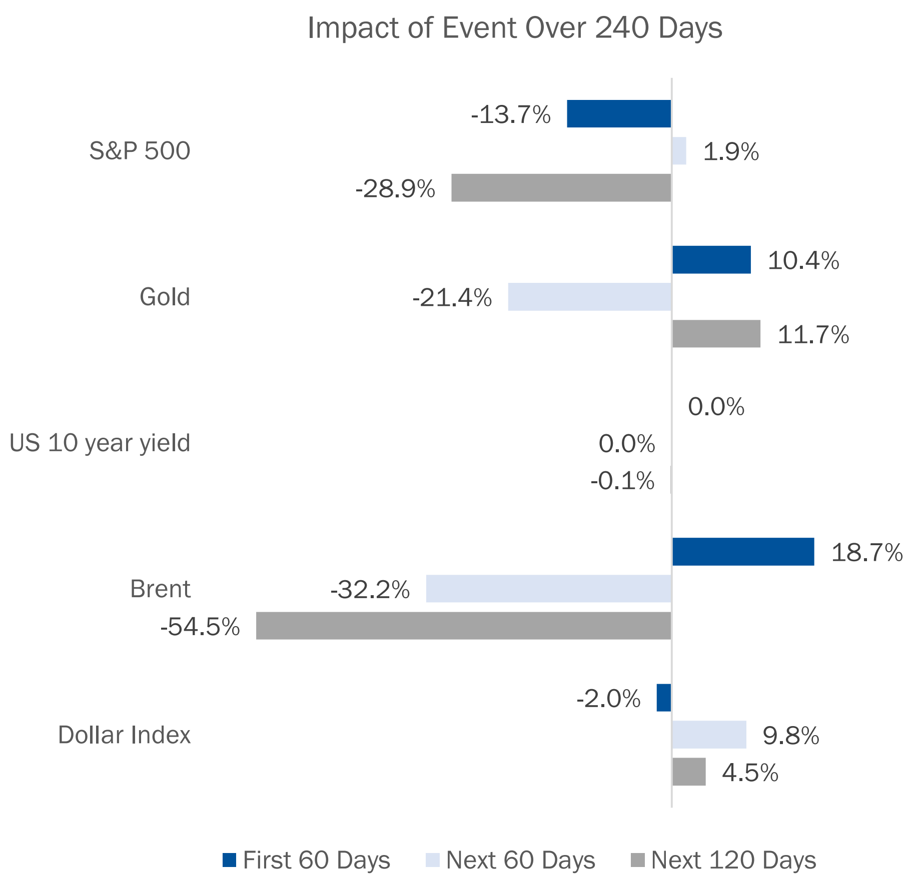
MORTGAGE CRISIS 2008...(4/4)

Further Reactions:

Countries with smaller increases in general government debt over 2005–08 experienced smaller losses relative to trends. Exchange rate flexibility is associated with less damage, pointing to a buffering role of nominal exchange rates. Notably among the advanced economies most severely affected by the crisis, the measures combined central bank monetary policy actions i.e. unconventional monetary policy support through asset purchases as policy rates approached their effective lower bounds.

Liquidity support to specific segments of credit markets through targeted central bank facilities, discretionary fiscal stimulus, and financial sector operations like bank balance sheet stress tests, government guarantees of banking sector liabilities, purchases of toxic assets from banks, capital injections. State-dependent forward guidance (specifying particular levels of unemployment and inflation as conditions for rate hikes), negative interest rates (charging commercial banks a penalty on excess reserves held at the central bank), and yield-curve control (targeting the yields of longer-maturity government bonds through central bank purchases).

IMF provided unconditional financial resources to its members through a general allocation of SDR 204 Bn ($316 Bn) during Aug–Sep 2009.



