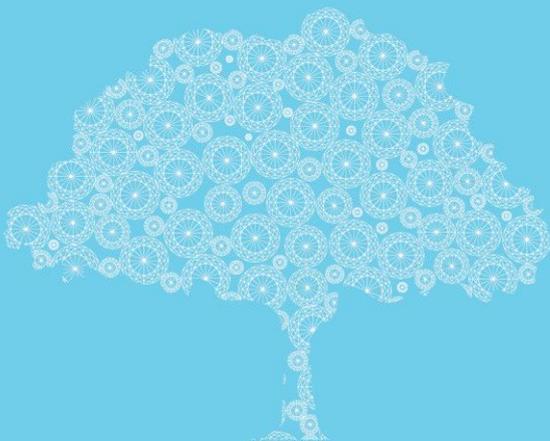




# Al Masah Capital: MENA Yearbook 2018

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February 2018

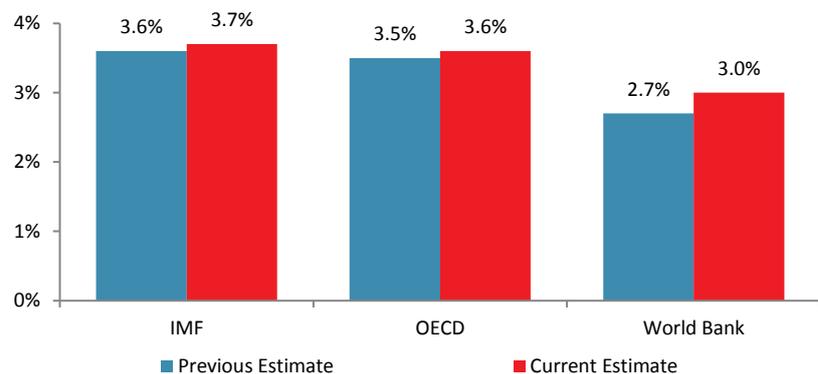
## A YEAR OF SYNCHRONIZED GROWTH

### Global Economy

*The year saw a robust global growth since the last financial recession*

The global economies started 2017 on a vulnerable note despite the signs of the economic growth picking up during the second quarter of 2016. There were several questions raised about the sustainability of growth and fear of populism within the markets at the beginning of the year 2017. However, the persistent improvement in the leading global indicators, especially in US, Europe and Japan, forced the change in perception since the second quarter of 2017. This also led several global agencies to change their forecast upward as growth was only beating earlier predictions but also signaling towards further acceleration in the coming quarters.

**Exhibit 1: Changes in Global Growth Forecast by Leading Agencies (2017)**



Source: IMF, OECD, The World Bank, Al Masah Capital Research

The most impressive part about 2017 has been the synchronized growth witnessed across major economies, especially the acceleration of recovery in the Eurozone and robust growth in Japan, coupled with stabilization in the Chinese economy. There have been a number of factors that have led to the sustained growth in 2017 but the main driver has been the accommodative monetary policy. Central Banks have shown confidence in the global growth and provided a clear direction about monetary policy in 2018 to the markets. While the Central Banks have been closely monitoring the pace of growth, the movement in inflation which continued to remain below their targets during the year played a crucial role in maintaining the accommodative policies. As a result, 2017 proved to be the year of investments across the global markets, with low double digit returns recorded across leading markets on the back of a solid rise in corporate profitability.

*Global growth is expected to further rise in 2018 to 3.9% compared to 3.7% in 2017*

Given that the economic activity is strengthening globally, it has prompted leading agencies to revise their forecast upwards for 2017 and 2018. In January 2018, the IMF revised the global growth forecast to 3.7% for 2017 which is expected to further rise in 2018 to 3.9%, 0.1% higher than the October 2017 estimates. The World Bank expects the global economies to grow by 3.1% in 2018 on the back of the recovery in investment, manufacturing and trade continues coupled with firming commodity prices benefiting commodity exporting developing economies.

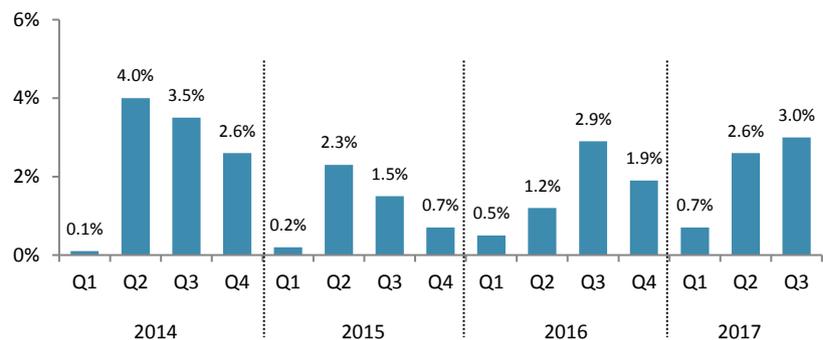
## Developed Economies

*The US economy strengthened further in 2017, continuing the positive momentum from the previous year*

### The US Continued its Strong Momentum in 2017

The US economy depicted a strong growth momentum in 2017, which was mainly supported by subdued inflation and loose financial conditions. The slowdown seen during the first quarter of 2017 sent a warning signal, however the US was quick to recover from the slack. The improvement in the leading economic indicators, especially the strong job market and robust retail sales pointed towards a one-off quarter and confirmed that the economy was still on a strong growth trajectory. The consumer confidence index reaching its highest level since November 2000 and the continued rise in employment were the main reasons behind the better than expected rise in retail sales during the year. The US economy is expected to record a growth of 2.3% in 2017, the fastest since 2014.

**Exhibit 2: US GDP Growth (2014-2017)**



Source: Thomson Reuters, Al Masah Capital Research

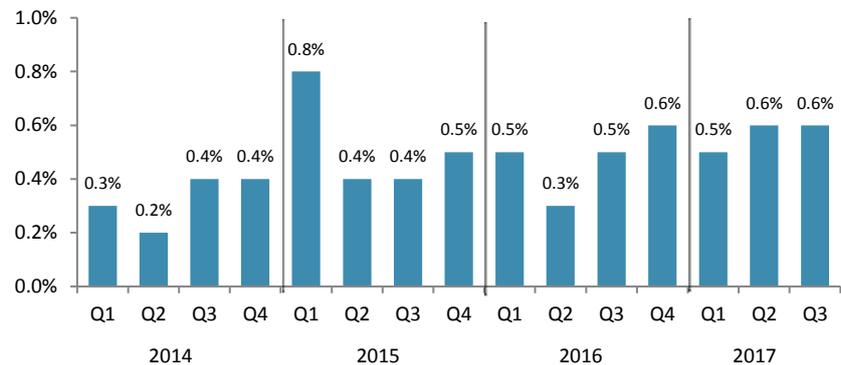
Although the IMF lowered its growth forecast for the US in its October 2017 edition, it expects the US to grow by 2.3% in 2018 compared to its earlier forecast of 2.5% in its April edition. The World Bank, on the other hand, has raised its forecast by 30 bps to 2.5% in 2018, indicating the growth momentum will continue to strengthen in the current year. Going forward, the US is expected to continue the strong uptick in the economic activity seen since the second quarter of 2017, which will be mainly supported by two factors - one is consumption and second is corporate investments. Further, the economy should also get a boost from the recently passed tax reform by the Trump Administration. The US Fed continued to normalize the monetary policy in 2017 by raising rates and started to gradually reduce the balance sheet size. Given that the economy is moving closer to full employment coupled with moderate wage growth, the Fed might resort to a more gradual tightening in 2018 to avoid any major shocks to the economy.

### Eurozone on a Strong Recovery Path

*Eurozone has positively surprised the global markets both economically and politically in 2017*

Eurozone gained significant traction during 2017 as the region has positively surprised the global markets, both economically and politically. The growth in the Eurozone has been spurred by policy stimulus and the strengthening in the global demand. The stimulus by the ECB finally started to reflect positively on the broader economy, which was an important element as many believed at the beginning of the year that the policy measures taken by the central bank were becoming ineffective and should rather start focusing on fiscal measures to stimulate growth.

**Exhibit 3: Eurozone's GDP Growth (2014-2017)**



Source: Thomson Reuters, Al Masah Capital Research

The sequential growth of the Eurozone during the first three quarters of 2017 was broadly consistent at 0.6% and is expected to grow by 2.4% for the full year. This solidifies the region's growth story as it has been consistently growing at a similar pace in the past two to three years. Loose monetary policies, stable labor market and strong consumption has ensured the growth remains intact, however political challenges continue to dampen the investments by both domestic and international investors.

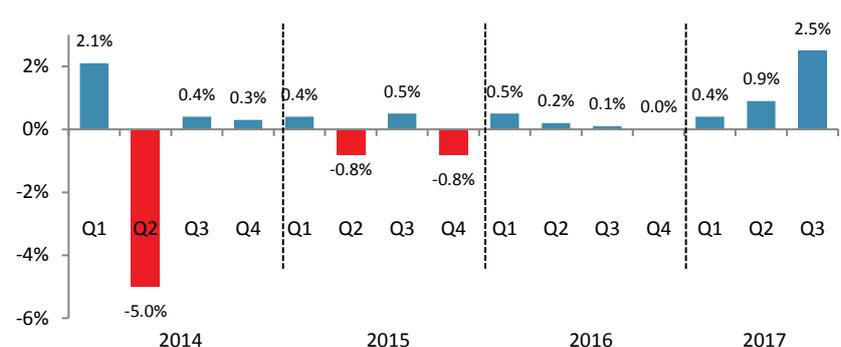
Going forward, the Eurozone is expected to continue the growth momentum, albeit at a slightly slower pace compared to 2017. Moreover, the Eurozone has enough capacity to continue to deliver solid improvements witnessed over the past year as suggested by host of leading economic indicators, despite the political challenges it might encounter in 2018. The UK, on the other hand, looks vulnerable as they struggle to strike a deal with the EU, which will be important to avoid any considerable slowdown in its economic activity during 2018.

### Japan is Now Contributing to the Global Growth

The Japanese economy outperformed the expectations during 2017, and more importantly it has started contributing to the global growth. The economic activity was boosted by a gradual recovery in consumer spending and robust growth in exports, coupled with significant improvement in corporate investments during the year.

*Japan has continued its recovery path on the back of the acceleration in export*

**Exhibit 4: Japan's GDP Growth (2014-2017)**



Source: Thomson Reuters, Al Masah Capital Research

The labor market environment tightened during the year as the unemployment rate dropped to a 22-year low. However, the growth in wages was relatively moderate

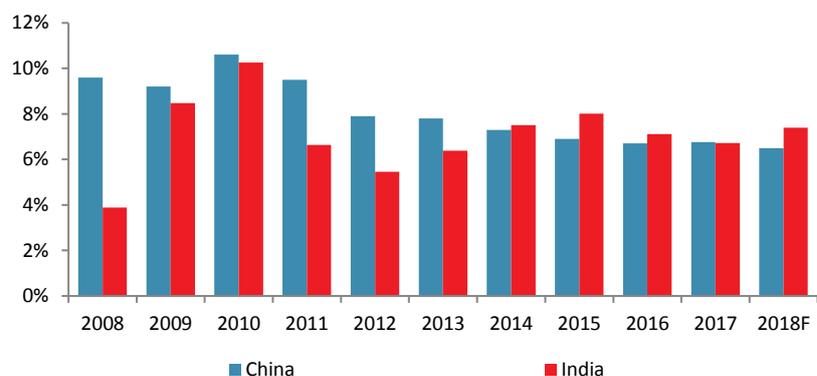
compared to the rise in the labor market, which kept the inflation below 1%. As a result, the Bank of Japan left rates unchanged in 2017 and ensured that they continue to purchase bond to maintain the long-term yields around zero.

Going forward, Japan is expected to benefit from a weaker Yen and an improvement in business confidence to maintain its growth momentum on the back of record profits and increasing cash flows. Further, the improvement in the labor market will continue and capex cycle will get further boost from rising profits in the year 2018. However, the growth is expected to moderate in 2018 on the back of slowing export and withdrawal of fiscal stimulus by the central bank.

## Emerging Markets

The emerging markets have continued to witness a steady growth in the economic activity during the year. However, the growth pattern within the region varies significantly as the dynamics have changed over the past few years but are broadly supported by the strong rise in the global demand. The growth in emerging markets in 2017 helped in recovering corporate earnings and supported local currencies. Further, the central banks have adopted conducive monetary policies to support growth but have maintained the economic equilibrium.

**Exhibit 5: GDP Growth in China and India (2008-2018F)**



Source: IMF, Al Masah Capital Research

*China might witness a deceleration in its economic activity during 2018 but the growth will remain above 6%*

China, on the other hand, is undergoing structural changes but is continuing to grow at a pace, which is beating both government and market expectations. The real GDP is expected to grow by 6.8% in 2017 on the back of rising household income and improved external demand. There were several questions raised about the Chinese economy at the beginning of the year, but the country has depicted consistent improvement in the economic activity over the course of the year. Further, the concerns about elevated debt levels and weaker growth are expected to re-emerge but the government has the buffer to mitigate the downside risk going forward. China will continue to focus on the quality of growth rather than pace as it embarks to rebalance from an export-based economy to a consumption-based economy.

India is experiencing a mild slowdown in its economic activity on the back of reform measures taken by the government in the past 12 months. The country is expected to grow at a rate of 6.7% in 2017 compared to 6.8% in the previous year. On the positive side, the inflationary pressures have eased during the past couple of years, which have



# MENA Yearbook

*India is expected to recover from the mild slowdown seen in 2017*

*Emerging markets are expected to maintain their growth trajectory in 2018*

provided the RBI the room to reduce rates to offset some of the slowdown seen in the past four quarters. Going forward, India is expected to witness an uptick in its economic activity in 2018 and 2019 but the recapitalization of banks by the government will be an important element in returning to the growth levels seen prior to 2015.

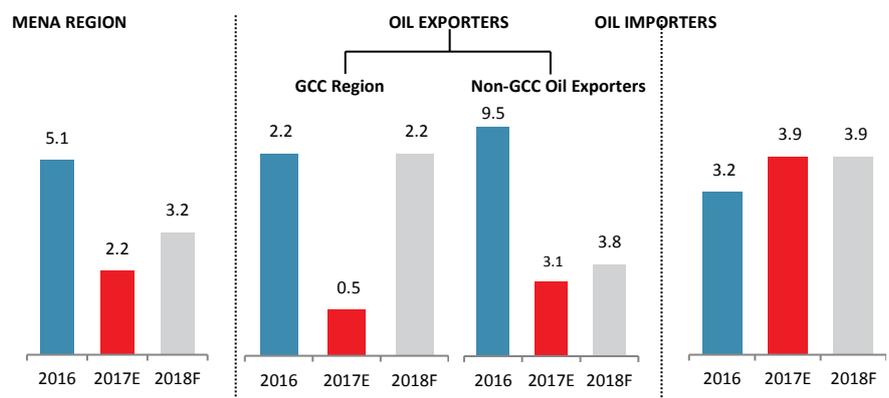
Overall, the region is expected to grow at 4.9% in 2017, but the growth might accelerate further in 2018. The emerging markets have historically outpaced the growth in global and developed markets, which is likely to continue in 2018. Given that the global economic growth is expected to strengthen further in 2018, the emerging markets will continue to benefit from an increasing global trade. The regional growth will be led by Asian heavyweights - China and India, while Brazil and Russia are likely to continue their recovery path from their recent recessions.

