

GCC and Egypt - Bright Spots in the Emerging Markets Space in 2018

Zahoor Bhat

2018 started as a volatile year for emerging markets as multiple headwinds rose - trade wars escalated, inflation was higher and monetary policy was tighter. **With emerging markets facing such new risks, GCC markets now appear to be more attractive and poised to make decent gains as the region moves away from oil and focuses on non-oil sectors.** GCC economies have already introduced expansionary budgets, mainly to drive the non-oil sector. Additionally, introduction of reforms and higher infrastructure spending are going to benefit these economies in the near to medium term. Improving oil prices will likely be the icing on the cake, with the MSCI and FTSE upgrading stocks driving inflow of billions of dollars to the market.

Emerging markets performed strongly in 2017, with most reporting double-digit returns. However, GCC market performance was subdued due to rising geopolitical tensions, lower growth and weak earnings, despite the sharp rise in oil prices in the second half. **Most GCC markets started 2018 on a positive note because of introducing expansionary budgets.**

Major macroeconomic drivers for the GCC in 2018:

- A rebound in economic growth on increasing contributions from non-oil sectors. The IMF expects overall GDP growth of 2.2% in the GCC, compared to just 0.5% in 2017. It expects GDP growth in Egypt to rebound to 4.5% from 4.1% in 2017
- Fiscal discipline, backed by subsidy reforms over the past two years, will likely lead to additional efficiencies in government spending, reducing fiscal breakeven oil price levels
- Higher government spending should benefit project activity in the near term
- Additional spending on account of the FIFA World Cup 2022 in Qatar and the Expo 2020 in the UAE
- Increasing business opportunities due to social reforms (such as cinemas opening and women being allowed to drive in Saudi Arabia)

Market drivers:

GCC markets are currently trading at the lower end of their historical valuation ranges. "Following

will be key catalysts for equity markets in 2018:"

- Increasing flows due to the potential inclusion of Saudi Arabia and Kuwait in the MSCI Emerging Markets (EM) Index and FTSE, and an increasing free float in Qatar
- Privatization of government-owned entities
- A recovery in corporate earnings
- Attractive valuations, supported by higher dividend yields

Analysis by country:

Saudi Arabia, Kuwait, Qatar and Egypt are better positioned than the UAE, Oman and Bahrain. Key themes at the country level:

Saudi Arabia: Better growth visibility with lower valuations

- Expansionary budget to boost domestic consumption through increased wages, subsidies and social benefits account
- Recent reforms (such as allowing women to drive and opening cinemas) should benefit the economy in the near to medium term
- Earnings recovery to be supported by the banking, consumer and insurance sectors
- Market-linked catalysts include Saudi Arabia's inclusion in the MSCI and FTSE, and the listing of Saudi Aramco

Kuwait: Inclusion in key indices to support inflows

- Consumption recovery, aided by a favorable inflation environment
- FTSE EM upgrade, set for September 2018
- Potential upgrade of Argentina (resulting in a bigger weight for Kuwait on the MSCI Frontier Markets Index)

Qatar: Project activity supports growth; valuations remain attractive

- Higher government spending to sustain project-led growth
- Corporate earnings set to recover as the embargo's crippling effects ease
- Valuations remain at their lowest in seven years

Egypt: Fiscal strength supports earnings recovery

- Lower interest rates and an earnings recovery
- Increase in real disposable income and a rebound in tourism growth
- Increase in gas production to benefit industrials and reduce import bills for liquefied natural gas

Risks:

- Geopolitical risks remain elevated due to intra-regional diplomatic tensions
- Widening fiscal deficits and depleting foreign reserves to test currency pegs
- Delay in reforms may limit any positive impact

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