Start Date considered as May 15, 2008

Source Market Data from Refinitiv Eikon

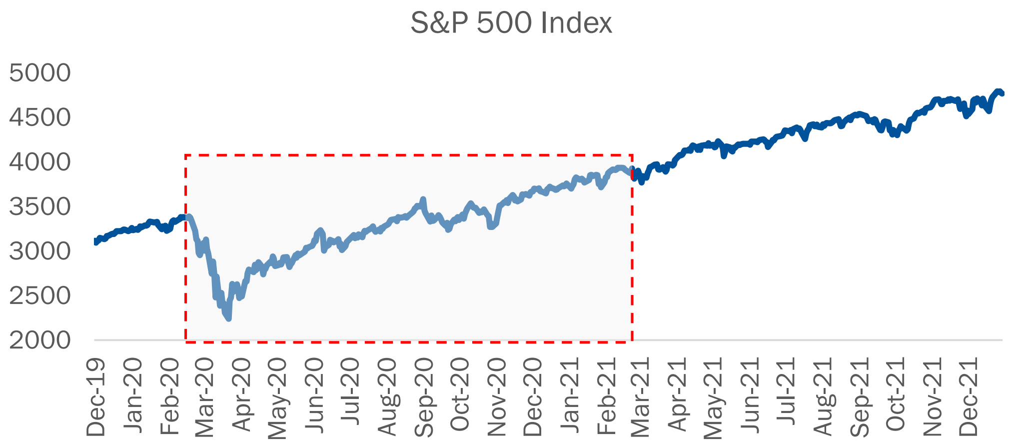
COVID-19 – 2020…(1/3)

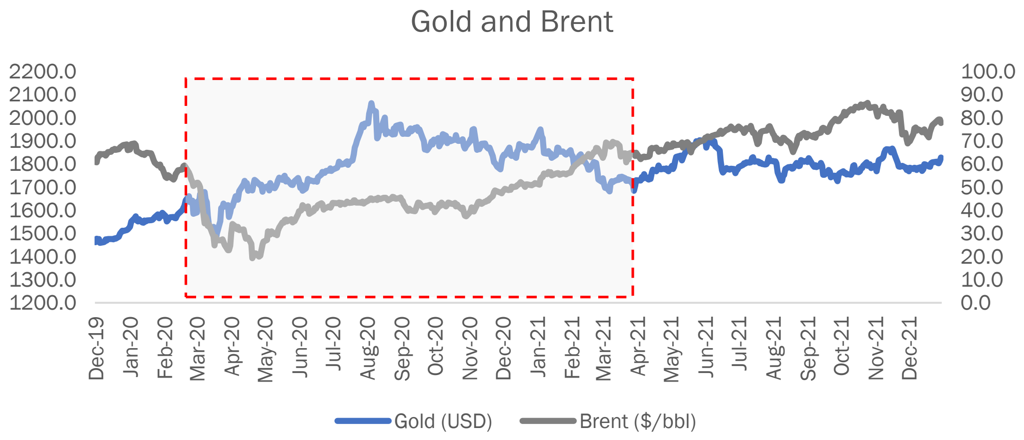
The Event:

The Corona Virus pandemic (Covid-19) is an illness that was first detected in Wuhan, China. This virus is transmissible thereby impacting the entire world, leading to a global toll of more than 3 Mn deaths in 2020. Over the course of time there have been many variants, causing medical, financial, and economic unrest globally.

Global Impact:

Lockdowns were imposed across the globe lasting for a period of 3 to 4 months on an average. Post the lockdowns, movement was restricted, social distancing and face mask applications were enforced and restrictions on the number of people in private gatherings were announced. Consumption levels declined given the fall in income levels due to job losses and closure of business ventures.





