Kuwait Financial Centre "Markaz"
RESEARCH

Global and GCC markets recover Corona losses on the back of Stimulus

Oil testing new lows while gold rallies

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GCC markets, other than Bahrain, posted gains spurred by policy responses and ease of lockdown despite historically low oil prices and weak economic outlook.

We see the following issues as key developments during the month of April:

1. **A Distorted Oil market –** US Crude Oil prices turned negative for the first time in history on April 20, 2020, witnessing a sharp sell-off. We examine the reasons behind such a dramatic price action and if the nature of the Oil markets itself contributed to the fall.

2. **Rating Actions on Kuwait post-COVID-19 outbreak -** Despite having the situation largely under control from a social perspective, Kuwait's economy is expected to take a hit due to the fall in prices of oil. As a result, major rating agencies - Moody's, S&P and Fitch have decided to review Kuwait's sovereign rating.

3. **Impact of Oil Price Volatility on GCC economies, markets and businesses-** The oil volatility index recently reached its highest level since inception. As nations where oil is a major source of revenue, in addition to oil prices, its volatile nature might make a place for itself in policy and business decisions.

4. **GCC stocks that have weathered the COVID-19 storm–** The past few months have been brutal for GCC stock markets, leaving very few places for investors to hide. However, a handful of names in defensive sectors have managed to return gains despite all the doom and gloom.

5. **GCC fiscal deficits and financing post COVID-19 –** Fiscal deficit for the GCC countries is expected to widen from 2.1 to 10.4 percent of GDP. To cover the same, we expect the financing mix to decisively shift towards reserve drawdown from debt issuance. Overall, GCC sovereigns could issue debt worth USD 67billion in 2020 compared to USD 52.9billion last year. While, the reserve drawdown would be USD 84billion to USD 15billion last year.

6. **COVID-19's direct and indirect impact on GCC Banking sector-** The Banking sector will be directly impacted operationally and financially and also indirectly impacted by the effect of the various lock-downs and restrictions on other sectors. We take a look at the impact of COVID-19 on the GCC banking sector.

GCC Market Commentary

GCC Market Trends – April 2020

Index	M. Cap (USD Bn)	Last Close	2019 %	Apr'20	YTD %	S&P correlation**	ADVT* (USD mn)	P/E TTM	P/B TTM	Div. Yield
S&P GCC	359.0	95	8.3	8.6	-18.4	0.349	N.A	14.8	2.0	3.4
Saudi Arabia	2,132.4	7,113	7.2	9.3	-15.2	0.318	1,156.0	16.5	1.7	-
Qatar	123.7	8,764	1.2	6.8	-15.9	0.166	78.2	13.3	1.1	4.6
Abu Dhabi	127.7	4,230	3.3	13.3	-16.7	0.268	39.0	10.9	1.1	5.6
Kuwait (All Share PR)	93.1	4,975	23.7	3.2	-20.8	0.209	109.4	12.2	1.1	4.1
Dubai	59.6	2,027	9.3	14.4	-26.7	0.298	71.4	5.1	0.6	4.9
Bahrain	21.5	1,311	20.4	-3.0	-18.6	0.192	2.3	9.8	0.7	5.0
Oman	11.3	3,539	-7.9	2.6	-11.1	0.191	2.3	7.6	0.6	7.8

Source: Refinitiv, Zawya, Note: * Average Daily Value Traded ** - 3-year daily return correlation with S&P 500 index

S&P GCC composite index increased by 8.6% for the month, with all markets except Bahrain posting gains. Optimism over OPEC+ deal, policy responses and ease of lockdown boosted market sentiments. Dubai registered the highest gain, increasing by 14.4%, followed by Abu Dhabi, which gained 13.3%. UAE announced measures such as doubling of stimulus to USD 70 billion and extension of VAT payment. Dubai Expo has been postponed by a year to October 2021. Saudi Arabia gained 9.3% for the month. Bahrain ended the month in negative territory, losing 3.0%. Saudi Arabia, Qatar and Abu Dhabi have issued sovereign bonds to the tune of USD 24 billion in April. Spending cuts were announced by Saudi Arabia, Dubai, Oman and Bahrain on expectation of lower oil revenue. The countries have also eased lockdown seeking to contain economic fallout. IMF has estimated GCC's real GDP to contract by 2.7% in 2020.