## THE WORST MIGHT BE OVER FOR MENA ECONOMIES

*The MENA region is expected to witness a pick-up in its economic activity in 2018*

The years 2016 and 2017 can be considered as a period of consolidation for the region coupled with host of initiatives to introduce alternative measures to boost government receipts. The regional governments have remained focused on the pace of fiscal consolidation, which was mainly through rationalizing the spending programs. Further, the policy makers have also been prudent in managing the liquidity environment across the region since the start of 2017. According to the IMF, the region is expected to record a real GDP growth of 2.2% in 2017 and rise to 3.2% in 2018. The World Bank, on the other hand, expects the region to grow by 1.8% in 2017 and 3.0% in 2018. The consensus view is that the MENA region is expected to recover and reap the benefits of the measures introduced by the governments in 2018. However, the biggest challenge to the economic outlook will continue to be sustained by geopolitical uncertainties and further extension of the OPEC's oil-cut during the course of the year.

**Exhibit 6: MENA Economic Growth Over 2016-18F (% change)**



Source: IMF, Al Masah Capital Research

*GCC economies are expected to recover from their structural challenges in 2018 and are expected to grow by 2.2% this year*

In the MENA region, the GCC countries continue to adjust to the new reality of lower oil prices, which has changed the dynamics of the region. As a result, the GCC is expected to report a significant slowdown in its economic activity during 2017 on the back of fiscal consolidation, lower oil production and regional conflicts. According to the IMF, the real GDP of GCC is expected to grow by 0.5% in 2017 compared to 2.2% in the previous year. The real oil GDP is expected to drop by 2.3% in 2017, which is expected to be offset by 2.6% rise in non-oil GDP during the year. However, the region is expected to rebound in 2018 as growth is expected to reach 2.2%, mainly on the back of strong oil prices and projected rise in the domestic demand coupled with measures introduced by the governments during the past two years.

*Oil importing economies have recovered from 2016 and are expected to maintain the pace of growth in 2018*

The oil importing economies in the MENA region have recovered from the challenges faced during 2016. The region is expected to grow by 3.9% in 2017 compared to 3.2% in the previous year. In the oil importing countries, Egypt continues to remain the most promising economy as the country is expected to grow by 4.5% in 2018 compared to 4.1% in 2017 and 4.3% in 2016 as the measures implemented by the government are beginning to feed into the real economy coupled with the aid package received by the IMF. Both of these factors have helped the country in attracting foreign investments and boosting the foreign reserves during the year.

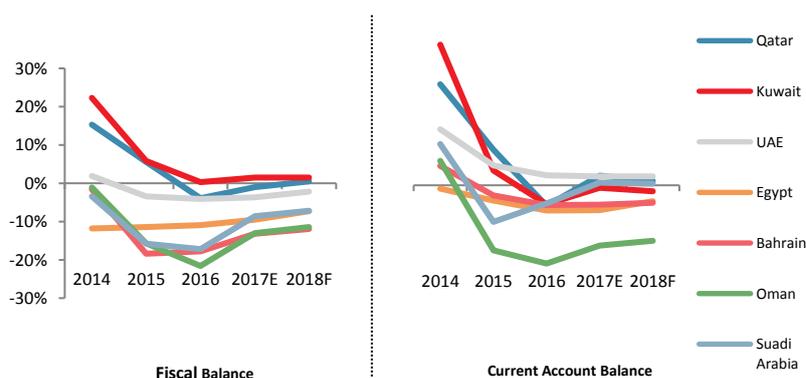
*Fiscal deficits are expected to contract in 2017 due to a significant growth in the fiscal consolidation reforms*

## Fiscal Deficits have Contracted but Still Significantly High

The fiscal deficits of the GCC is expected to have contracted in 2017 compared to the previous year, however it is still significantly higher across the region. The regional governments have taken prudent steps in accelerating the pace of fiscal consolidation during the year; however, they will have to continue to introduce reforms and other measures to bring down the deficits to acceptable levels and avoid being a drag on the broader economies. The introduction of VAT this year is one such example of measures taken by the regional governments, however the pace of such reforms should continue even though the oil prices are showing news signs of stabilization since the start of 2018.

The fiscal deficit of the GCC region in 2017 is expected to range from 3.7% of GDP in the UAE to 13.2% in Bahrain. Saudi Arabia, the largest economy in the GCC, is expected to report a fiscal deficit of around 8.6% of GDP in 2017 compared to 17.2% in the previous year. This can be attributed to the austerity measures taken by the government coupled with approximately 20% rise in average oil prices during 2017, which helped to offset the extension of production cut until the end of 2018. The current account balances within the region have improved across the board; however, challenges continue to persist in some of the regional countries. The most notable improvement was seen in Saudi Arabia; however, Bahrain and Oman continue to face challenges in 2017. The improvement in the current account was on the back of higher oil prices coupled with stable exports.

**Exhibit 7: Fiscal and Current Account Balances (% of GDP)**



Source: IMF, Al Masah Capital Research

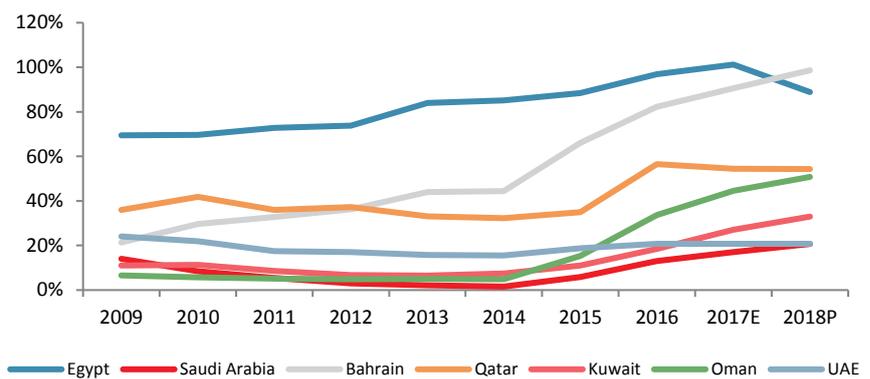
In 2017, the average oil price stood at USD 54.7, which is around 21% higher compared to USD 45.1 seen during 2016. The start of 2018 has been exceptional for the oil prices as it has managed to touch the USD 70 mark level, something which has not been witnessed during the past three years. There are a number of factors that have led to the rise in oil prices in the recent weeks, which are mostly associated to constraints or drop in supplies. However, the robust global economic outlook means strong demand going forward, which has also played an important role in supporting the oil prices. The gradual rise in oil prices bodes well for the region as it will help in increasing government receipts and reduce the overall deficits during the year. The recent budget announcements of the regional governments are also a further testimony that the authorities are in a much better position for expansionary budgets to support the broader economies and stage a much anticipated recovery across the region.

*Gross debt increased gradually across MENA in 2017 to fund the fiscal deficit*

## Debt Rising to Fund Fiscal Deficit

The total debt of the MENA region has been rising since 2014, which has become more prominent and significant since 2016. Initially, the regional authorities funded the deficits through deposits and Forex reserves but the rapid depletion of assets and persistent decline in the oil prices forced the governments to tap the debt market to avoid major liquidity crisis in the domestic markets. The total debt since 2014 stood at USD 95.4 billion, of which USD 90.1 billion was raised in 2016 and 2017 alone. As a result, the region has witnessed a significant increase in its debt to GDP ratio compared to 2010, however it is much lower compared to the global markets.

**Exhibit 8: Gross Debt as a Percentage of GDP (2009–2018P)**



Source: IMF, Al Masah Capital Research

Within the GCC region, Saudi Arabia and the UAE have raised more than USD 25 billion through international bonds and local Islamic bonds to support their budget deficits. As a result, the debt to GDP of Saudi Arabia rose to 17.0% in 2017 from 13.1% in 2016. In the GCC, Bahrain has the highest debt to GDP ratio of 90.6% in 2017, which has increased from 82.3% in 2016. Within the wider MENA region, Egypt is the only country to have a debt to GDP ratio of above 100% as it continues to support the broader economy.

## Inflation Depicts Inconsistent Pattern

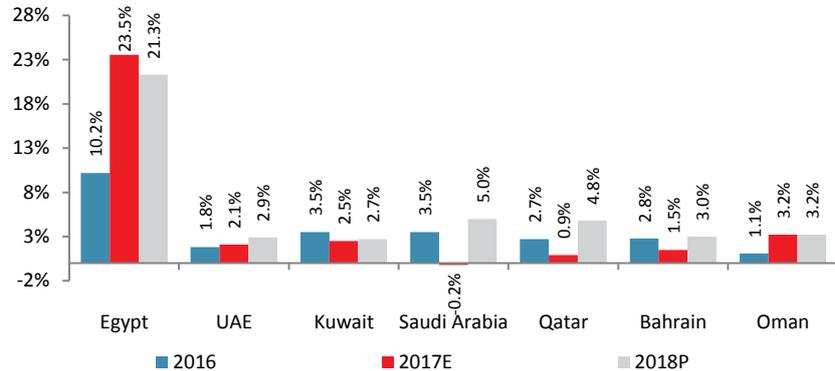
Inflation in the MENA region has provided mixed signals as individual countries are witnessing different patterns during the year. The inflationary pressure has moderated during the second half of the year, which was mainly due to a deceleration seen in Egypt on the back of measures taken by the regulators.

According to the IMF, inflation in the MENA region is expected to rise to 7.1% in 2017 compared to 5.4% in 2016. During 2017, Egypt recorded the highest rise in inflation rate, registering 23.5% in 2017 compared to 10.2% in 2016 on the back of the sharp currency devaluation, implementation of reforms such as subsidy cuts and two rounds of hikes in the energy prices. Similarly, inflation in the UAE and Oman has also increased during the year. In the region, Saudi Arabia was the only country to witness a drop in inflation, reporting negative readings for most of the months of the year.

*Inflationary pressures were seen across the MENA region, mainly due to a significant rise in Egypt*

*Inflation in Saudi Arabia is one of the lowest in the region for 2017*

**Exhibit 9: Inflation (2016-2018P)**



Source: IMF, Country Statistical Authorities, Al Masah Capital Research

*Inflationary pressures are likely to resurface with the introduction of VAT in 2018*

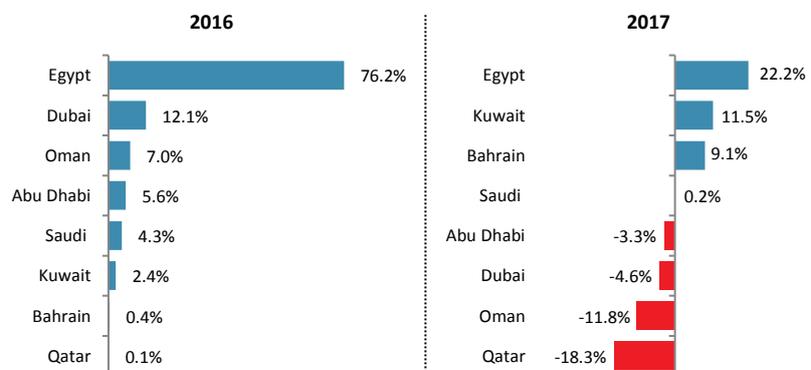
Inflationary pressures are expected to resurface again in 2018 on the back of higher commodity prices and introduction of VAT at the start of the year. However, the impact of VAT might be witnessed during the first year of its implementation and start fading out from the second year. The main concern about the VAT would be the impact on consumption as it is a new phenomenon within the region. Within the region, inflation in Egypt should start improving, signs of this have already being seen during the past two to three months and a more concrete reduction will be recorded in 2018 and 2019.

## Equity Market Performance

*Equity markets in the region have underperformed the global markets during the year 2017*

The regional markets ended the year on a negative note, broadly underperforming the global markets in 2017. Although, the oil prices gathered the positive momentum during the second half of the year to appreciate by 21% compared to the previous, it was not able to change the trajectory of the regional markets as investors remained concerned about the regional overhang. The slowdown in government spending, as it focused on fiscal prudence, also weighed on the regional markets. On the whole, there was lack of conviction within the investors to move the markets higher during the year.

**Exhibit 10: Index Returns (2017 vs. 2016)**



Source: Thomson Reuters, Al Masah Capital Research

In the MENA region, Egypt was the best performer in nominal terms as the index was up by 21.7% in 2017 compared to the gains of 76.2% recorded in 2016. The index was supported by the recovery in the economic activity and the changing perception of

*GCC Equity markets ended 2017 on a sluggish note as sentiments were dampened by the regional overhang and a slowing economic activity*

*Trading activity mostly declined across the region in 2017*

international investors post the aid from the IMF. Further, the regulatory authorities have taken appropriate measures to tackle the structural challenges, which are beginning to have a positive impact on the broader economic activity.

In the GCC, the sentiments were sluggish for most part of the year as investors were concerned about the regional overhang coupled with structural headwinds arising from lower oil prices. Although the regional markets started 2017 on a strong note, continuing the momentum from 2016, the geopolitical environment coupled with a slow economic activity weighed on investor sentiments. In 2017, four out of the seven indexes ended on a negative note, while only three managed to close on a positive note. Kuwait was the best performing index within the region as it recorded gains of 11.5% in 2017, followed by 9.1% in Bahrain and 0.2% in Saudi Arabia. The largest market in the GCC, Saudi Arabia witnessed a strong rebound during the fourth quarter, which helped the broader index in recovering the losses to turn marginally positive for the year. Among the losers, Oman led the pack with losses of 11.8%, followed by 4.6% in Dubai and 3.3% in Abu Dhabi.

### Trading Activity Depicted Mixed Trends in 2017

Trading activity across the region depicted a subdued picture as both the volumes and traded value declined during the previous year. The trading activity within the region, especially the value of shares traded was mostly impacted by Saudi Arabia as it witnessed a drop of 28.4% during the year. Excluding Saudi Arabia from the regional calculation suggest that rest of GCC countries witnessed an increase of 5.2% in total traded value during the year 2017. The impact was not so prominent on traded volumes as the rest of the GCC still witnessed a decline of 3.2% compared to 12.6%, including Saudi Arabia. The subdued trading activity can be attributed to the lack of conviction within the investors, especially due to the ongoing geopolitical uncertainty during the year.