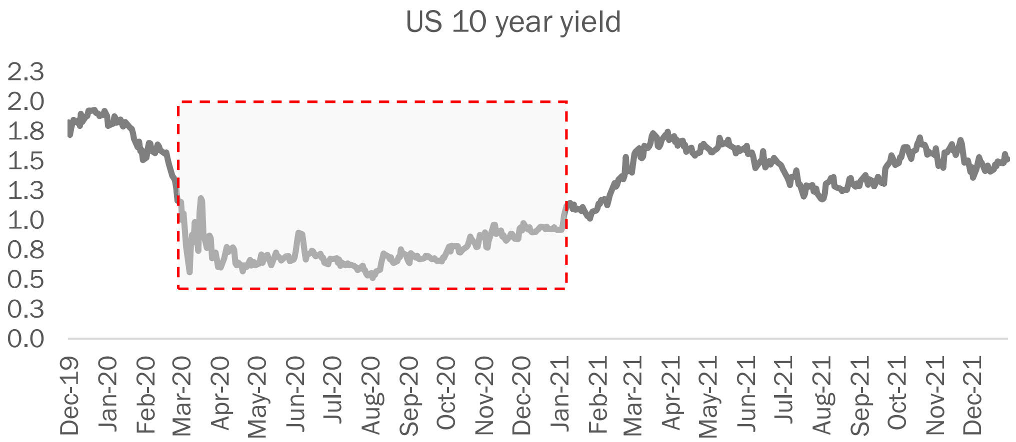
Source Market Data from Refinitiv Eikon

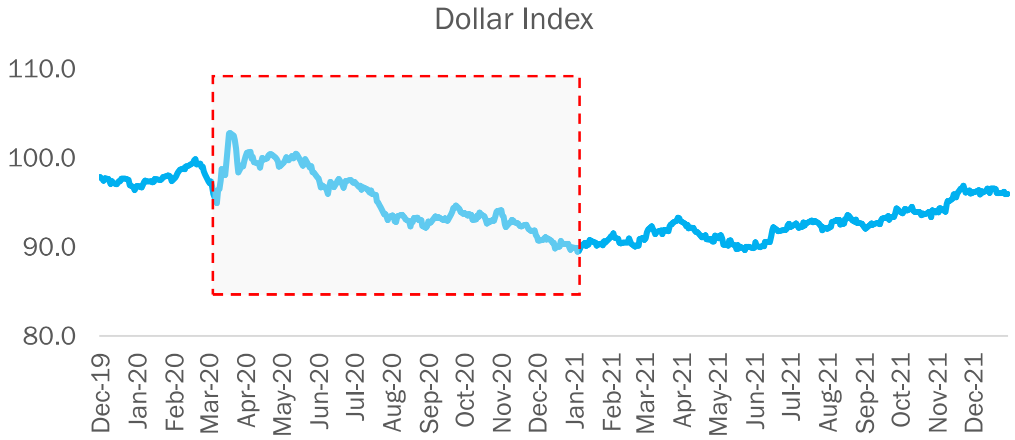
COVID-19 – 2020…(2/3)

Global Impact:

This led to a decline in global economic growth leading to low inflation levels and monetary authorities lowering rates to propel growth. Financial markets went in the red zone with S&P 500 declining by 30% in March 2020. Gold became an attractive investment option as can be seen from the fund flows into the asset class which accelerated further in the post COVID period with both prices and fund flows at all-time highs.

Global demand for oil declined leading to falling Brent prices. The hardest hit sectors were Finance and Insurance, Accommodation & food services, Travel and Tourism, Construction and Real Estate. In response to the crisis, governments had to announce stimulus packages to instill growth and revive the economy.





Source Market Data from Refinitiv Eikon

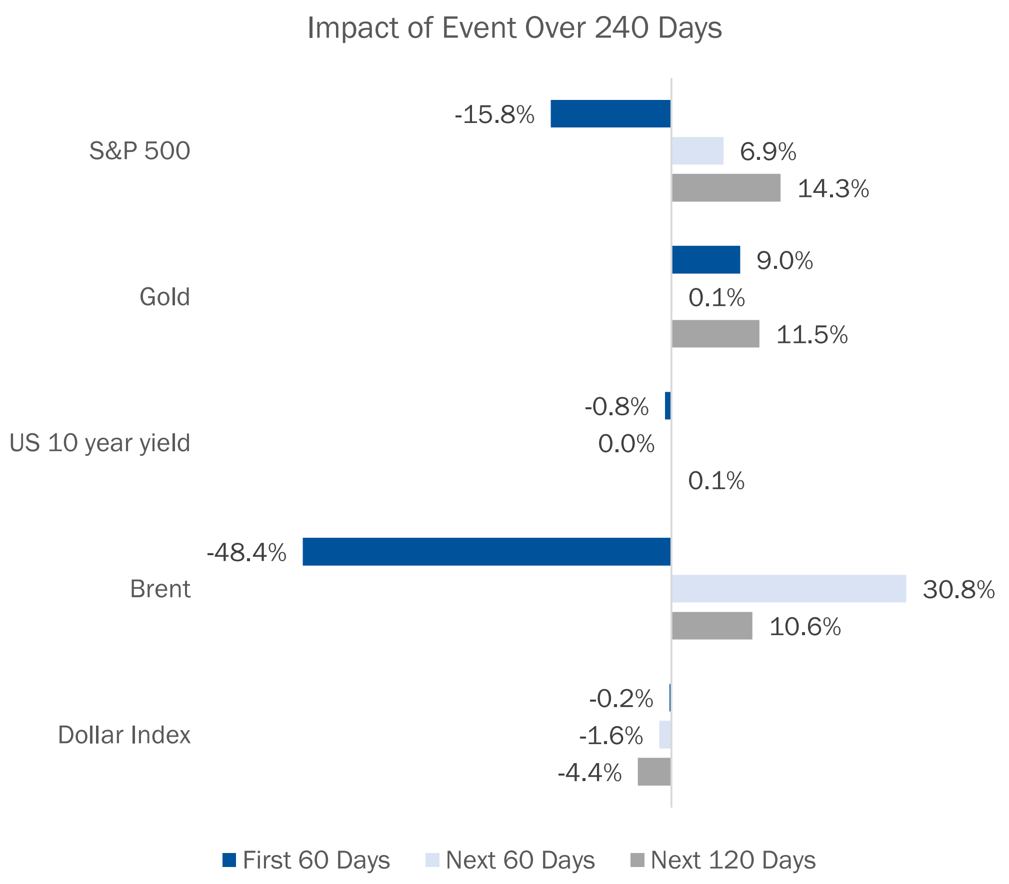
COVID-19 – 2020…(3/3)