Monthly returns heat-map of S&P GCC Composite index

S&P GCC	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2014	3.4%	3.7%	2.7%	2.8%	3.2%	-7.4%	8.1%	6.4%	-1.4%	-6.8%	-10.9%	-4.4%	-2.6%
2015	2.8%	4.4%	-6.9%	10.1%	-2.3%	-3.5%	0.1%	-13.2%	-1.1%	-2.7%	-2.3%	-2.4%	-17.3%
2016	-10.7%	3.7%	1.9%	5.7%	-5.1%	1.1%	-0.1%	-1.2%	-3.9%	2.2%	7.9%	4.2%	4.3%
2017	1.6%	-0.8%	-1.5%	-0.4%	-1.4%	3.2%	-0.4%	0.9%	-0.6%	-2.7%	-1.5%	3.4%	-0.4%
2018	5.3%	-2.5%	3.4%	2.9%	-0.4%	1.1%	2.2%	-2.5%	0.2%	0.1%	-2.0%	0.7%	8.4%
2019	6.8%	-1.0%	2.8%	4.4%	-5.6%	2.5%	1.1%	-5.8%	-0.7%	-2.6%	1.3%	5.9%	8.3%
2020	-0.9%	-7.4%	-18.2%	8.6%									-18.4%

Source: Refinitiv

Kuwait All Share Index registered gains of 3.2% in April. MSCI has postponed Kuwait's inclusion to its Emerging Markets Index from May to November 2020 due to the coronavirus outbreak. Fitch Ratings has affirmed Kuwait's long-term foreign-currency issuer default rating at 'AA' with a stable outlook, citing the country's strong fiscal and external balance sheets. In its April outlook, IMF has revised its estimate of Kuwait's GDP to fall by 1.1% in 2020 due to COVID-19. Among Kuwait's Blue Chip companies, Agility Public Warehousing gained the most at 13.0%. Central Bank of Kuwait has announced a slew of measures during the month to support the economy. The measures include reducing banks' capital adequacy requirements, easing the risk weighting for SMEs, increase in maximum lending limit etc. Banking sector index was up by 2.0% for the month. Listing of Boursa Kuwait's shares and KFH-AUB merger process have been postponed citing coronavirus outbreak. While Consumer goods sector was the top gainer at 16.9%, Insurance sector was the top loser, falling by 1.8%.

Among the GCC Blue Chip companies, International Holding Company (UAE) had gained the most, increasing by 87.4%. Abu Dhabi Commercial Bank(UAE) has declined by 4.1%. The bank has an exposure of USD 981 million to the troubled NMC Health.

Global Market Trends – April 2020

Equity	Last close	April change (%)	2020 change (%)
S&P GCC	95	8.6	-18.4
MSCI World	2,053	10.8	-13.0
S&P 500	2,912	12.7	-9.9
MSCI EM	925	9.0	-17.0
MSCI FM	765	6.0	-22.8
Commodities			
IPE Brent($)	25	11.1	-61.7
Gold($)	1,680	6.9	10.8

Source: Refinitiv

The performance of Global equity markets was positive with the MSCI World Index gaining 10.8% for the month. U.S. equities (S&P 500) gained by 12.7% in April. The UK market (FTSE 100 index) closed 4.0% higher during April. The markets gained on the back of stimulus measures to cushion coronavirus' impact and news of easing of lockdown. However, the economic data looks dire with U.S unemployment rate for April expected to reach 16% and its GDP for Q2 2020 expected to fall by 30-40%. Emerging markets ended the month in positive, with the MSCI EM posting monthly gain of 9.0%.

Oil prices closed at USD 25.0 per barrel at the end of April 2020, which is 11.1% higher than March 2020. Earlier this month, OPEC+ agreed to cut crude oil production by 9.7 million barrels per day. The momentum towards achieving a deal helped push prices up, to about USD 34.0 per barrel. However, the markets started falling back as the supply cuts were perceived to be lesser compared to the reduction in demand. WTI Crude oil futures expiring in May touched USD -40.0 per barrel towards contract expiry because of concerns over storages nearing their full capacity in the face of steep fall in demand. Oil ended the month in positive territory supported by announcement of production cuts, U.S crude glut growing at a slower rate than expected and news of easing lockdown. Gold has gained 6.9% over the month.