**Exhibit 11: MENA Trading Activity (2016 vs. 2017)**

Exchange	Volume (billion)			Value (USD billion)		
	2016	2017	% Change	2016	2017	% Change
Egyptian Exchange	68.6	74.6	8.7	15.4	17.6	14.3
Saudi Stock Exchange	67.7	43.4	-35.9	308.1	220.6	-28.4
Kuwait Stock Exchange	30.3	50.2	65.8	9.3	20.2	117.2
Muscat Securities Market	3.2	2.6	-19.4	2.1	1.8	-15.2
Qatar Exchange	2.0	2.5	23.0	19.4	18.0	-7.3
Bahrain Stock Exchange	0.7	1.1	57.0	0.3	0.5	73.7
Abu Dhabi Securities Market	25.1	25.0	-0.4	12.7	12.6	-0.4
Dubai Financial Market	105.8	80.3	-24.1	36.2	31.0	-14.3
<b>GCC Market</b>	<b>234.8</b>	<b>205.1</b>	<b>-12.6</b>	<b>388.1</b>	<b>304.7</b>	<b>-21.5</b>

Source: Zawya, Al Masah Capital Research

In 2017, Egypt witnessed an increase of 8.7% in traded volumes and 14.3% in traded value, which was also reflected in the performance of the index during the year. In the GCC, Kuwait and Bahrain were the standout performers as both of them witnessed an increase of 117.2% and 73.7% respectively in total traded value during the year, while Saudi Arabia and Dubai were the worst performers as they witnessed a decline of 28.4% and 14.3% respectively in 2017. Saudi Arabia has witnessed a decline in its trading activity for the last

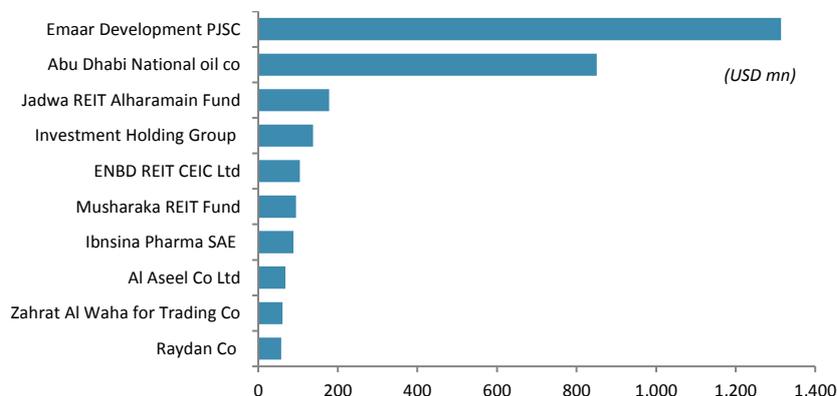
two consecutive years, which can also be attributed to the overall dynamics of the country.

## IPO Closings during the Year

The MENA region witnessed a positive upturn in its IPO activity in 2017. During the year, as many as 30 IPOs worth around USD 3.4 billion were launched compared to only seven IPOs worth USD 473 million in 2016. The regional markets showed a strong bullish investment climate compared to the previous year on the back of lower volatility and the equity markets being at an all time high. Going forward, the continued stability of oil prices, the on-going privatization plans of the governments, coupled with the strong economic reforms are likely to drive the IPO activity to a significant level. The majority of the PE and VC firms are looking to reduce their downside risk and are preparing their portfolio companies for their respective IPO's.

**Emaar Development PJSC had the largest IPO in the region**

**Exhibit 12: Major IPOs in 2017 (USD million)**



Source: Thomson Reuters, Zawya, Al Masah Capital Research

Saudi Arabia witnessed the largest number of IPOs (15) for 2017, followed by UAE and Oman (4 each), Egypt (3), Tunisia (2); while Qatar and Bahrain recorded (1) each. In terms of value, UAE led with IPOs in the region worth over USD 2,286.2 million, followed by Saudi Arabia (USD 639.5 million) and Egypt (USD 176.4 million). Sector-wise, real estate firms recorded 8 listings during the year, followed by financial services (6 IPOs), manufacturing (4 IPOs), F&B (3 IPOs), and consumer goods and retail (2 IPOs each).

In 2017, the largest IPO in the MENA region was that of UAE's Emaar Development PJSC at USD 1.3 billion. The company bagged huge investments from institutional investors, which hold approximately 90% of the shares being offered, while the residual shares were distributed to the public (retail investors) at large.

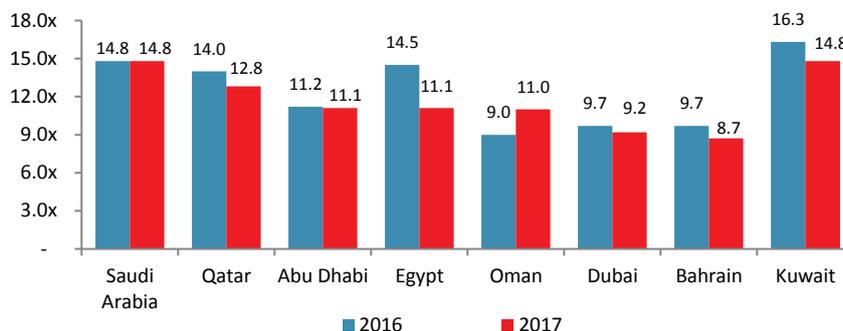
## Market Valuations (P/E and P/B)

Since the regional markets have underperformed during 2017, the market multiples have dropped across the region to reach the levels seen at the end of 2015. The market indexes have not moved in line with the oil prices or with the earnings, which have been broadly stable during the year. Hence, the regional markets are looking attractive at current levels, especially when the consensus is optimistic about the recovery in the region going forward. However, the regional overhang seems to be the main concern for investors,

*Market multiples are back to 2015 levels after rising in 2016*

which is reflecting in the current market valuations across the region, especially for the GCC countries.

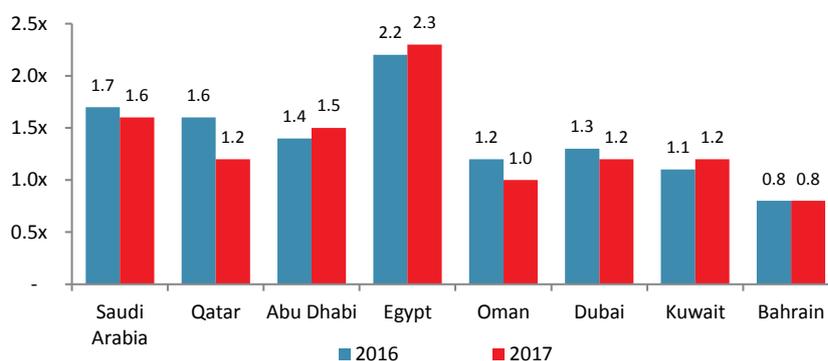
**Exhibit 13: P/E Valuations (2016 and 2017)**



Source: Thomson Reuters, Al Masah Capital Research

In 2017, the price-to-earnings (P/E) ratio have declined across the region with the exception of Oman as it increased from 9.0x in 2016 to 11.0x in 2017. Saudi Arabia's P/E remained flat during the year, which is in line with the index performance as not much changed during the year. However, the re-rating of earnings during the year should change the outlook of the country and the multiples should accordingly adjust to the changing dynamics. The UAE market seems to be the most attractive within the region as it continues to be lower compared to its regional peers. Given that the economic environment in the region is expected to recover in 2018, both Dubai and Abu Dhabi might be the biggest beneficiary of the same.

**Exhibit 14: P/B Valuations (2016 and 2017)**



Source: Thomson Reuters, Al Masah Capital Research

The price-to-book (P/B) ratio of the regional markets indicate that there has not been any significant change during the year. The P/B multiples are looking attractive for most of the regional economies as they are much lower compared to their historical averages. Given that the region is poised for recovery in 2018 coupled with expansionary budgets approved by the regional authorities, one can expect the multiples to move higher in the coming year if investors start factoring in rebound in earnings, especially the large and prominent corporate.

## SAUDI ARABIA

### Real GDP Growth

Saudi Arabia continued its struggle in 2017 as the economy witnessed its lowest GDP growth since 2010, coming in at -0.7%. Contrasting the 1.7% rise in 2016, the largest economy in the GCC retracted with subdued domestic demand, lower consumer confidence and the effects of the pullback in government spending. The imposition of excise taxes on tobacco amongst other commodities and levies on expatriate dependents, both of which came into effect in mid-2017, had a dampening effect on demand. Furthermore, reduced oil output in compliance with OPEC's oil-cut deal, low oil prices and the on-going political dilemma added to the woes. During the year, the Kingdom's non-oil growth reached a better than expected 1.5%, while oil sector GDP contracted by 3.1%.

The drop in oil prices has forced Saudi Arabia to rethink its economic strategy, and to boost growth and solidify the 'Saudi Vision 2030' diversification plan, the government presented the 2018 budget in December which includes the recently introduced VAT and prioritizes capital expenditure. In its largest ever budget, the Kingdom expects the economy to rebound in 2018 to 2.7%, largely driven by the non-oil sector which is projected to grow by 3%, as authorities ease austerity measures and build a pathway for the post-oil era. Most notably, a surge in oil prices to almost USD 70 during the end of 2017 has given a tailwind to the government's efforts to revive growth. Therefore, adopting an expansionary fiscal stance in the recent budget to support domestic consumption and stimulate the private sector also prompted the IMF to raise its growth forecast to 1.6% in 2018 from the previous estimate of 1.1%.

*Saudi Arabia's GDP contracted by -0.7% in 2017; the government remains positive on 2018 outlook*

Exhibit 15: Real GDP Growth (%)



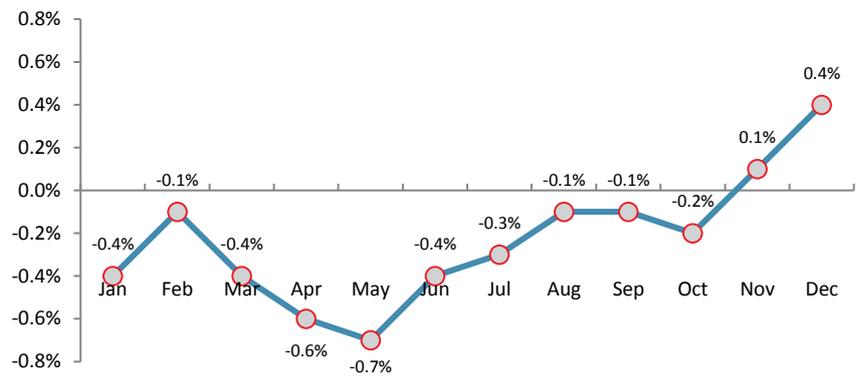
Source: IMF

### Inflation

2017 was marked by a deflation in consumer prices, and the CPI is estimated to have ended the year on a negative average rate of -0.2% compared to 3.7% in 2016. Demand remained cowed on the back of recent reforms with food, housing and transportation, the three largest components in the Saudi cost of living index, lingering in the negative territory. However, 2018 is bound to tell a different story as inflation is expected to bounce back to approximately 2.5% or above driven by the recent introduction of 5% VAT, a further round of energy price hikes, and general recovery in consumer spending.

*2017 was marked by deflation in consumer prices*

**Exhibit 16: Inflation (Y-o-Y)**



Source: Saudi Arabian Monetary Agency (SAMA)

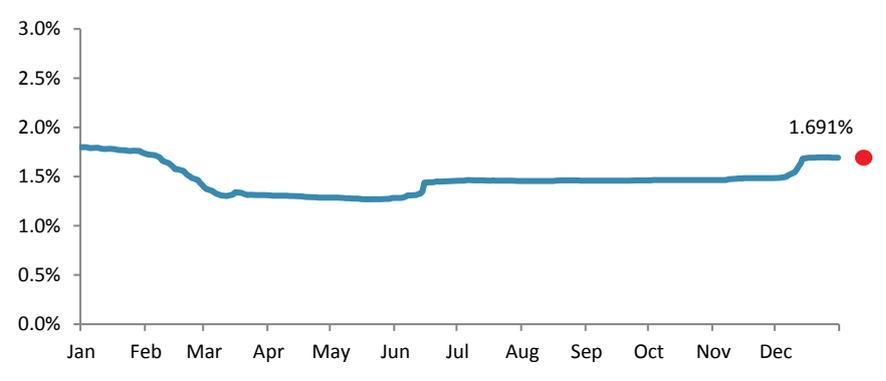
Affirming the government's commitment on the Fiscal Balance Program and Vision 2030, soon-to-be introduced tariffs aimed at residential, commercial, agricultural, healthcare, private education, and charitable institutions are further expected to boost inflation substantially in 2018.

### Policy Interest Rates

With the sovereign bond issuances having injected a much-needed liquidity into the banking system, interbank rates have remained lower. The 3-month SAIBOR fell by approximately 11 bps to stand at 1.691% at the end of December from 1.8% in January. On the other hand, borrowing costs rose in 2017 following three successive interest rate hikes of 25 bps in SAMA's benchmark reverse repo rate which reached 1.5%, in line with the US Federal Reserve's monetary tightening program. With the US Fed envisaging further hikes in 2018, SAMA will likely follow suit but also raise its repo rate, which has remained at 2.0% for more than 10 years, to restore the spread.

*3-month SAIBOR fell by approximately 11 bps to reach 1.69%*

**Exhibit 17: SAIBOR (3 Months)**



Source: Thomson Reuters

*Saudi Arabia's fiscal deficit for 2017 has shown marked improvements*

## Budget Surplus/Deficit

Historically, Saudi Arabia has enjoyed huge surpluses until the onset of the oil price crisis in mid-2014 which has resulted in a fiscal deficit that has marred the economy ever since. However, with the introduction of several fiscal measures, the Kingdom's budget deficit is expected to have narrowed to around -8.6% of GDP in 2017 from -17.2% the year ago. The government's fiscal position during the year has shown marked improvements with the original 2017 budget plan projecting a deficit of SAR 198 billion (~USD 53 billion), while in Q3 2017 the deficit stood at SAR 48.7 billion (USD 12.9 billion), much lower than SAR 53.8 billion (USD 14.3 billion) during the same period of 2016. This reinstated the government's position to carry out its ambitious infrastructure projects and meet its spending targets for the year.