Impact on KSA:

The Saudi Market Index, TASI, declined by around 25% in March 2020, due to the pandemic. Decline in the oil prices due to low demand levels had a severe negative impact on the Kingdom. The Saudi Government announced an initial stimulus package of around $22 Bn, recording the highest in the GCC.

Further Reactions:

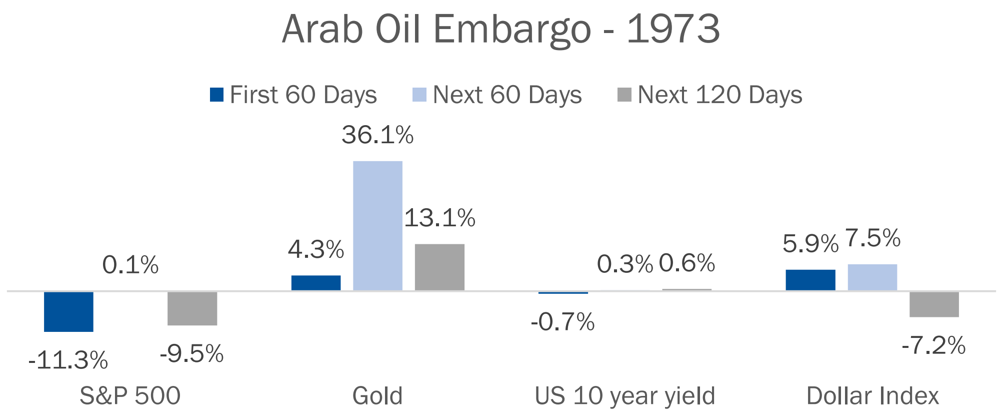
Global financial markets benefitted from the liquidity created by interest rate cuts announced by many Central Banks around the world to counter the slowdown. GCC markets saw a recovery by June 2020 with a bounce back in oil due to gradual demand restoration around the world. Global Markets started showing signs of recovery, S&P Index increased backed by lifting of restrictions, announcement of vaccine dozes, opening of the economies, and restoring global trade links. Treasury yields stared rising back to 2019 levels. Oil prices showed significant recovery from the Covid low levels of $20/bbl in 2020 to the range of $70 to $80 in 2021. The TASI rose by almost 90% in the second half of 2021, benefiting from rising oil prices and improving business environment.