1. A Distorted Oil Market

Crude Oil prices turned negative for the first time in history on April 20, 2020. While the supply is plentiful and demand has completely collapsed due to COVID-19 impact, the sharp sell-off that was witnessed was historic. The West Texas Intermediate (WTI) crude for May delivery fell more than 100% to end the day at negative $37.63/barrel, meaning producers would pay traders to take the oil off their hands. This historic price plunge is due to a combination of plummeting demand, lack of storage capacity in the US and more importantly the nature of the oil futures markets.

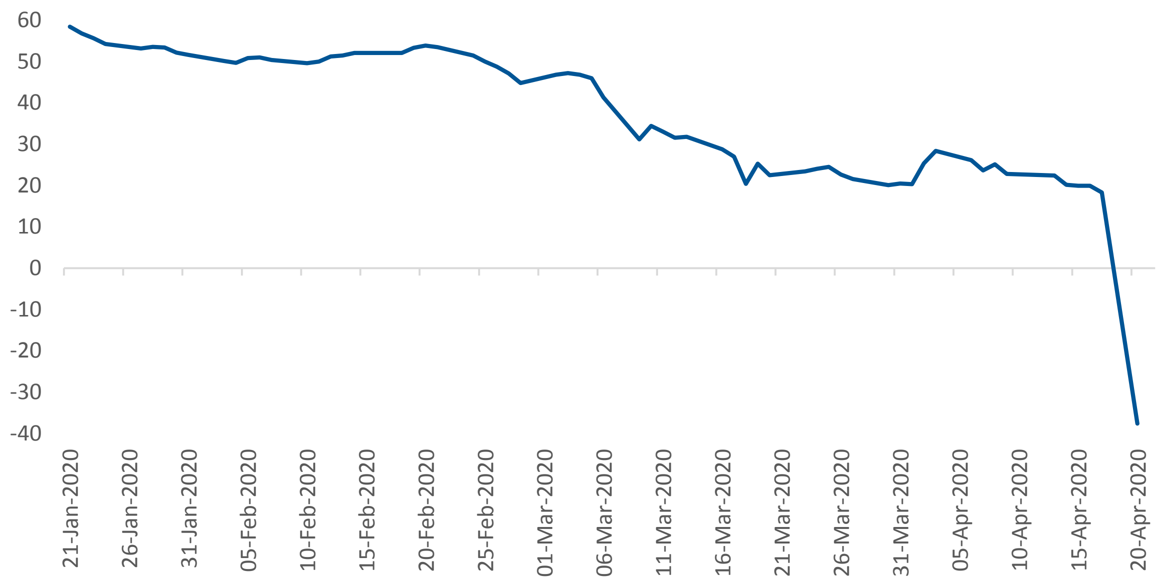
US Oil Storage Capacity has almost run out

In this particular case, the WTI May futures contract expired on April 21. Upon expiry, WTI Futures contracts are settled by physically delivery of the oil to the owner of the contract. So as expiry approaches, many traders roll their positions into further-out contracts. In this case, by selling the May futures (to traders with storage capacity who buy on behalf of clients like refiners) and buying the June Futures. The demand destruction caused by coronavirus led to refiners with a glut of inventory and they did not want to take physical delivery of more crude than necessary. Besides, the main oil storage hub in the U.S. in Cushing, Oklahoma was nearing its estimated capacity of 79 million barrels. Traders were fast running out of storage space for oil.

Meltdown in the WTI Futures market

All these factors would come to a head on April 20, as traders without physical storage capacity scrambled to sell their May contracts to non-existent buyers before the next day's expiry. They were basically paying other traders with storage capacity to take the oil off their hands! Though the prices are low, financial investors may not be able to take advantage of the situation. Only those market participants who could take physical delivery could stand to benefit from it. However, going by the market information it appeared that there were very few in that category. The paucity of bidding meant that once the CME, the exchange through which WTI futures are traded allowed negative pricing, below zero prices were inevitable.