Going forward, the government revenues are likely to rise sustainably led in parts by the increasing oil prices and higher output (post extinction of the OPEC deal to curb production), supporting the hydrocarbon sector growth, and the fiscal reforms following which the budget deficit is expected to further narrow to about -7.2% of GDP. As per the 2018 budget, expenditures are projected to rise by 5.6% to SAR 978 billion (USD 261 billion), while revenues are expected to increase by 12.5% to SAR 783 billion (USD 209 billion). Based on these projections, the government is budgeting for a fourth consecutive fiscal deficit in 2018 of SAR 195 billion (-7.3% of GDP, USD 51.9 billion). Furthermore, the Saudi Ministry of Finance (MoF) anticipates that the recently initiated VAT and the Expatriate Tax are expected to generate SAR 23 billion (USD 6.9 billion) and SAR 28 billion (USD 7.4 billion), respectively in 2018.

*Saudi Arabia's current account surplus in 2017 is estimated to stand at 0.63% of GDP*

## Current Account Balance

As per the IMF, Saudi Arabia's current account balance in 2017 is estimated to stand at 0.63% of GDP, improving its position from a deficit of 4.3% of GDP in 2016. In the second quarter of 2016, the Kingdom recorded a current account deficit of SAR 10.23 billion (USD 2.73 billion) compared to a deficit of SAR 25.73 billion (USD 6.86 billion) in the corresponding quarter of the previous year. The Kingdom witnessed a renewed confidence with the recovery of oil prices during the second half of the year, while the increase in foreign reserves and rise in Central Bank's foreign assets in the form of securities holdings lent further support. According to the Saudi MoF, the current account balance is projected to marginally expand in 2018 and 2019 on the back of more stable oil export receipts driven by a gradual improvement in external demand.

*Saudi Arabia's gross debt is expected to be around 17% of GDP in 2017*

## Debt

Saudi Arabia has the lowest gross debt to GDP levels in the GCC region, though rising since 2014 and is estimated to reach around 17.0% of GDP by 2017 (around SAR 458 billion, USD 122 billion) compared to 13.1% in 2016 and 5.8% in 2015. Total national debt for 2017 was estimated at approximately SAR 432.7 billion (USD 112.9 billion), a significant increase from SAR 316.7 billion (USD 84.5 billion) in 2016. During the year, the government financed the deficit through the withdrawal of government deposits and foreign exchange reserves which was down to USD 494 billion as of July (the lowest since 2011). Moreover, in order to shrink the projected budget deficit of USD 53 billion, the government raised about USD 31.5 billion through bond sales (which should cover ~59% of deficit) including

a USD 9 billion Islamic bond (first international Sukuk), a USD 12.5 billion bond for international investors, and a local Islamic bond of USD 4.5 billion, during the year.

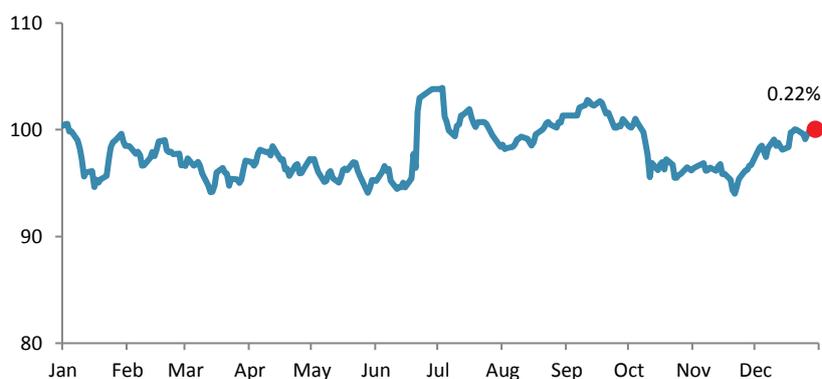
Going forward, the Kingdom's deficit will continue to be financed through debt issuance and reserve drawdown, leading to a peak debt to GDP ratio of around 21% in 2018, as per the IMF. The authorities have indicated that further sovereign international bond issuances could be in the offing in 2018 and beyond, while the government has capped the maximum permissible level of debt at 30% of GDP by 2020.

## Stock Market Performance

The Tadawul All Share Index (TASI) ended the year on a relatively flat note reflected by a marginal upswing of 0.22% at the end of December. However, the index witnessed a buoyed performance during the second half of the year on the back of stabilizing oil prices and marked improvements in the non-oil sector growth resulting from high government spending. Moreover, the reinstatement of the public sector allowances and solid Q2 corporate earnings lent positive support for equity valuations. While there was some disappointment in 2017 when the FTSE Russell ruled in September that Saudi had missed out on a classification upgrade, modernizing and liberalizing reforms by the regulatory authorities and the potential MSCI/FTSE emerging markets inclusion provided the backdrop for a general improvement in investor sentiments.

*TASI was up marginally by 0.22% in 2017*

**Exhibit 18: Tadawul All Share Index Performance (2017)**



Source: Thomson Reuters

## Outlook

Saudi Arabia has been reeling under the low oil price scenario which has prevailed since mid-2014, reflected in the Kingdom's GDP growth that came in at -0.7%, the lowest since 2010. The spiraling effect has led the government to take significant fiscal reforms (introduction of the Fiscal Balance Program in 2017) to maintain its spending agenda and boost the non-oil economic growth, while it has continued to tap into its reserves in order to ensure stability in the economic activity.

Since the beginning of 2016, Saudi Arabia has embarked on a structural reform plan with the objective to diversify its economy and reduce the dependency on oil prices. The Kingdom has since made commendable progress in implementing reforms that are aligned to the plans laid out in the Saudi Vision 2030, to change the economic landscape of the country and become more sustainable in the long term. In addition to measures such as

cutting subsidies, the recent introduction of VAT, further round of energy price hikes and soon to be introduced tariffs across a plethora of sectors are expected to boost the government revenues and reduce its fiscal deficits to a large extent. While the authorities have indicated that further sovereign international bond issuances could be in the offing in 2018 and beyond, the government's goal of balancing the budget by 2020 does not seem to be too far-fetched.

The Saudi economic growth is seen to be rebounding due to a stronger domestic demand and government stimulus, which could help it bounce back with a growth of 1.6% in 2018 and around 2% in 2019. Cautious optimism has begun to take shape in the Saudi market, partially helped by the recovery in oil prices and the government's loosening of austerity measures. While public sector allowances have been reinstated, capital spending projects have resumed, and economic stimulus programs have been announced after two years of relative fiscal austerity. Under the new 2018 budget, the government plans to raise public spending to a record high, while its primary agenda remains on the diversification strategy with plans entailing higher spending in non-oil sectors (especially in healthcare and education), promoting PPPs and creating job opportunities with a key focus on 'Saudization'. Additionally, the changes in policies seen in the past 15 to 18 months to develop the capital market have been well received by the international investor community, who have started looking at Saudi Arabia as an important investment destination of the future. The listing of 5% of Saudi Aramco along with other planned State Owned Enterprises (SOEs) will be positive for liquidity and valuations.

With an estimated projects pipeline of USD 820 billion, across both economic and social sectors, the recent reforms will play an important role in attracting foreign capital and enhancing the role of private sector in meeting the long-term objective of the country. The potential inclusion into the MSCI emerging markets will further encourage the government to continue with its reform agenda, while sending strong signals to international investors that the country's capital market has attained greater maturity in terms of efficiency, governance and regulatory framework. Furthermore, the opening up of key sectors for 100% foreign ownership can be seen as a transformative catalyst towards implementing the plans laid out in the National Transformation Program (NTP), as the scope for private players in these sectors is massive given the demographics and sheer size of the potential market. All these activities will help unlock Saudi Arabia's potential to international investors which will eventually trickle down to boost its economic activity.

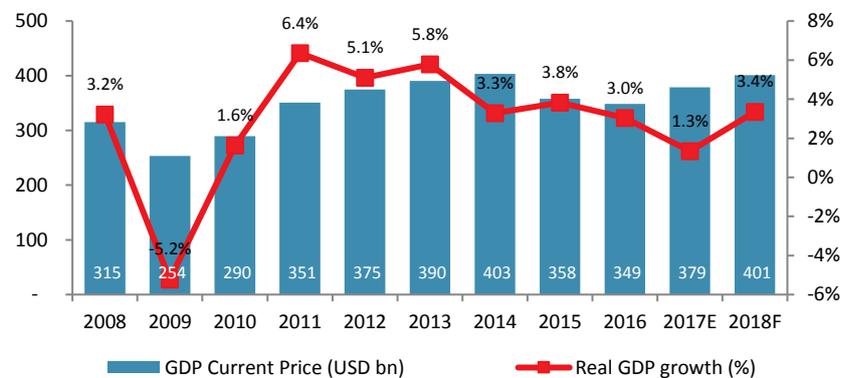
## UNITED ARAB EMIRATES (UAE)

### Real GDP Growth

*The UAE is expected to grow by 1.3% in 2017 higher than the regional growth which is expected to grow by 0.5%*

The UAE has been the most resilient economy within the region, due to pro-active steps taken by the Abu Dhabi and Dubai governments to reduce the reliance on oil to drive the overall growth. The economic activity has witnessed a marked slowdown since 2013 on the back of depressed oil prices but this has been more than offset by the growth in the non-oil sector unlike its regional peers, which were significantly impacted during the same period and undergone several structural changes. According to the IMF, the real GDP of the UAE is expected to grow by 1.3% in 2017 compared to 3.0% in the previous year, which can be attributed to 2.8% decline in oil production during the year. The growth in the UAE is much higher compared to the regional growth, which is expected to be 0.5% in 2017. This further substantiates the country's ability to adjust to the new realities, which otherwise have been challenging for the regional peers.

**Exhibit 19: Real GDP Growth (%)**



Source: IMF

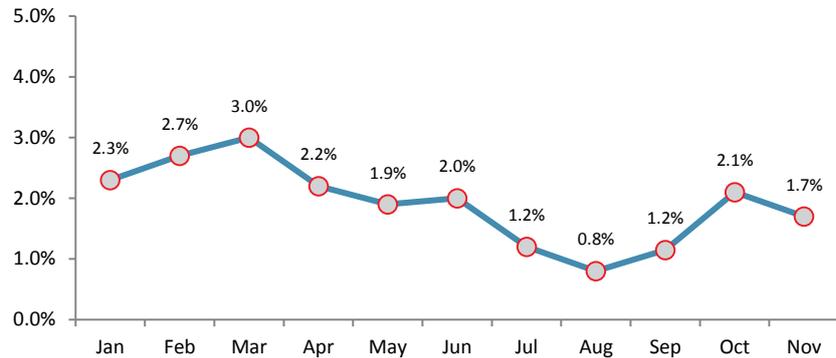
According to the IMF, the growth in the UAE is expected to more than double in 2018 as it is expected to report a growth of 3.4%, while the region might grow by 2.2% during the same period. The strategic initiatives undertaken by Abu Dhabi and Dubai governments have not only strengthened the country's position but have also provided a more sustainable economic backdrop to weather such storms in the future. Further, the expansionary budget approved by the government will focus on spending on key sectors such as infrastructure should feed into other economic sectors, especially in Dubai as it prepares for EXPO 2020. Further, the real estate sector is also expected to get a boost from a recovery in the UAE and other GCC countries, and in turn help the non-oil sector to continue recording robust growth and add to the broader economy.

### Inflation

*Inflation has broadly remained under control mainly due to the moderate growth in housing cost*

According to the IMF, inflation in the UAE is expected to reach 2.1% in 2017 compared to 1.6% in the previous year. The rise in inflation can be attributed to the rise in prices of essential utilities, which have been part of the subsidy cuts by the government to shore up receipts to offset the decline in revenues from oil receipts. The housing cost, which has a significant role to play in the overall inflation, has remained under control, which is the primary reason for a marginal increase in inflation during the year.

**Exhibit 20: Inflation (Y-o-Y)**



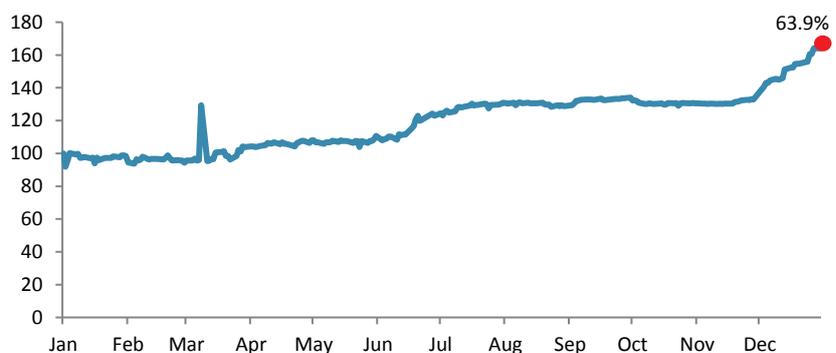
Source: National Bureau of Statistics

Going forward, the inflation is expected to rise in 2018 on the back of VAT and excise duty. Moreover, in order to maintain the peg with the US dollar, the Central Bank of the UAE is expected to continue following the Fed's monetary policy tightening in the coming year, which is also likely to add to the inflationary pressures going forward. Since residential rents, public transport, healthcare and school fees are exempted from VAT, the impact on overall inflation is likely to be limited during the first year. The impact should start to normalize in the following years as the initial impact will be factored in during the first year of introduction.

### Policy Interest Rates

The liquidity environment in the UAE has improved from 2016 with a modest growth of around 3.0% in the money supply and deposit mobilization between 6% to 7% in the year 2017. However, the US Fed continued to tighten the monetary policy thrice during the year, which was immediately followed by the UAE due to its peg to the US dollar. As a result, the liquidity environment has remained vulnerable within the UAE, which is also reflected by the interbank rates as they have increased from 0.95% in 2016 to 1.65% at the end of 2017.

**Exhibit 21: Emirates Interbank Offered Rate (EIBOR) – 3-month**



Source: Central Bank of UAE

Although the banks are witnessing growth in their deposits, it is being mobilized at a higher growth. However, the banks are able to pass on the hike in the benchmark rates to

*The UAE is expected to record a budget deficit of 2.2% of GDP in 2017 compared to 7.2% in the previous year*

*The UAE's total debt is likely to have increased to 20.72% of GDP in 2017 versus 20.7% of GDP in 2016*

its customers, which is helping offset the rise in cost of funding. Going forward, the liquidity will continue to remain vulnerable, however it will remain at manageable levels during 2018. The change in Fed's monetary policy stance from moderate to aggressive can have a significant impact on the liquidity environment going forward.

## **Budget Surplus/Deficit**

The UAE government has taken a number of important steps to shore up the revenues; however, it will only help offset part of the revenue losses recorded from the oil receipts. As a result, the country is expected to record a budget deficit to the tune of 3.7% of GDP in 2017 compared to 4.1% in the previous year. Although the government has continued the pace of fiscal consolidation, it has ensured to maintain the spending program to support the non-oil economy.