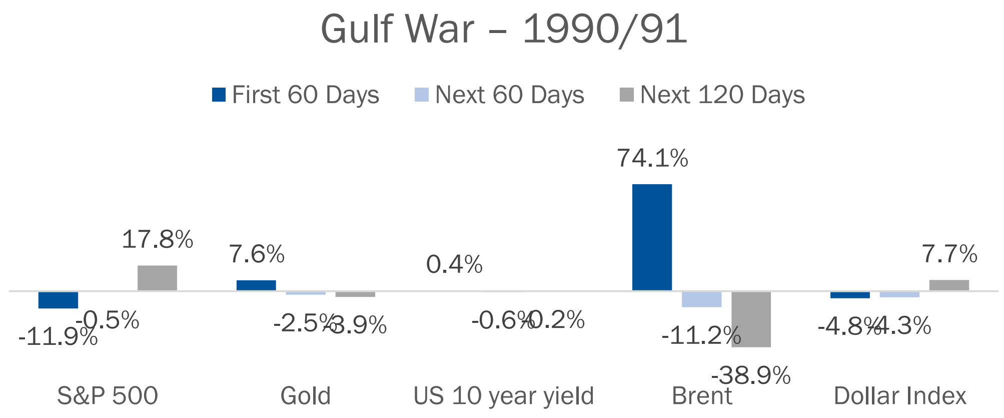


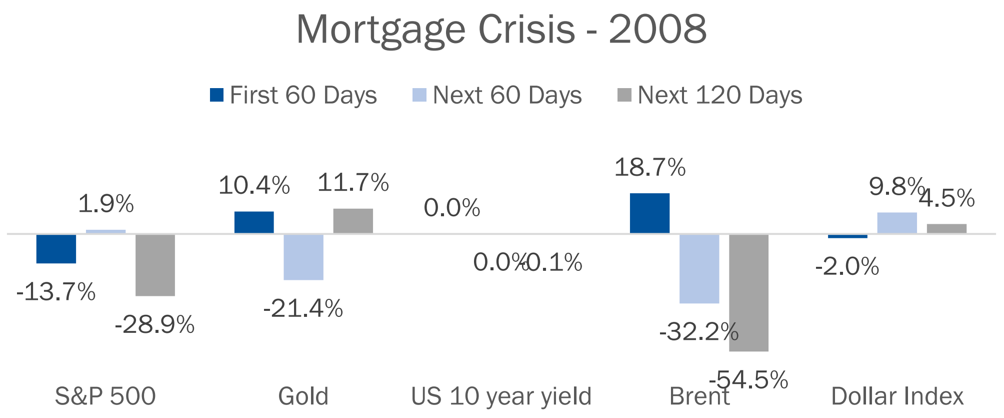
Start Date considered as Feb 14, 2020

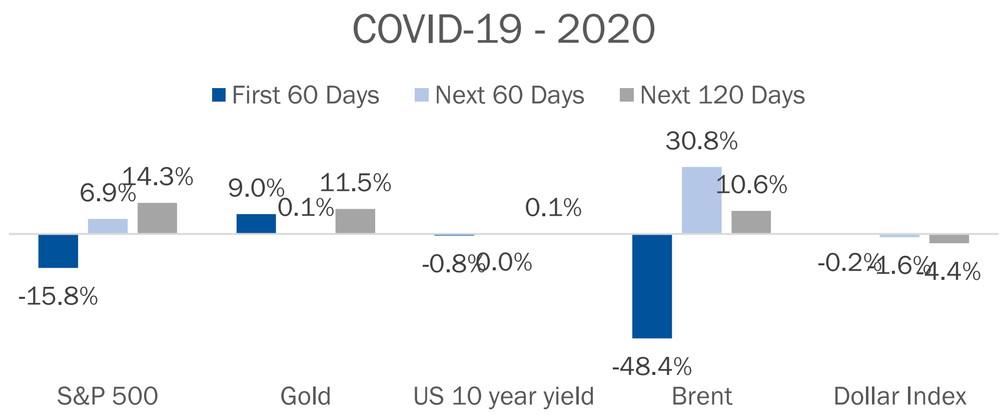
Source Market Data from Refinitiv Eikon

IN SUMMARY









Source Market Data from Refinitiv Eikon

KEY TAKEAWAYS

- Past events have provided mixed signals at best, with various readings seen across the first 240 days
- Broader market indices tend to edge lower over the first 60 days period, with drops ranging from 11% to 16%, largely driven by oil price uncertainties and inflationary pressures rising from demand – supply gaps
- Oil prices become the main dictator of global economics and financial markets, and appear to be the most volatile during these events, as most of these events have seen severe impacts on oil
- As such, inflationary pressures are seen across other products, mainly consumer staples and raw materials and input costs
- However, post the first 60 days, it appears to be a slower recovery over the next 180 days all events other than the COVID-19 period, where strong stimulus actions added to a rapid recovery
- In the case of Saudi markets as well, markets end up generally tracking the global markets during the 2008 crisis as well as during COVID-19
- However, economics turn volatile for the Kingdom due to the previously mentioned extreme volatility seen in oil markets