WTI May Futures – Closing Values for past 3 months (USD/bbl)



Source: Refinitiv

Brent stays above zero

The nature of WTI futures market with the physical delivery clause is probably the main factor behind the negative prices. The international benchmark for oil prices - Brent crude - does not require physical delivery at the time of settlement, ended the day down 8.9% at $25.57/barrel, far from negative territory. Brent is also less affected by storage issues since it is a seaborne crude enabling traders to easily ship it to areas of higher demand. Due to this, Brent crude prices are always a few dollars higher than WTI. But the 'spread' between the two has rarely reached the levels seen on April 21. Similarly, the spread between the front month (May) and the second month (June) for WTI futures is also the widest in history. Today, June WTI - the front month contract now - is also expected to reach negative prices before its expiry on May 19 if similar conditions prevail.

Oil has always been a haven for speculators

Oil has always been one of the most volatile commodities to be traded, which makes it a haven for speculators hoping to make a quick buck. The massive increase in Oil prices in 2008 was partly blamed on speculators. The negative oil price seen this month can also be partly attributed to retail investors around the world taking long positions on May WTI futures as it kept falling below $20. However, as expiry approached, all big institutional players had rolled their positions and moved to the June contract and trading volumes were low. Only unsophisticated and mainly retail investors were left holding the contracts and no means of taking delivery of the oil. In this situation, it made sense to pay someone $40 to get rid of their contract rather paying a much higher price for storage capacity.

Conclusion

The price differences in the various oil markets have been exacerbated by the COVID-19 crisis and further distorted by requirements like physical delivery in the WTI futures. This distorted nature is likely to continue until oil demand returns to some semblance of normalcy.

2. Rating Actions on Kuwait post-COVID-19 outbreak

The global economy is at a standstill with countries still trying to control the spread of COVID-19. The pandemic has already sent the world into recession, with things getting murkier by the day. Despite Kuwait having the situation largely under control from a social perspective, the economy is expected to take a hit due to the fall in prices of oil. A series of demand and supply side shocks have sent oil prices to record lows, with a recovery not at sight in the near term. This has prompted major rating agencies to revisit the sovereign ratings assigned to Kuwait. Among the three major rating agencies, Fitch ratings is the only agency to keep the ratings unchanged at the moment. S&P has downgraded Kuwait by a notch while Moody's has placed Kuwait under review for a possible downgrade soon.

Rating Actions on Kuwait post-COVID-19 outbreak

Rating Agency	Sovereign Credit Rating		
	From	To	Change
S&P Ratings	AA/Stable	AA-/Stable	Rating downgrade
Fitch	AA/Stable	AA/Stable	Unchanged
Moody's	Aa2	Aa2	Placed under review for downgrade

Source: S&P Global Ratings, Fitch, Moody's

S&P Global Ratings lowered Kuwait's sovereign credit ratings to 'AA-' from 'AA' due to lower oil prices and slow reform progress. The agency further said that lower oil prices in 2020 and 2021 will have negative economic and fiscal implications for Kuwait due to its high reliance on oil revenues. In addition, Kuwait's reform momentum has generally lagged that of other GCC countries in recent years. S&P has forecasted the general government balance to be in deficit that exceeds 10% of GDP in 2020 but maintained a stable outlook due to Kuwait's large financial buffers, which would provide the government enough headroom for future reforms. S&P has revised its average Brent oil price forecasts to USD 30/bbl in 2020, USD 50/bbl in 2021, and USD 55/bbl from 2022. According to the rating agency, oil markets are now heading into a period of severe supply-demand imbalance in the second quarter of 2020. A recovery of GDP and oil demand through the second half of 2020 and into 2021 is expected as the most severe effects of the coronavirus outbreak moderate. Kuwait's sovereign wealth fund remains substantial at about 500% of GDP. However, the portion of it readily available for budgetary needs - General Reserve Fund (GRF) is much smaller, estimated at around 50% of GDP, and is continuously being used. Kuwait's use of the GRF will likely accelerate, as it needs to increase infrastructure spending in a low oil price environment. Kuwait is yet to pass a revised debt law authorizing the government to borrow, raising questions about how future budget deficits will be financed. If the passage of the law is further delayed, Kuwait could face budget constraints in future and might have to start drawing on assets in the Future Generations Fund (FGF), which happened only once before, during the Gulf War.