The UAE has approved an expansionary budget of AED 201.1 billion (USD 54.7 billion) for the years 2018-2021, of which AED 51.4 billion (USD 13.9 billion) is for 2018 compared to AED 48.7 billion (USD 13.26 billion) in the previous year. The government will continue to focus on key economic sectors such as allocating AED 26.3 billion (USD 7.2 billion) or 43.5% of the total budget towards social development, followed by AED 10.4 billion (USD 2.8 billion) towards education and AED 4.5 billion (USD 1.2 billion) to the healthcare sector.

The fiscal consolidation pace of the UAE is likely to continue in 2018 as it is expected to report a deficit of 2.2%, which is expected to gradually decline in the coming years. The government is unlikely to shy away from spending on key economic sectors as the deficit forecasted over the next couple of years is manageable by the government, unlike its regional peers. Further, the government is committed towards its spending programs to stimulate the economic activity going forward. The government also remains committed to introducing new reforms such as fuel subsidies and the introduction of VAT to boost the development in the country.

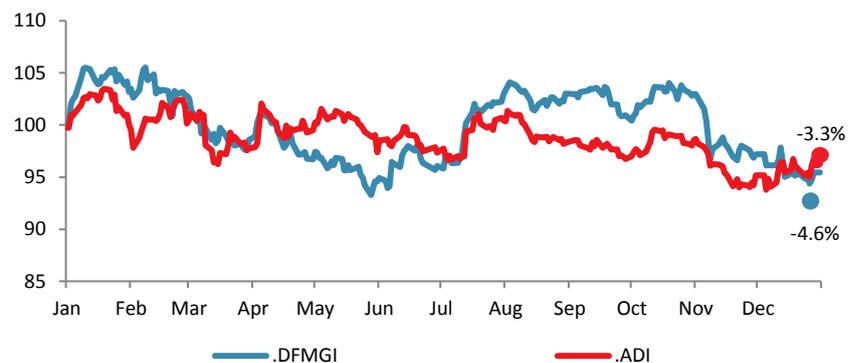
## **Debt**

According to the IMF, the UAE's total gross debt is likely to reach 20.8% of GDP in 2018 compared to 20.7% of GDP in 2017. Total debt was estimated to reach AED 306.6 billion (USD 83.48 billion) in 2017, which is a marginal increase from AED 288.2 billion (USD 78.5 billion) recorded in the previous year. The falling oil exports have reduced the accumulation of Forex reserves, hence Abu Dhabi's government raised USD 10 billion from the international debt markets during the year. Further, the UAE government has announced that they are planning to sell treasury bills in order to support the budget deficit. The government has ensured to tap alternative financing measures such as international debt or selling commercial papers rather than tapping into deposits, which can disrupt the liquidity environment of the banking sector. Going forward, the UAE government is expected to raise more debt as it continues to stare at a deficit while embarking on an aggressive spending program to boost its economic development.

## Stock Market Performance

The UAE markets started the year on a positive note, continuing the momentum from the previous year and in line with the sentiments seen in the global markets. However, the emergence of regional conflicts and unfavorable economic conditions changed the trajectory of the equity markets during the second half of the year. As a result, both of the UAE markets ended the year on a negative note, which is largely in line with its regional peers.

**Exhibit 22: UAE Stock Indexes Performance (2017)**



Source: Thomson Reuters

Dubai's index recorded a loss of 4.6% in 2017 compared to gains of 12.1% in 2016. Similarly, Abu Dhabi was also down by 3.3% in 2017 compared to its gains of 5.6% in the previous year. The trading activity was broadly stable as both values traded and traded volumes recorded a marginal change in 2017 compared to the previous year. During the year, UAE markets witnessed 4 IPOs, but the two important ones for the market were the listing of ADNOC Distribution in Abu Dhabi and Emaar Development in Dubai. Both of these IPOs signify the government's commitment towards the continued development of the financial markets and also leading from the front in a challenging environment. Going forward, the outlook for the UAE indexes has been optimistic on the back of the expected recovery and an expansionary budget by the government to continue the economic development.

## Outlook

The UAE is one of the most resilient economies in the GCC region but the persistent drop in oil prices has negatively affected its growth. The extent of slowdown in the UAE is much lower compared to the regional peers, which is evident from the growth rates seen over the past three years. UAE is clearly outperforming the regional growth as the government has taken pro-active measures to tackle the slowdown and more importantly the decline in government receipts. The non-oil sector of the UAE has been impressive over the past two to three years as it has been able to offset the decline in the oil sector arising from 2.8% drop in oil production and depressed oil prices. Although the Central Bank has followed the Fed in raising rates during the year 2017 and will continue to do so in the future, it has ensured that the liquidity environment within the UAE remains at manageable levels.



# MENA Yearbook

A number of initiatives taken by the government in the private sector, such as issuing new rules and regulations to further improve the business environment, opening the gates for global business opportunities and introducing reforms such as VAT is likely to have a positive impact on the broader economy over the next two years. The planned Expo 2020 is also playing an integral part in the diversification drive as the country will showcase its ability to host global events in the future, which will add an economic value to the Emirates.

According to the IMF, the real GDP of the UAE is expected to grow by 3.4% in 2018 compared to 1.3% in 2017. The improved outlook of the region and the UAE has been attributed to the measures taken by the government and expected recovery in the oil prices. Further, the focus of the government has slightly shifted from fiscal consolidation to an increase in spending to drive the economic development and support the non-oil economy, which has been robust over the past three years.

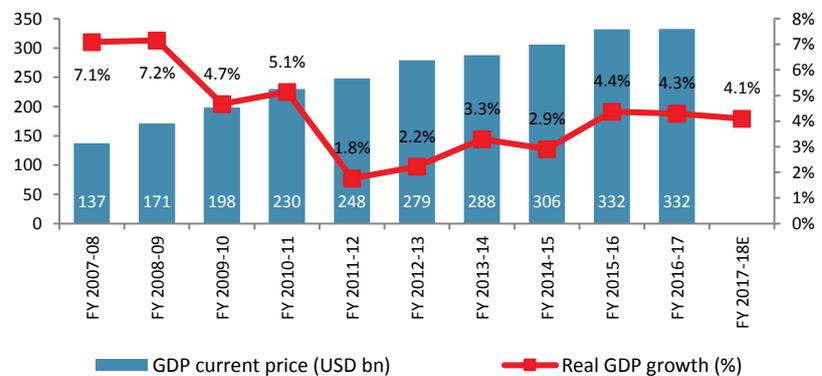
## Egypt

### Real GDP Growth

*Amid healthy recovery, the economy is expected to grow at 4.1% in 2017*

The Egyptian economy has come a long way since the 'January Revolution' back in 2011, the event which drove tourists and foreign investors away amid political instability. Ever since, the economy has continued to recover gradually, on the back of the improvement in the economic activity in response to the reform procedures adopted by the government. According to the IMF, the Egyptian economy is expected to grow at 4.1% in FY 2017-18 after showing a healthy recovery during the first half of 2017 which has trickled down to the robust performance during the latter part of the year. The economy has generally benefited from the floating of the Pound, which has helped drive optimism and made the economy more competitive. On the other hand, fiscal and structural reforms initiated by the government led to a strong export growth, recovery in the tourism industry and higher investments stemming from renewed confidence over the recent USD 12 billion IMF loan program. According to the latest available data, the private sector has been a key source of growth which expanded by 5% Y-o-Y in Q1 2017, while the public sector grew marginally by 2.4% Y-o-Y.

**Exhibit 23: Real GDP Growth (%)**



Source: IMF

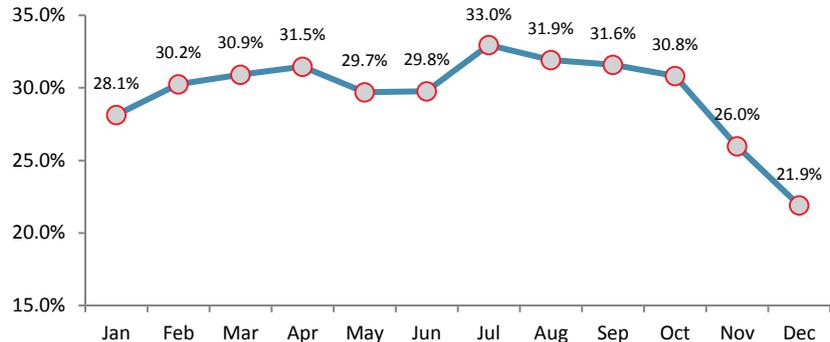
The IMF has projected the economy to grow by 4.5% in FY 2018-19 and 5.2% in FY 2019-20, primarily driven by fiscal reforms such as energy subsidy cuts, an uptick in the private and public sector consumption, as well as an increase in foreign investments with net exports contributing positively for the first time in two years, though still marginally.

### Inflation

*Egypt's inflation is expected at 23.5% in 2017 compared to 10.2% in 2016*

Egypt's average inflation is expected at 23.5% in 2017 compared to 10.2% in 2016. It stood at 21.9% Y-o-Y in December after peaking at 33% in July, largely reeling under the Central Bank of Egypt's (CBE) decision to float the Pound in November 2016, devaluing its currency by half against the US dollar, accompanied by a gradual price hikes (two rounds of hikes in energy prices), introduction of VAT, and austerity measures. Though the CBE policy rate hikes have helped bring inflation under control, it remains relatively elevated and has started weighing on the social conditions of Egyptians.

**Exhibit 24: Inflation (Y-o-Y)**



Source: Central Bank of Egypt

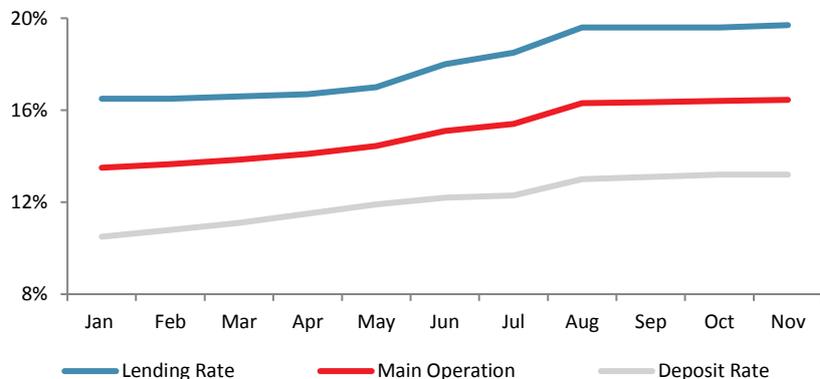
The government has planned to slash down fuel and energy subsidies over the course of three years, in order to secure USD 12 billion under the three-year IMF loan program that includes tax hikes and subsidy cuts. Going forward, the CBE's prudent monetary policy and the government's increased spending on social protection is projected to bring inflation down to approximately 13% by FY 2018-19 and further to single digits thereafter.

### Policy Interest Rates

The central bank raised interest by 300 bps after the currency floatation, which helped Egypt clinch a three-year USD 12 billion IMF lending program tied to ambitious reforms such as tax hikes and subsidy cuts. Since then, the CBE raised its key interest rates by 200 basis points each in its May and July meeting with the Monetary Policy Committee (MPC). Effectively, the CBE raised its key interest rates by 700 bps since the floatation of the pound, seeking to ease the inflationary pressure and encourage investors to buy its debt. The CBE has since held the overnight lending rate at 19.75%, overnight deposit rate at 18.75% and the discount rate at 19.25%.

*CBE raised its key interest rates by 700 bps since the floatation of the Pound*

**Exhibit 25: Monetary Policy (2017)**



Source: Central Bank of Egypt

According to the central bank, the temporary rate hike was implemented to ease-off the effects of subsidy cuts for fuel and energy and tax increases on the inflation.

*The fiscal consolidation program has led to a budget deficit contract of -10.9% of GDP during FY 2016-17*

*Current account deficit has narrowed down by 21.5% to USD 15.6 billion in FY 2016-17*

*Egypt's gross debt for 2017 is forecasted to rise to an all time high of 101.2% of GDP*

*The EGX 30 ended 22.2% higher in 2017 and was up by 25.9% in US dollar terms*

## Budget Surplus/Deficit

The fiscal deficit of Egypt continues to remain under pressure, though it is estimated to have receded to manageable levels. Egypt's budget deficit is expected to stand at 10.9% of GDP during FY 2016-17, down from 11.4% during the previous year, in wake of ongoing fiscal reforms, reduced government spending, hike in tax revenues and the introduction of VAT. Consequently, the World Bank and the IMF predicts that the fiscal consolidation programs are expected to further narrow down the budget deficit to -8.5% of GDP and below going forward with the government's drive to decrease poverty in part through the strengthened social protection measures embedded in the budget for FY 2017-18. Egypt's approved draft budget for FY 2017-18 forecasts a deficit target of 9.1% of GDP with the aim of generating a primary surplus for the first time in 10 years.

## Current Account Balance

Egypt's current account deficit shrank to its lowest level in nearly three years in Q2 2017 and benefited from a strong export growth, rising tourism receipts and remittances. The country's current account deficit is expected to have narrowed down by 21.5% to USD 15.6 billion in FY 2016-17 from USD 19.8 billion a year earlier, primarily boosted by the flotation of the Pound, resulting in increased foreign reserves, improvement in trade deficit, and a strong revival of the Tourism industry. According to the CBE, the current account deficit reduced by almost 50% to USD 2.4 billion in the Q4 2016-17, compared to USD 4.8 billion in the corresponding quarter of the previous year. Going forward, the current account deficit is expected to narrow further to 5.9% of GDP in FY 2017-18 and to 3.8% in 2018-19 through the elimination of distortions in the foreign currency markets and the government's commitment to fiscal consolidation.

## Debt

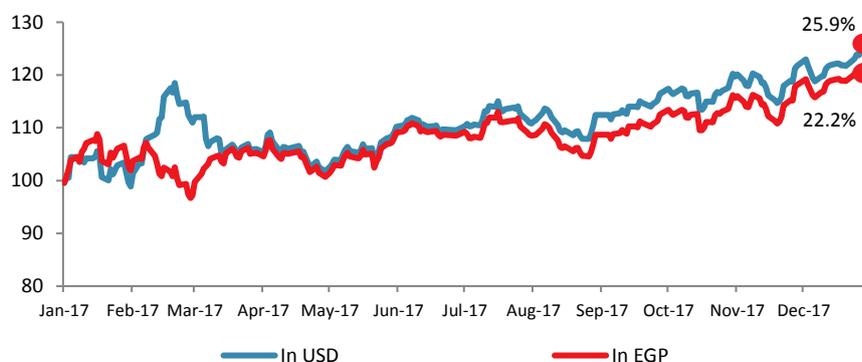
The Egyptian public debt has been increasing significantly on the back of a rise in government borrowing of direct foreign loans from several countries and international financing institutions, as well as its issuance of bonds in international stock markets during 2016 to bridge the gap in the state budget, fund the fiscal deficit and improve the current account stance of the economy. According to the IMF, the gross debt for 2017 is forecasted to rise to an all time high of 101.2% of GDP, compared to 96.9% of GDP in 2016. The country has further raised its debt levels by striking a USD 12 billion deal with the IMF, which is seen as a positive step for the economy and has been well received across the investment community. In addition to the IMF's loan, Egypt has also received USD 1 billion from the World Bank, USD 500 million from the African Development Bank, USD 1 billion from the UAE, and USD 2 billion from Saudi Arabia, during 2017, in addition to a recent issuance of Eurobonds to the tune of USD 4 billion. According to the IMF, Egypt's foreign debt is expected to exceed USD 100 billion by 2020 if the government continues to tap the international market.