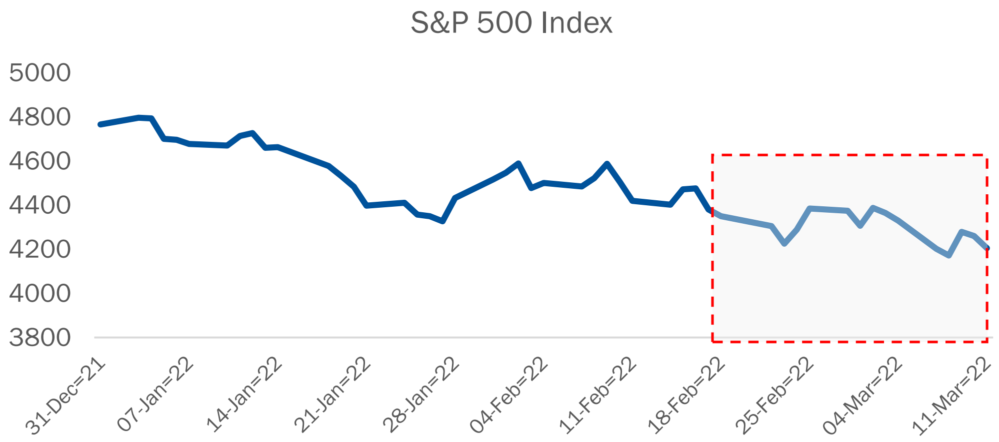
- ***Markets drop 11% - 16% in the first 60 days***
- ***Slow recovery over the next 180 days***
- ***Extremely volatile oil markets***
- ***Spiking inflation driven by input costs***
- ***Flight to Gold with dropping Dollar Index***

Source Market Data from Refinitiv Eikon

RUSSIA - UKRAINE CONFLICT…(1/3)

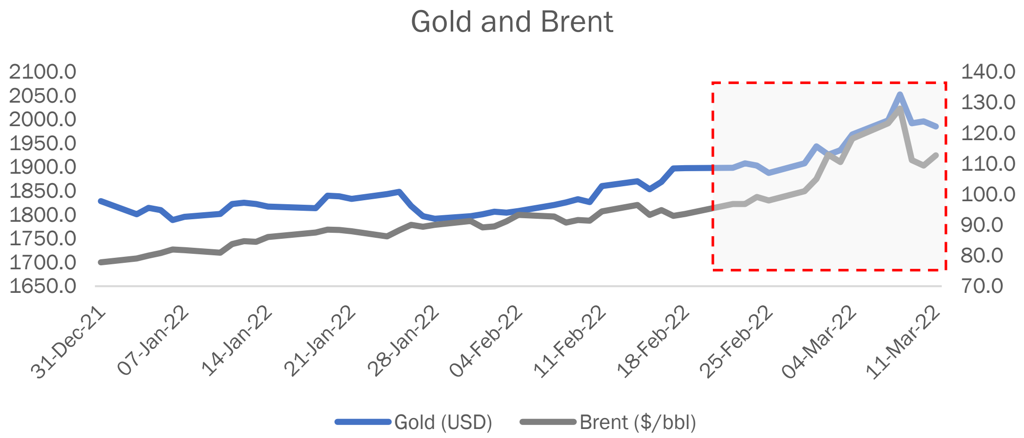
The Event:

Russia has requested that the West provide a legally binding commitment that NATO would not conduct military operations in eastern Europe or Ukraine. A similar situation had aroused when Russia invaded Ukraine in 2014, when insurgents captured vast swaths of eastern Ukraine and has been fighting Ukraine's army ever since during which Crimea was annexed. The renewed conflict between Russia and Ukraine, which borders the European Union, has consequences for the EU. As a result, the EU, the majority of which are NATO signatories, has joined the US in imposing sanctions against Russia.



Global Impact:

The conflict between Russia and Ukraine, as well as the ongoing crisis of supply chain disruption, caused crude oil prices to rise above $100/bbl for the first time since 2014, as Russia is the world's second-largest crude oil producer and provides 35% of Europe's and 50% of Germany's natural gas supply.