Fitch on the other hand, affirmed a rating of 'AA' with a stable outlook. They expect a general government deficit of 20% of GDP (KD 7.3 billion) for FY20/21. This is based on the assumption that the Brent price will average USD 35/bbl in 2020 and USD 45/bbl in 2021. Fitch stated that the government is unlikely to be able to mount a significant fiscal policy response to the oil shock given the ongoing pandemic and parliamentary elections in October 2020. Furthermore, the agency stated that the key strengths of Kuwait are its exceptionally strong fiscal and external balance sheets, while also highlighting the slow pace in addressing growing public finance challenges stemming from heavy oil dependence, a generous welfare state and its large public sector. Kuwait's fiscal and external metrics are particularly sensitive to changes in oil prices and production. Fitch estimate that a USD 10/bbl change in the average oil price from the current assumptions would shift Kuwait's fiscal balance by around 9% of GDP. An additional 100,000 bbl/day of oil production would impact the fiscal balance by around 1% of GDP. The agency, however warned that the continued depletion of the GRF in the absence of a new debt law and the confidence in the ability of Kuwaiti authorities to take other extraordinary measures to ensure timely debt service are factors to watch out in the future that could potentially place Kuwait in a position for downgrade.

Moody's affirmed Kuwait ratings at its current level Aa2 but placed it under review for downgrade. The agency cited similar reasons such as weakening government revenues due to low oil prices, increase need for financing and the lack of progress in austerity measures as the reason for the ratings action.

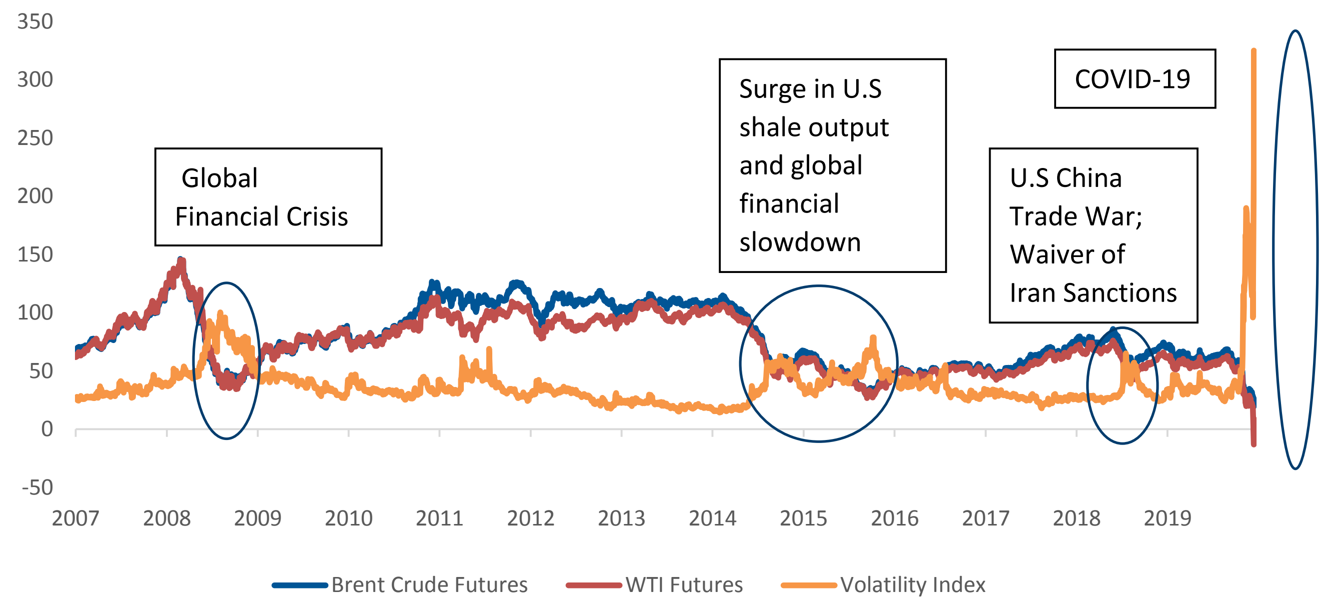
In terms of other major GCC economies, S&P has kept the sovereign credit ratings unchanged for UAE (Abu Dhabi), Qatar and Saudi Arabia at 'AA', 'AA-' and 'A-' respectively. The rating agency stated that Abu Dhabi's net asset position exceeds 250% of GDP, which alongside proactive policymaking comfortably cushions it from the sharp fall in oil prices and other external shocks. Likewise, in Saudi Arabia's case, strong net asset position on both its fiscal and external balances continue to be a key ratings support, but prolonged low oil prices will erode its net assets and begin to put pressure on the ratings. S&P believes that Qatar's government and external balance sheets currently remain strong and provide a buffer to withstand external shocks.