## Stock Market Performance

The Egyptian Bourse was one of the best performing indexes in the MENA region witnessing a rise of 22.2% in 2017 after surging by approximately 76% in 2016. In 2017, Egypt witnessed an increase of 8.7% in traded volumes and 14.3% in traded value, which was also reflected in the performance of the index during the year. The improvement in the foreign investments have resulted in the Egyptian stock index to perform well, and the

index value in US dollars was up 25.9% at the end of December 2017. Net foreign contributions to the Egypt stock market reached EGP 7.4 billion (USD 414 million) in 2017. Going forward, a gradual improvement in the economic indicators for Egypt and further reforms by the government is likely to push the index to new heights in 2018 and beyond.

**Exhibit 26: EGX30 Index Performance (2017)**



Source: Thomson Reuters

## Outlook

Over the past three years, the revival in Egypt's economic growth has been short of a comeback, due to gradual improvement in the economic activity with the government making increased efforts through reform procedures. Resultantly, the IMF has raised its forecast for the economy to grow at 4.5% in FY 2018-19 and 5.2% in FY 2019-20, while the country's average inflation is expected to narrow down to 21.3% by 2018 and 13.5% by 2019 in response to the CBE's prudent monetary policy. The CBE raised its key interest rates by 700 bps since the floatation of the Pound, seeking to ease the inflationary pressure, although it has kept them steady since.

Egypt's economy is currently facing a number of structural problems, mainly low growth rates and high deficit. Hence, the country has been trying to curb a big trade deficit and boost domestic industries after years-long of hard currency shortage that has hit the business activity hard. The liberalization of the exchange rate has eased shortages in foreign currency and kick-started an improvement in Egypt's external accounts. Consequently, the overall BOP achieved a USD 13.7 billion surplus (5.8% of GDP) in FY 2016-17, 90% of which was realized only following the November exchange rate floatation.

Since securing the IMF deal, the country agreed to implement series of sensitive reforms that aim to stimulate growth and address major macroeconomic imbalances. The reforms which entail improvements towards the private sectors activity and business environments, liberalization of the exchange rate regime, fiscal consolidation measures, and containment of the wage bill bodes well with the country's ideology of restoration of confidence. Backed by such prudent initiatives, Egypt has the opportunity to transition to a higher growth trajectory by cashing-in on the gains from macroeconomic stabilization and harnessing its full growth potential. Going forward, growth is expected to be primarily driven by an uptick in private and public consumption, as well as foreign investments with an increased contribution of net exports, supported by government initiatives and increasing revenue streams from the tourism industry.

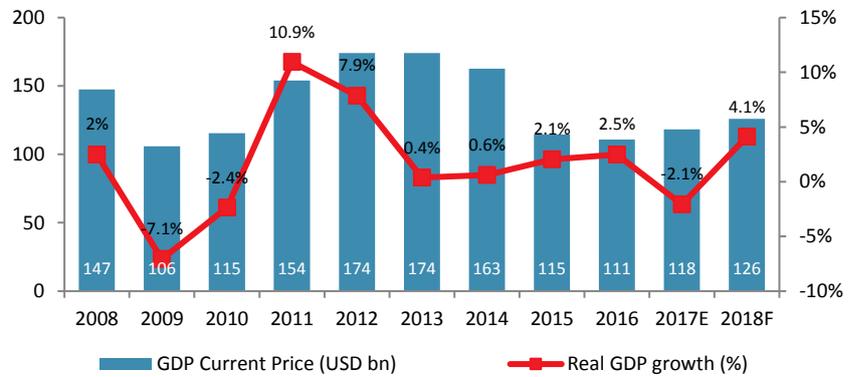
*Kuwait's economy is expected to have decreased -2.1% in 2017 compared to 2.5% in 2016*

## KUWAIT

### Real GDP Growth

Lower economic production on the back of continued OPEC-related oil production cuts has impacted Kuwait's economy negatively, resulting in the country posting the weakest performance among the GCC nations in 2017. According to the IMF, Kuwait's GDP growth is estimated to shrink 2.1% in 2017, down drastically from a growth of 2.5% in 2016. Considering hydrocarbons account for over half of Kuwait's GDP, 92% of export revenues, and 90% of government income, the decrease in oil production linked to the OPEC deal, has led to a sharp decline in its oil output by approximately 6% in 2017 from 2% in 2016. In contrast, non-oil GDP is likely to increase steadily at about 3.5% for the year and beyond, largely supported by the implementation of the five-year Development Plan which contains several large infrastructure, transport and refinery projects and the 'New Kuwait 2035 Strategic Plan', a long-term economic diversification effort, to convert the country into a regional, financial and commercial hub.

**Exhibit 27: Real GDP Growth(%)**



Source: IMF

However, on the brighter side, the IMF expects Kuwait's economic activity to recover in 2018 and record the fastest growth within the GCC at 4.1%, largely driven by the government's structural reform to encourage the private sector, infrastructure investments, and increased public spending, coupled with a solid private consumption. On the downside, the country's fiscal position is not likely to benefit from the recent announcement that VAT will be implemented significantly behind schedule due to a lack of technical and logistical preparedness.

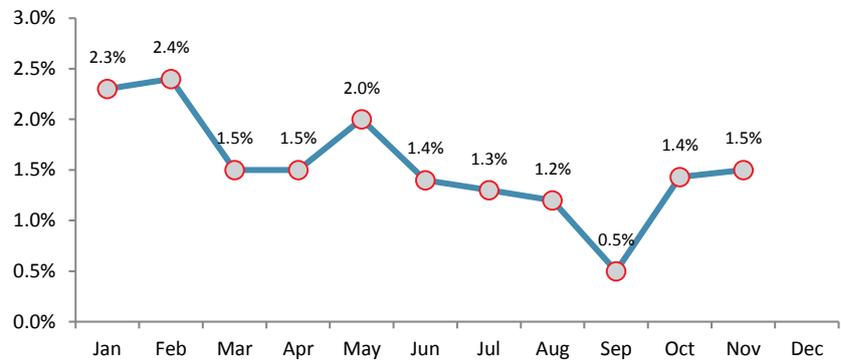
### Inflation

*Inflation in Kuwait continues to remain under control in 2017 at an average of 1.7%*

Inflation in Kuwait stood at 1.5% as of November and is likely to average around 1.7% in 2017, a notch below 3.5% witnessed in 2016, its lowest since 2004 due to the ongoing deflationary pressures in housing rents and weak food inflation despite price growth in the transportation sector stemming from fuel subsidy cuts. While headline inflation bounced back from September, when it slipped to a multi-year low of 0.5% on the back of declining housing costs and fading impact of last year's fuel price hikes, improved consumer spending and price rises of retail goods and services have added support. As per the IMF, Kuwait's inflation is expected to average around 2.5% in 2017 and going

forward, the country is expected to witness a tangible increase in inflation in 2018 (2.7%) with the introduction of VAT and continuation of the fiscal consolidation efforts.

**Exhibit 28: Inflation (Y-o-Y)**

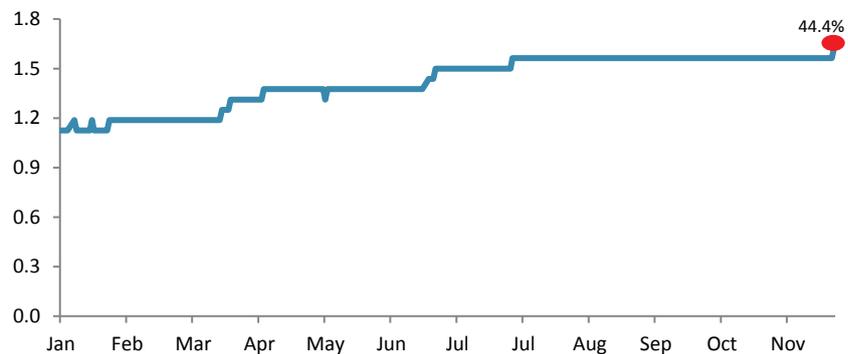


Source: Central Statistical Bureau

## Policy Interest Rates

The three-month interbank rates (KIBOR) continued to increase gradually and ended up rising by 44.4% in 2017. The interbank rate surged by 0.5 bps since the beginning of the year (increasing from 1.125% in January to 1.625% at December end) as the Central Bank of Kuwait (CBK) raised the interest rates in tandem with the US Federal Reserve. However, in June, the CBK opted to keep its key policy rate on hold, despite the US Federal Reserve hiking rates twice since then, largely due to an increase in the banking sector liquidity over the past few months, as well as concern surrounding its economic growth.

**Exhibit 29: Kuwait's Interbank Offered Rate (KIBOR) – 3-month**



Source: Central Bank of Kuwait

## Budget Surplus/Deficit

Kuwait enjoys large foreign assets and reserves with low leverage and has one of the strongest balance sheets in the GCC region which provides the country with significantly more space to move gradually with fiscal adjustments than its peers. According to the Ministry of Finance (MoF), Kuwait registered a KWD 1.9 billion (USD 6.4 billion) deficit during the first half of FY 2017 (ending September), representing 25% of the total planned deficit for the entire financial year, which amounted to KWD 7.9 billion (USD 26.2 billion), excluding money set aside for the Future Generations Fund (FGF). The country's external

**KIBOR increased by 44.4% in 2017**

**Kuwait reported a budget deficit of KWD 1.9 billion in H1 2017**

position remains strong and supportive of Kuwait's currency peg, backed by sovereign wealth funds (SWF) estimated at approximately USD 560 billion (~450% of GDP), one of the largest in the region. As a result, authorities are keen to maintain the commitment to their capital spending plans.

After FGF, the country's budget stood at 12.5% of its GDP in 2017, much better than its position last year (17.7% of GDP). In order to plug the deficit, the government has taken several key measures including, cutting government subsidies, introducing VAT along with new reforms to limit annual public spending for the next three years. While the government raised USD 10 billion in March 2017 through an international bond sale, the IMF suggests that gross financing needs will remain large with the country needing USD 100 billion over 5 years, as mandated contributions to its FGF leave a fiscal deficit. Excluding FGF contributions and income, the overall budget is expected to remain nearly balanced through 2019, as oil prices will recover enough, following the expiration of the OPEC deal by the end of 2018, and the expected introduction of VAT along with further subsidy cuts by 2020.

## Current Account Balance

Current account deficit in Kuwait is set to improve to a broadly balanced position in 2017 (0.6% of GDP) primarily helped by the gradual recovery in the oil prices, after the country recorded its first deficit (4.5% of GDP) in more than a decade in 2016, a significant deterioration from a surplus of 45% in 2013. On a quarterly basis, the current account balance has been seen shifting into a modest surplus until the first three quarters of 2017 on the back of rising oil receipts, lower remittances, a decline in imports, and some gain in investment income. Oil export revenues have seen steady growth driven by higher oil prices even as production declined due to OPEC cuts, while import growth has remained robust boosted by a healthy domestic demand. However, after improving in 2017, Kuwait's current account balance is expected to weaken in 2018 and 2019 on the back of firming oil prices, continued growth in imports and worker remittances.

## Debt

Despite holding a large SWF, Kuwait has relied heavily on debt to finance its deficit and has continued to add to the FGF even as oil prices declined, at the expense of the General Reserve Fund (GRF) or increasing public debt. Since April 2016, the government issued KWD 6 billion (USD 20 billion) in debt (KWD 3.6 billion domestically and KWD 2.4 billion internationally), which has increased the total debt to KWD 7.1 billion (~20% of GDP) as of October 2017. Most notably, debt issuance has financed around 66% of the deficit since April 2016. According to the IMF, Kuwait's total gross debt to GDP is expected to increase drastically from 18.5% in 2016 to around 27.1% in 2017.

While debt issuance has been on hold since September 2017 following the expiration of the law that allows the MoF to issue debt, the government is aiming to amend the law for allowing the sale of 30-year bonds and double the sovereign borrowing ceiling to KWD 20 billion (USD 66.7 billion). In order to control rising debt, the government is considering an annual public spending cap of KWD 21 billion (USD 69.5 billion) on an average over the next three fiscal years, while the presence of large external financial buffers is likely to provide for cushion in case of emerging fiscal deficits.

*Kuwait's current account deficit is expected to reach 0.6% of GDP in 2017*

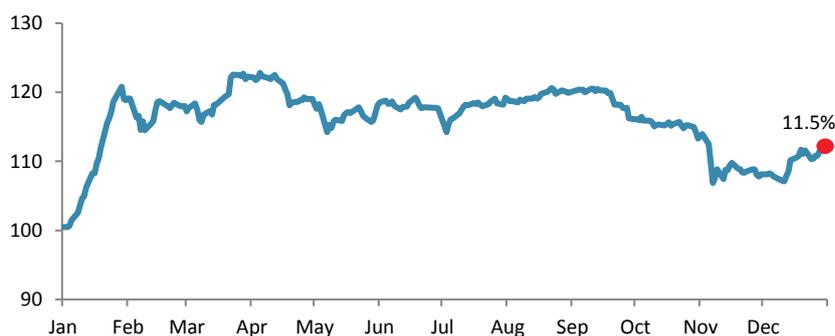
*Kuwait gross domestic debt is expected to reach 27.1% in 2017*

*Kuwait Index was up significantly by 11.5% in 2017*

## Stock Market Performance

Kuwaiti equities were among the best performing in the GCC, with the index witnessing a rise of 11.5% in 2017 largely driven by the recovery in oil prices and uptick in the private sector contribution. Since the beginning of the year, the indices witnessed continued growth until the third quarter with high trading activities in the financial, real estate and industrial sectors, while regional developments late in the year weighed heavily during the last quarter. While most gains occurred during the first quarter of the year, the Boursa managed to remain competitive and bullish compared to its peers throughout 2017. Moreover, the Boursa witnessed a strong uptake and improved performance in light of FTSE Russell upgrading Kuwait's market to emerging market status in September.