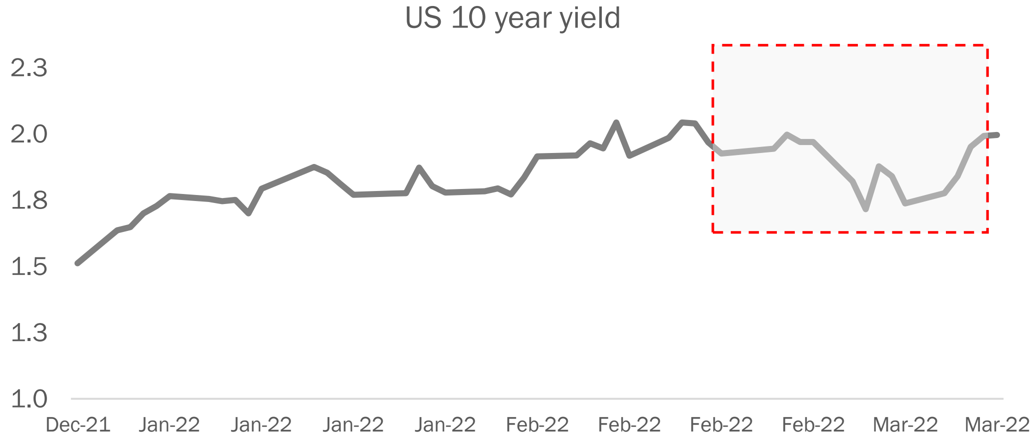


Source Market Data from Refinitiv Eikon

RUSSIA - UKRAINE CONFLICT…(2/3)

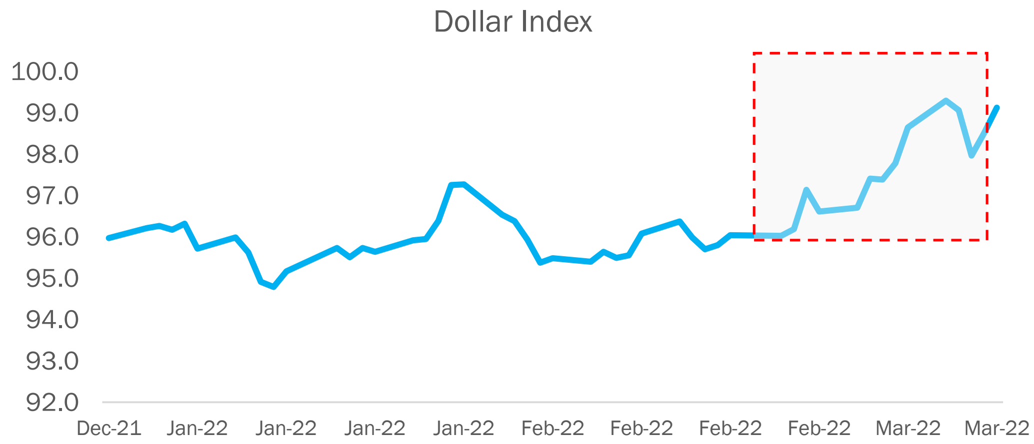
Global Impact:

Rising prices of energy led to higher inflation levels, fuelling for excess payments for inflation linked bonds, rate sensitive yields Treasury Inflation-Protected Securities (TIPS) fell, as breakeven approached 3.0%. On Feb 24, 2022, the global stock markets lost around US$ 1Tn in value and accelerated decline in major indices. Russia and Ukraine both account for majority of the world's food grain exports such as wheat which is 25% of the world's exports, one fifth of world's barley exports, and maize. Due to the ongoing conflict, prices have increased significantly by 28%, 23%, and 22% in wheat, barley, and maize respectively. Ukraine's exports have continuously grown over time, and it is now a "major source" of raw materials, chemical goods, and even machinery such as transportation equipment and therefore, the prices for materials have increased significantly with the LME index by nearly 10%.



Impact on KSA:

Russia is the second largest crude exporter behind Saudi Arabia, the current crisis is fuelling the supply to boost prices thereby leading to additional inflationary pressures. In the short-term, the Gulf exporters are poised to benefit from increasing energy prices and thereby from the export revenues.