3. Impact of Oil Price Volatility on GCC economies, markets and businesses

Closely intertwined with economic growth, oil has been vulnerable to global growth outlook. The recent collapse in oil prices caused by demand destruction on account of COVID -19 was exacerbated by the OPEC+ disagreement, pushing prices down to historically low levels. In the current dynamic scenario, where the world is controlled by COVID-19, while news on OPEC+ agreement, stimulus etc. causes some increase in prices, news on extension of lockdowns and filling up of oil storage causes a steep fall in oil prices. These movements have caused increased oil price volatility.

Oil price volatility is measured by the Oil Price Volatility Index(OVX).[1] Though the OVX measures volatility in price changes in WTI, as both WTI and Brent crude are driven by similar market sentiments and follow similar trajectory, the volatility index is considered to represent volatility of oil in general.

Trajectory of Brent Crude Futures, WTI Futures and Oil Volatility Index



Source: Refinitiv; Oil Volatility Index introduced in May 2007.

The oil volatility index reached a value of 325, its highest level since its inception in 2007 on 21st April 2020. This indicates oil price could swing in either direction by 20% in a day.[2] This spike was on the back of the WTI crude oil turning negative, as storage facilities neared their full capacity and producers paid buyers to take the oil off the facilities.

While there have been spikes in volatility during low oil price years of 2008 and 2014-16, the current spike has dwarfed them. Volatility is generally known to be higher when the market in the bear run, and the same has panned out in the oil markets too. Higher volatility signals higher riskiness of an asset and negative sentiments.

As nations where oil is a major source of revenue, these are more vulnerable to the volatility in oil prices. As coronavirus continues with no end in sight, in addition to lower oil prices, their uncertainty of their direction or magnitude of fall adds to the woes of GCC. We take look at the impact of oil price volatility on economies, markets and businesses.

[1] The OVX or "Oil VIX," measures the market's expectation of 30-day volatility of crude oil prices based on options on the United States Oil Fund LP. USO is an exchange-traded fund intended to reflect, as closely as possible, the spot price of West Texas Intermediate light, sweet crude oil, less USO expenses.
[2] Daily Volatility = Index Value/ Square root (365)

GCC Economies

Citing lower oil prices and COVID-19, IMF has projected Gulf Cooperation Council's growth to shrink 2.7% in 2020, compared with its October 2019's forecast of 2.5% growth for the same period. As governments dole out stimulus to contain COVID-19 impact amidst lower oil prices, their borrowing needs would increase. Saudi Arabia has said its total debt could reach 220 billion riyals (USD 58 billion) in 2020. Given the expected economic contraction and increased borrowing, the government debt as percentage of GDP is expected to increase.

October 2019 Forecasts for 2020 (Oil Price Assumption: USD 57.94 per barrel)

Parameters	KSA	UAE	Kuwait	Qatar	Oman	Bahrain
Real GDP growth	2.18	2.52	3.07	2.76	3.68	2.10
Fiscal Balance (% of GDP)	-6.64	-2.81	3.83	6.86	-8.37	-8.06
Current Account Balance (% of GDP)	1.50	7.11	6.78	4.14	-8.01	-4.38
Gross debt (% of GDP)	28.36	20.32	17.4	47.9	63.8	106.8

Source: IMF

April 2020 Forecasts for 2020 (Oil Price Assumption: USD 35.61 per barrel)

Parameters	KSA	UAE	Kuwait	Qatar	Oman	Bahrain
Real GDP growth	-2.28	-3.49	-1.11	-4.35	-2.84	-3.59
Fiscal Balance (% of GDP)	-12.59	-11.13	-11.33	5.25	-16.90	-15.71
Current Account Balance (% of GDP)	-3.08	1.52	-10.24	-1.92	-14.19	-9.64
Gross debt (% of GDP)	34.04	33.61	18.93	57.36	78.26	N.A

Source: IMF

Given their dependence on oil, its volatility makes the outlook for the region uncertain and increases its perceived risk. This uncertainty affects many aspects of the GCC economies from economic growth prospects and fiscal policy to debt levels and sovereign rating.