**Exhibit 30: Kuwait Stock Exchange Index Performance (2017)**



Source: Thomson Reuters

## Outlook

After bouncing back from a 2015 slowdown, induced by a fiscal adjustment in the wake of the decline in oil prices, the country's GDP growth is expected to suffer a sharp decline of 2.1% in 2017 driven in parts by weaker oil production due to the OPEC-related production cuts. Nevertheless, growth in non-oil activity is expected to improve by 3.0% in 2017 and further accelerate to 3.5-4% in 2018 and 2019, driven by the improved project implementation under the National Development Plan, increased government spending, a third of which is slated to come from PPP projects. Overall, the economy is expected to remain resilient in 2018 and beyond on the back of structural reforms, tapering-off of OPEC related production cuts and improved exports which in turn should help ease the current account and budgetary pressures.

However, on the downside, Kuwait's dependence on the hydrocarbon sector remains one of the key challenges for the policymakers, as another low oil prices scenario could generate higher deficits and financing needs, making the government susceptible to shifts in market sentiment. While comprehensive reforms are needed to rebalance the economy and shift towards a more diversified growth path underpinned by innovation, private sector entrepreneurship and job creation, the government also plans to invest around USD 115 billion in the oil sector over the next five years, and boost hydrocarbon output. Furthermore, the implementation of spending and revenue reforms including the delayed introduction of VAT in 2018, will help to partially relieve the financial burden of the government.

*In 2017, Oman's economy is expected to remain flat, touching a six year-low*

## OMAN

### Real GDP Growth

The economic environment in Oman has been held back and remained subdued in 2017 largely due to the lower oil production stemming from production cuts under the OPEC deal. According to the IMF, the Sultanate's GDP is projected to remain flat no relative growth, down from a healthy 3% rise in 2016, the slowest in the last 6 years. During the year, Oman's hydrocarbon sector is expected to have contracted by 2.8%, while the non-hydrocarbon GDP growth is estimated to fall down to 2.5% from a robust 3.4% growth witnessed in 2016 on the back of a slowdown in public spending with the knock-on effects on consumption and investment.

Going forward, the economy is set to grow at a modest pace with the IMF forecasting its GDP growth to rise to 3.7% in 2018 as the fiscal consolidation effects start wearing in and oil exports revenue rise. Furthermore, the government's economic National Diversification Program (Tanfeedh) which provides a roadmap for increasing the private sector participation focusing on logistics, manufacturing and tourism sectors and the Vision 2020 are expected to help propel the Sultanate's economy.

**Exhibit 31: Real GDP Growth (%)**



Source: IMF

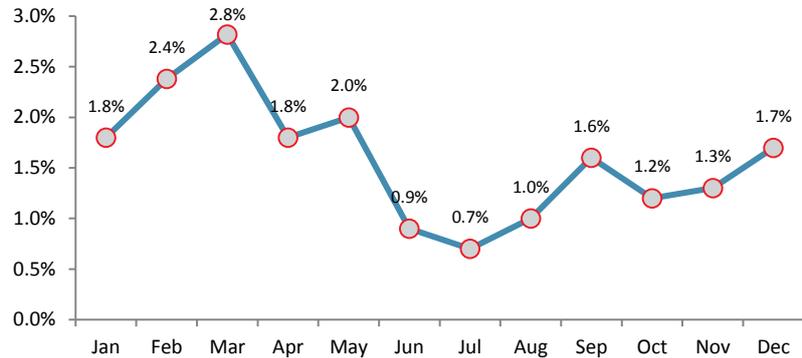
### Inflation

*Oman's inflation is likely to rise to 3.2% in 2017 and is expected to remain stable reflecting the ongoing subsidy reform*

Oman has continued to slash energy and water subsidies and raised fees and taxes in an attempt to bring down government spending and improve the overall fiscal position. According to the Central Bank of Oman (CBO), the government has cut down subsidy expenditures by almost 20% in the past three years in order to reduce the fiscal deficits and plan expenditure allocation accordingly. As per the IMF, Oman's Inflation is expected to rise to 3.2% in 2017 from 1.1% in 2016 and is forecasted to remain stable throughout 2018, reflecting the ongoing subsidy reform. Inflation stood at 1.7% Y-o-Y at the end of December on the back of a pick-up in food and transport prices. Going forward, inflation is expected to steady down in 2019, as the government continues to liberalize prices on energy and other goods and services with the introduction of VAT (delayed until 2019) offsetting downward pressures from global food and energy prices.

*The CBO increased interbank rates by 350% in 2017, rising US Fed rates may compound pressure*

**Exhibit 32: Inflation (Y-o-Y)**

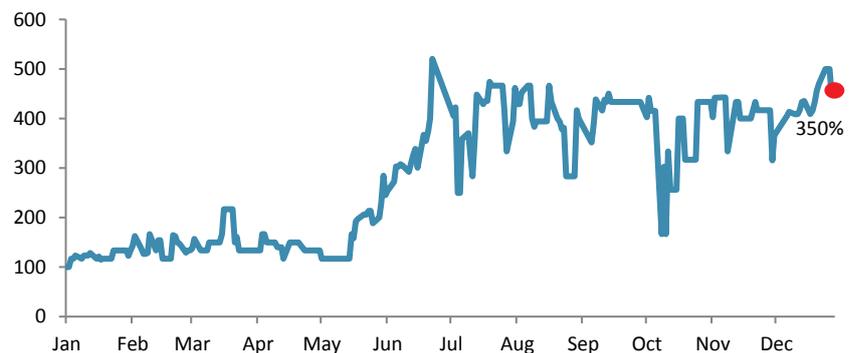


Source: National Center for Statistics and Information

### Policy Interest Rates

Negating last year's decision not to raise the interest rates, the CBO raised interest rates in 2017 by 350% (Oman's Interbank Rate increased by 105 bps in 2017). Though it did not follow the recent US policy rate hikes like the other GCC states but given its peg to the US Dollar the CBO alternatively implemented a gradual rate increase to match the US. Going forward, the prospect of rising US interest rates may compound pressure and the monetary policy is expected to remain tight. Resultantly, the funding conditions and bank lending could deteriorate in an environment of rising interest rates and concerns over the government's fiscal position.

**Exhibit 33: Interbank Overnight Domestic Lending Rates (2017)**



Source: Central Bank of Oman

However, the Sultanate's banking sector remains well capitalized. According to the CBO's September 2017 quarterly financial soundness statistics, credit risk remains low with non-performing loans at 1.9% of gross loans, while capitalization remained high with a capital adequacy ratio (CAR) of 16.6% as of June 2017.

### Budget Surplus/Deficit

Considering Oman has one of the highest break even prices of oil in the region, its economy has been facing a fiscal deficit since the beginning of the decline in oil prices in mid-2014. According to the IMF, the country's fiscal deficit is estimated to stand at 13.0%

*Oman's budget deficit is estimated at 13.7% of its GDP in 2017*

of its GDP in 2017, much better than its position last year (21.6% of GDP) and is expected to further weather down in 2018 and 2019 to 11.4% and 10.5%, respectively. This can be attributed to a rise in oil prices (production cut agreement due to expire in 2019) more than offsetting a modest increase in government spending. To finance the 2017 deficit, Oman raised USD 5 billion from the international debt markets in March and USD 2 billion from Sukuk in May 2017. On the other hand, the government continues to majorly focus on reducing the fiscal deficit through cutting down expenditure, further subsidy cuts (in January 2017 electricity subsidies were removed for large consumers) and increasing revenue through tax. However, Oman is likely to delay the introduction of the 5% VAT until 2019, which will eventually hurt its decision to strengthen its shaky state finances in the medium-term.

According to the Ministry of Finance (MoF), the 2018 budget reports a projected deficit of OMR 3 billion (USD 7.8 billion) compared to a projected actual OMR 3.5 billion (USD 9.1 billion) incurred in 2017, a welcoming drop-in deficit. However, the government's constrained financial position adds uncertainty to its long-term vision, with much riding on favorable oil prices and a friendly foreign investor environment. While initiatives such as a revamped foreign-investment law are in the horizon, the government has already sought large foreign investment partnerships (DuqmSEZ - partnership with China and Kuwait) and funding to boost up industries such as refinery, ports and logistics, which is considered to be the highest non-oil contributing industry to the GDP.

## Current Account Balance

*Oman's current account deficit continues to remain large; expected at -14.3% of GDP in 2017*

Oman's fiscal and current account deficits continue to remain large. Moreover, with the Sultanate increasingly resorting to external borrowing to finance its deficits, public debt is rising rapidly. According to the IMF, the Sultanate incurred huge deficits of 15.5% of GDP in 2015 and 18.6% of GDP in 2016 due to low oil prices affecting the overall exports. The IMF estimates that the current account deficit will persist, though it is expected to ease out in 2017 to 14.3% of GDP and further improve by 2018 to 13.2% amid steady oil prices and higher LNG and non-oil exports, helping offset a mild expansion in the imports. On the other hand, remittances are expected to be broadly steady on the back of a weaker labor market, while a stronger focus on tourism and the ease of doing business are expected to keep the service deficit in check.

## Debt

*Gross debt of approximately 45% of GDP is expected to increase the government's interest burden manifold*

Oman's gross government debt has been rising since 2014 and is estimated to reach 44.5% of GDP by 2017 compared to 33.6% in 2016 and 15.3% in 2015. Though still at manageable levels, it has started to increase the interest burden which stood at 1.5% in 2016. Majority of the debt is sourced by external borrowing such as international and Islamic bonds and syndicated loans. In 2017, Oman borrowed over USD 10 billion internationally, including a USD 3.6 billion loan from a group of Chinese financial institutions, USD 5 billion multi-tranche bond and a USD 2 billion Sukuk. Following the trend witnessed in the last couple of years, Oman is expected to witness higher funding requirements which is likely to come from the further drawdown of the government assets, including both the estimated USD 24 billion in SWFs and the Central Bank's USD 16 billion foreign exchange reserves. Resultantly, the Sultanate's heavy reliance on debt to finance its deficit is expected to

*The MSM index plunged by 11.8% in 2017, one of the worst performing markets in the GCC*

shoot-up to around 50% of GDP, while the interest burden could rise to approximately 6% of the total spending in 2019.

## Stock Market Performance

The Muscat Securities Market Index plunged by 11.8% in 2017, a seven year-low, as the weaker operating environment continues to weigh on Omani corporates with most reeling under poor earnings. Further, the sustained weakness in the financial sector and the lack of support from both institutional and retail investors weighed heavily on the index.

**Exhibit 34: Muscat Securities Market Index Performance (2017)**



Source: Thomson Reuters

## Outlook

Oman is undergoing substantial reforms, in the wake of the new oil price scenario, such as the reduction in subsidies and plans of diversification to promote and boost the non-oil economy. Over the medium-term, the economic growth is expected to modestly recover from the current turmoil with the IMF projecting the Sultanate's GDP growth to rise to 3.7% by 2018, supported by a gradual rally in oil prices, increasing exports, and an increment in the private sector investment. Over the longer term, Oman's fiscal stance is expected to improve gradually with pro-business reforms such as the foreign ownership law and the FDI law resulting in improved investment opportunities and favorable business conditions. However, Oman's massive infrastructure spending program is likely to witness a setback on the back of rising debts and fiscal position remaining strained. On the other hand, Oman's monetary policy will remain tight as interest rates continue to climb, while inflation is expected to hike on the back of subsidy cuts and the pending implementation of VAT.

While the Sultanate is expected to continue plunging on its revenue savings and rely on foreign borrowing to partially finance the fiscal deficit, higher corporate income tax and the introduction of VAT are expected to narrow the fiscal deficit to manageable levels going forward. In January 2018, Oman raised USD 6.5 billion, effectively covering the vast majority of the OMR 3 billion (USD 7.8 billion) deficit projected in its 2018 budget. Further, the 2018 budget plan noted that OMR 500 million (USD 1.3 billion) of the deficit would be covered by withdrawals from the financial reserves. This implies that Oman may not borrow any more in 2018, internationally or domestically but another issue is possible if the market conditions remain favorable.

*Bahrain has grown by 3.6% during the first three quarters of 2017, the fastest in the GCC*

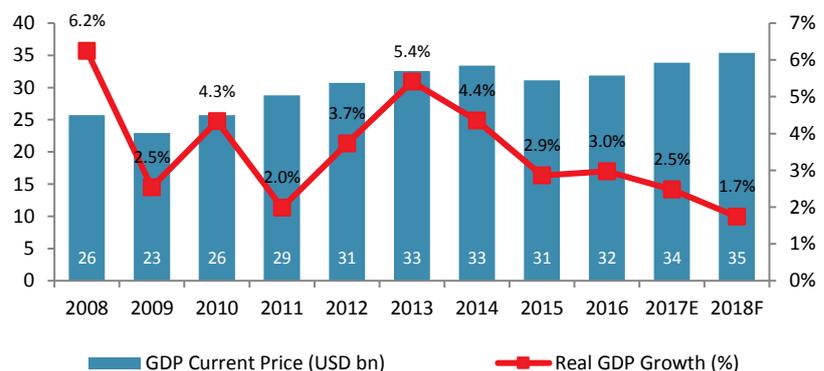
## BAHRAIN

### Real GDP Growth

Bahrain's economy is expected to positively surprise in 2017 as it continues the optimistic momentum seen during the last two quarters of 2016. According to the Bahrain Economic Development, the economy has experienced a growth of 3.6% during the first three quarters of 2017, which is the fastest in the GCC region. The growth in Bahrain has been entirely driven by the non-oil sector, while the oil sector is expected to have remain muted during the year. Bahrain remains on course to either achieve or surpass the estimates of 3.0% growth in the 2017 and should continue to strengthen in 2018. Bahrain's growth is particularly impressive as it is expected to report substantial twin deficits coupled with a relatively weaker Forex reserves during 2017. Further, Bahrain will also look for additional support from its GCC allies to continue the growth momentum as funding the twin deficits might become challenging and a hurdle to continue the growth momentum.

The government has led from the front in 2017 as it has taken important measures to encourage the participation of the non-oil sector to offset the slowdown in the oil sector, including the launch of National Strategy for Tourism, subsidy reforms in the energy sector and continuing the development program outlined in the Vision 2030 plan. The financial service sector continues to remain important to the economy as it grew by 6.5% during the first three quarters of the year. Further, the government's thrust towards the tourism and hospitality sector has also yielded positive returns as it recorded a robust growth during the same period.