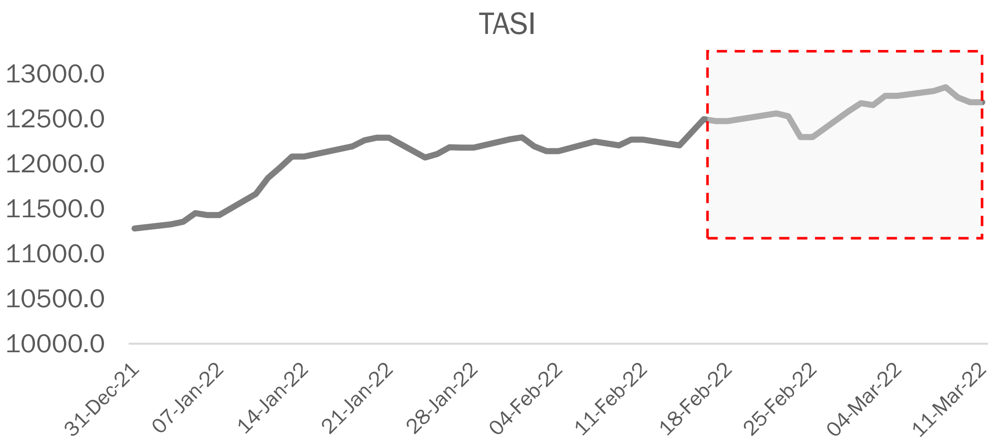


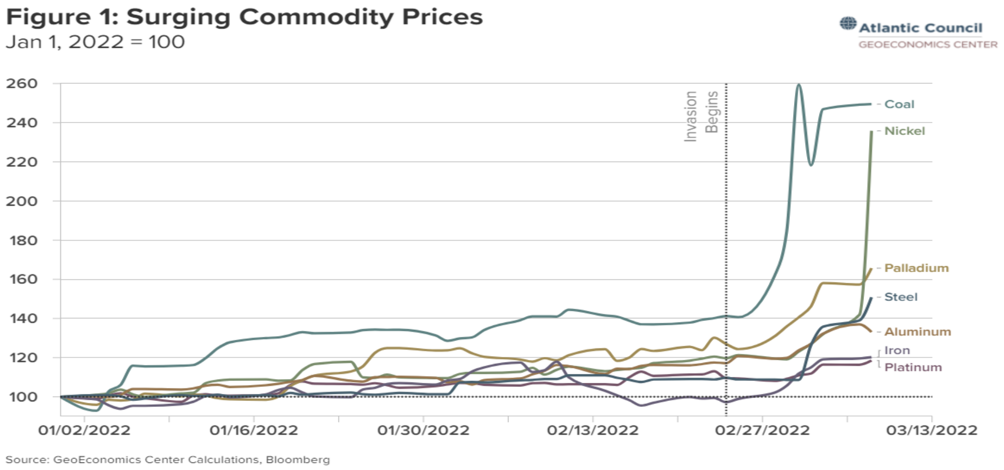
Source Market Data from Refinitiv Eikon

RUSSIA - UKRAINE CONFLICT…(3/3)

Impact on KSA:

Due to worldwide sanctions on Russia and ban on Russian exports particularly for oil might lead to additional pressures on Saudi for expansion on production capacity which is already witnessed between US and KSA. The events saw oil prices rise beyond $100 to average of $109.52 since invasion announcement. Fertilizer prices spiked post announcement, Urea prices increased by 66% reaching $905 on the 18th of March from $545 on the 23rd of February. Steel is currently averaging at around $1,100/ton from $990/ton pre announcement. Thus, the impact on TASI has been quite reverse as seen in S&P 500 due to index composition of TASI index is heavily weighted towards materials by 20% and energy by 6% which induced the upward trend.





Source Market Data from Refinitiv Eikon, Bloomberg

EXPECTED OUTLOOK

بلوم إنفست
BLOMINVEST

- Strong budget position for all GCC countries with expectations of oil prices remaining above $100/bbl
- Possible rise in Saudi market share in the oil space in the event of prolonged Russian sanctions. Opportunity to supply more of Europe with their energy requirements
- OPEC+ is likely to add additional supply amid rising inflation pressures to address immediate demand as relatively all restrictions have been lifted on domestic and international travel
- Metals including palladium and nickel have also surged in price. Ukraine and Russia also are two of the world's largest agricultural exporters prices for the same are likely to soar. Egypt mainly imports agri produce from these countries. Possible benefit for the fertilizer input producers in the region
- Saudi banks appear to be well capitalized and relatively less affected in the current market scenario. The sector has the potential to drive further upside in the index
- Consumer staples and electronics are likely to see headwinds due to supply chain shortages and rising input costs

- ***Strong budget position for KSA***
- ***Materials continue to remain favourable***
- ***Inflation and supply issues to continue***
- ***Rate hikes to have limited impact in the short term***

Source Market Data from Refinitiv Eikon

DISCLAIMER

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