**Exhibit 35: Real GDP Growth (%)**



Source: IMF

According to the IMF, the real GDP of Bahrain is expected to grow by 2.5% in 2017 compared to 3.0% in 2016. However, the IMF expects growth to further drop to 1.7% in 2018 as the pace of the fiscal consolidation will continue to impact the broader economy and limit the government's ability to continue the spending program. Further, the decline in international reserves will put added pressure on the exchange rate peg and start impacting the liquidity environment of the banking sector. Hence, Bahrain remains the most vulnerable within the GCC within limited savings and high debt levels, which makes it more exposed to financial risks going forward. As a result, the government will have to

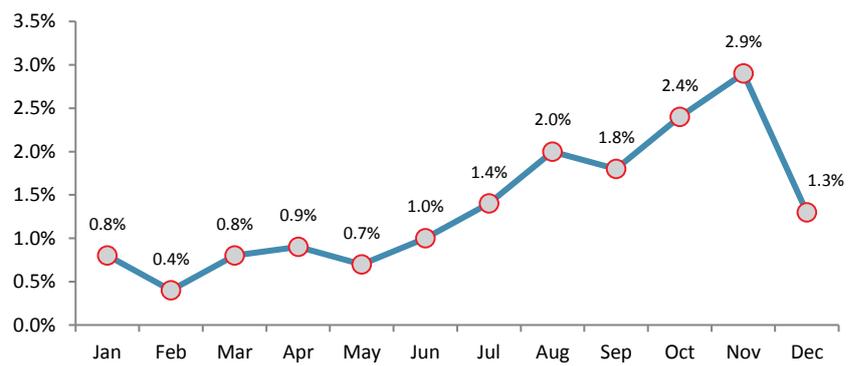
*Inflation in Bahrain is expected to reach 1.5% in 2017*

tap into alternative financing measures to ensure that the economic growth is sustainable and reduce the overall fiscal deficit position to avoid any financial risks in the future.

## Inflation

Inflationary pressures persisted in Bahrain during the most of 2017, more notably from June 2017 on the back of higher food and housing costs. Inflation reached a high of 2.9% in November 2017, before dropping to 1.3% in December. The introduction of GCC wide VAT, which is likely to levy a 5% tax on most goods and services, is expected to put further pressure on inflation during the first year of its implementation.

**Exhibit 36: Inflation (Y-o-Y)**



Source: Central Informatics Organization

According to the IMF, inflation is expected to stand at 1.5% in 2017, and further rise to 3.0% in 2018 and 3.5% in 2019. Although, the impact of VAT is likely to fade out in the second year, it will have a significant impact on the consumption as the savings and spending patterns will change and consumers might look at containing the spending habits going forward. Hence, the inflation forecast is likely to change during the course of 2018; however, the inflationary pressures will continue to persist during the year.

## Policy interest rates

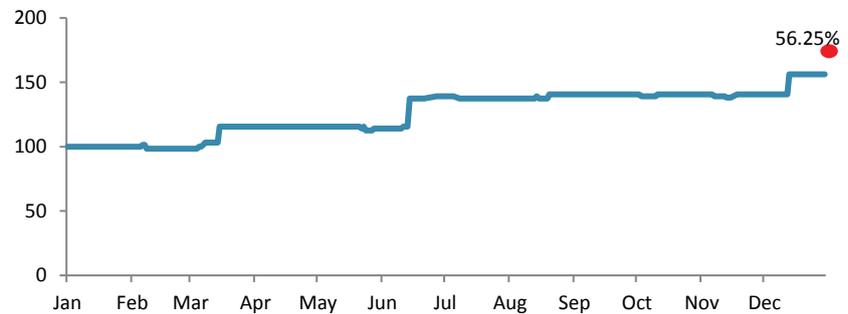
The government remains committed in maintaining a fixed exchange rate regime with the US Dollar, in line with the regional peers. Further, the policy has supported the country's financial position over the years and provided stability in the business environment, especially when the country is considered an off-shore hub for many international banks and financial institutions. The central bank will continue to play an important role in balancing the economic growth and the currency peg going forward.

*The Central bank has raised its benchmark rates thrice during the year, in line with the US fed.*

The US fed has increased the rates thrice during 2017, which led the Central Bank of Bahrain in increasing its benchmark rates. It is important to note that Bahrain along with Saudi Arabia and the UAE are the three countries that have risen three times, while Kuwait, Oman and Qatar have only made similar changes twice during the year. In December 2017, the central bank of Bahrain increased the deposit rate from 1.25% to 1.50% and adjusted the one-month deposit rate from 2.15% to 2.40% and the lending rate from 3.25% to 3.50%, in line with the decision of the US Fed. Going forward, the

central bank will continue to follow the decision of the US Fed, which is likely to rise at least twice if not three times during the year 2018.

**Exhibit 37: Interbank Rate(2017)**



Source: Thomson Reuters

*Fiscal deficit to GDP ratio of Bahrain has narrowed in 2017 but it remains significantly higher compared to its regional peers*

## Fiscal Deficit

The fiscal position of Bahrain continues to remain one of the biggest challenges as well as a constrain on the broader economy. Although, the fiscal deficit to GDP ratio is expected to decline in 2017, it is still very high compared to its regional peers. Further, the pace of fiscal consolidation has been relatively slow in Bahrain when compared to its peers who have been more prudent on fiscal discipline to compromise the growth in the past two years. Bahrain's fiscal deficit is expected to narrow at 13.2% of GDP in 2017 compared with a deficit of 17.8% in 2016.

The fiscal deficit is expected to stand at around 9.7% and 8.0% of GDP in 2018 and 2019, which is a cause of concern for Bahrain. As a result, there has been series of downgrades of the government's credit rating. The most recent being the S&P downgrading the long-term issuer rating by one notch from BB- to B+, placing it deeper in the non-investment grade territory. The main reason for the higher fiscal position is the government's decision to focus on rationalizing subsidies during 2015 and 2016, while keeping the spending literally unchanged unlike the austerity measures taken by others.

The decline in budget deficit during 2017 was on the back of higher revenue generated from the oil prices and the continued prudent fiscal management. However, the government's decision to tap the international markets to fund its deficit is likely to come at a price as higher interest payments and debt repayment will slow the pace of reduction in 2018. Hence, the government will have to focus on its fiscal position and compromise on its growth to ensure sustainability of the economic activity going forward.

## Debt

Bahrain has relatively smaller reserve surplus accumulated during the record of oil prices unlike other members of the GCC; hence the government has limited resources to fund the deficit. Resultantly, the country has continued to tap the debt market over the years, and the central bank of Bahrain has raised USD 3.0 billion worth of bonds in late 2017 at a comparatively high premium of 5% to 8% with maturities ranging from 7 to 30 years. According to the IMF, total debt to GDP ratio of Bahrain is expected to rise to 90.6% in

*Bahrain has one of highest debt to GDP ratio in the region*

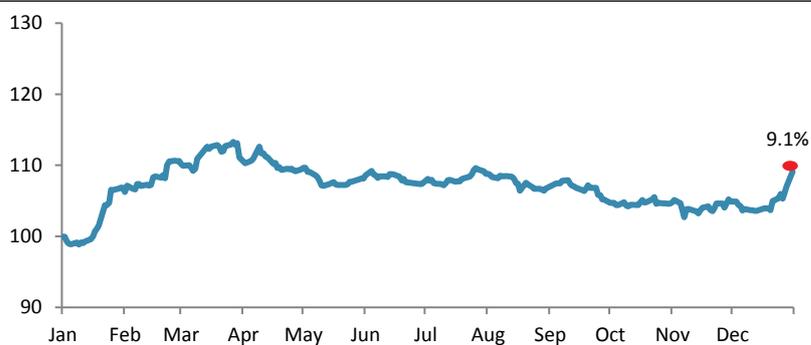
*Bahrain closed on a positive note to emerge as one of the top performers in 2017*

2017 compared to 82.3% in the previous year. Since the government has no other alternative source of funds, the ratio is expected to rise to 98.6% in 2019 and probably cross the 100% mark in the following year. Considering the alarming situation, the government has asked for financial assistance from Saudi Arabia, the UAE and Kuwait to lend support on shoring up its reserves. A positive response would be improving the government's ability to tackle the issue; however, the pace of the fiscal consolidation should continue to become more sustainable in the long term.

## Stock Market Performance

Bahrain was one of the top performers within the GCC and the wider MENA region. The index ended on a positive note with gains of 9.1% in 2017 after recording marginal gains in the previous year. In terms of performance by sectors, the Industries index was the top performer with gains of 88.2%, followed by 11.7% in the banking sector index. Series of downgrades by leading rating agencies did not have much impact on the broader index as it continued to perhaps focus on the robust non-oil sector growth.

**Exhibit 38: Bahrain All Share Index Performance (2017)**



Source: Thomson Reuters

The trading activity during the year also witnessed a marked improvement as both traded value and volume grew by 73.7% and 57.0%, respectively, in 2017. There was a substantial rise in trading activity during December, which also helped in pushing the index higher by 3.7% during the month.

## Outlook

Bahrain is expected to report one of the fastest growth in real GDP during 2017; however, it remains the most vulnerable to the financial risk within the region. The government has adopted a different path in tackling the rising deficits compared to the regional peers. As a result, the pace of fiscal consolidation in Bahrain is much slower compared to the other GCC nations. This has resulted in series of downgrades by leading rating agencies as they remain concerned about the significantly high deficits and rising debt levels. According to the IMF, the real GDP of Bahrain is expected to slow down to 1.7% in 2018, while the agency expects recovery in the economic activity across the region. Going forward, the government will have to take more prudent steps to reduce the deficit and minimize the need to raise more debt to fund the rising deficits.

## **THE YEAR AHEAD: Global Growth to Remain Robust**

### **Investors Bracing for Another Year for Investments**

2017 has not only been an exceptional year but also a tempestuous one for the global markets as there were several questions raised about the sustainability of the global growth and fear of populism within the markets at the beginning of the year. The most impressive part about 2017 has been the synchronized growth witnessed across major economies, especially the acceleration of the recovery in the Eurozone and the robust growth in Japan, coupled with stabilization in the Chinese economy. Most notably, the Central Banks have shown confidence in the global growth and provided clear direction about the monetary policy in 2018 to the markets.

On the economy front, 2017 ended on a high note, shrugging off political disorders, with GDP continuing to accelerate over much of the world which has further raised the expectations for 2018. Resultantly, in January 2018, the IMF revised the global growth forecast to 3.7% for 2017 which is expected to further rise in 2018 to 3.9%. The World Bank expects the global economies to grow by 3.1% in 2018 on the back of a recovery in investment, manufacturing and trade continues coupled with firming commodity prices benefiting commodity exporting developing economies.

The US economic depicted a strong growth momentum in 2017, which was mainly supported by subdued inflation and loose financial conditions. The world's biggest economy is expected to continue the strong uptick activity seen since the second quarter of 2017, which is likely to get a fillip from the recently passed tax reform by the Trump Administration. The IMF expects the US to grow by 2.3% in 2018 compared to its earlier forecast of 2.5%, while the World Bank has raised its forecast by 30 bps to 2.5% in 2018, indicating the growth momentum will continue to strengthen in the current year.

Europe has been the surprise factor in 2017 as it played an important role in driving the overall optimism in the global economic growth, spurred by policy stimulus and strengthening global demand. It is expected to grow by 2.4% in 2017 and continue the growth momentum over the next couple of years, albeit at a slightly slower pace due to the political challenges it might encounter in 2018. On the other hand, the UK looks vulnerable as they struggle to strike a deal with the EU post the BREXIT.

The emerging markets witnessed a steady growth during 2017 as the policymakers have continued to offer accommodative reforms in the region to achieve desired results. The strong performance from the world's second largest economy, China, helped the emerging markets to grow continuously during the year. China's real GDP growth has remained strong and is expected to have grown by around 6.8% in 2017 on the back of the rising household income and the improved external demand. On the other hand, India is expected to grow at 6.7% in 2017, down marginally compared to 6.8% in 2016. While the Indian economy is experiencing transitional slowdown in its economic activity on the back of measures taken by the government during 2016-17 (impact of demonetization and implementation of GST), China will continue to focus on the quality of growth rather than pace as it embarks to rebalance from an export-based economy to a consumption-based economy.

## MENA Economies to Ride High on Expansionary Fiscal Stance

In 2016 and 2017, the GCC region has undergone a period of consolidation coupled with host of initiatives to introduce alternative measures to boost government receipts. Despite all the headwinds, the region has been able to witness modest growth during the past two years. Going forward, the region is expected to reap the benefits of the measures taken during the period, coupled with higher oil prices. Further, the recent budget announcements by leading governments is also pointing towards continued spending on key economic sectors to drive the non-oil sector activity. Given that the regional economies are largely driven by government spending, the strong surge in oil prices will further improve the government's fiscal position and improve investors' confidence, positively impacting the regional economies in 2018. Hence, the GCC sovereigns are looking at a much stronger footing into 2018, which should translate into a recovery in the economic growth. According to the IMF, the region is expected to record a real GDP growth of 2.2% in 2017 and rise to 3.2% in 2018, while the World Bank expects the region to grow by 1.8% in 2017 and 3.0% in 2018.

Regional opportunities across key sectors such as healthcare, education, e-commerce, and technology have now taken the centre-stage, especially in the GCC, as the governments continue to pursue backing the budding SME sector in a bid to diverge away from traditional oil revenues. Most notably, as the digital landscape in the region evolves, there is a pressing need for the MENA PE and VC houses to keep up with these rapid changes, or risk being left behind. In a bid to diversify their portfolio, regional firms are likely to increase their affinity towards funding technology and value-added companies, not only within the region but also from around the world.

The GCC equity markets have underperformed the global equities during the past two years on the back of a challenging economic and geopolitical environment across the region. While trading activity painted a mixed picture in 2017, the outlook for 2018 remains positive, largely driven by the recovery in oil prices and the uptick in non-oil GDP contribution. Further, the persistent improvement in oil prices will also be an important driver for improved investor sentiments, which is likely to push the markets higher in 2018. The regional equities will also benefit from global investors looking for growth stocks, especially in underperforming or lagging markets.

After witnessing a strong deterioration in IPOs in 2016, the region witnessed healthy offerings of 30 IPOs in 2017 amid improved market conditions and investor sentiments. Furthermore, with soaring equity indices, lower volatility and positive investor sentiment, 2018 is likely to witness a flurry of listings and it is bound to become one of the busiest years for IPOs in the region. Most notably, the GCC countries will see a number of IPOs in 2018, from both state-owned enterprises (SOEs) and private sector companies looking to capitalize on efforts within the region to make stock exchanges more liquid. Economic reforms and privatisation plans of the GCC nations are also likely to drive a significant level of IPO activity going forward.



# MENA Yearbook

## Al Masah Capital Management Limited

Level 9, Suite 906 & 907  
ETA Star - Liberty House  
Dubai International Financial Centre  
Dubai-UAE  
P.O.Box 506838  
Tel: +971 4 4531500  
Fax: +971 4 4534145  
Email: [Research@almasahcapital.com](mailto:Research@almasahcapital.com)  
Website: [www.almasahcapital.com](http://www.almasahcapital.com)

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