To reduce their oil dependence, GCC countries try to increase their non-oil revenue and boost non-oil sector growth. Oil volatility makes this move difficult. Boosting non-oil sector growth requires higher investment in these sectors. Volatility in oil prices hinders the planning and execution of the projects in these sectors, as their implementation is usually over long time frame. Lower oil prices and the accompanying volatility, while highlighting the urgency of fiscal reforms like levying taxes and reducing subsidies, also restrict the room available for those reforms.

Oil price assumption is an important linchpin of GCC governments' budget. Volatility makes the budgeting process uncertain. For example, budgeting assuming oil price at USD 50 per barrel is easier than assuming oil price to be in a range of USD 20 – 80 per barrel.[3] It also destabilizes fiscal policy and the governments are caught unawares. Lower oil prices and stimulus to cushion COVID-19's impact are increasing governments' borrowing requirements. While countries like Saudi Arabia are issuing sovereign bonds, Kuwait has not been able to do so as it is yet to pass the public debt law.

While governments' borrowing needs and debt levels increase, oil volatility would influence the risk perception of lending to these countries. Saudi Arabia's 5-year credit default swap (CDS) spreads reaching 233 bps and rating downgrade of Kuwait by S&P are a few recent examples of this increased risk perception.

[3] CFR - Oil Volatility

There has been volatility in the oil markets in the past and every time there has been a call for action. The current crisis only indicates the sheer magnitude to which volatility could spike and oil prices could fall, re-iterating the need for moving away from an oil-based economy.

GCC Markets

GCC capital markets are prone to oil price movements. In 2014-16 oil price crash, the S&P GCC index had dropped by about 43% when the volatility index had peaked. In the current volatility spike, the markets have dropped by 23%. The 3-year correlation between monthly returns of sector index and oil price is significant for almost all sectors other than healthcare, telecom and non-cyclicals.

Correlation between Sector Index and Oil Price Monthly Returns

Parameters	Apr 2017-Apr 2020
Banks	0.76
Financials	0.75
Industrials	0.70
Basic Materials	0.68
Real Estate	0.65
Cyclicals	0.62
Energy	0.54
Healthcare	0.48
Telecom	0.38
Non Cyclicals	0.16

Source: Refinitiv, Marmore Research;

GCC Businesses

From oil majors to petrochemical industry to banking, oil volatility affects businesses across sectors. As an indicator of risk, high oil volatility prompts a conservative and cautious approach. Oil majors are affected because of uncertainty in their revenue streams. This causes them to reduce operating costs and capital expenditure. An example would be Kuwait Petroleum Corporation and Saudi Aramco's announcement of spending cuts in the face of recent volatility. GCC Petrochemicals focus on basic petrochemicals and are highly correlated with oil prices.[4] Hence oil price volatility would impact GCC petrochemicals too in terms of uncertain revenue streams. In addition to spending cuts, uncertainty in revenue arising from oil volatility would affect debt repayments, raising new debt and makes capital structure choices difficult.

As government spending on non-oil sector reduces, their growth would also be stunted. This would affect sectors like construction and real estate as their demand decreases. As businesses reduce spending and cut down on investment and expansion plans, banks' credit growth would also be affected. As companies see decrease in revenues, banks' provisioning might also increase in anticipation of deterioration in asset quality.

Conclusion

Be it the Global Financial Crisis, slowdown in global growth, trade wars or COVID-19, oil is one of the first commodities to take a hit. Given the uncertainty of these events, it seems like volatility of oil is here to stay. Measures such as taxation, subsidy reduction and boost to non-oil growth would help GCC move away from oil-based economy. But until GCC moves considerably towards a non-oil economy, in addition to oil price levels, given the recent sharp movements, its volatile nature might make its own place in decision making.

[4] PwC

4. GCC stocks that have weathered the COVID-19 storm

The past few months have been brutal for GCC stock markets, leaving very few places for investors to hide. The dual pressure of COVID-19 outbreak and the oil price war has had a negative impact on stocks across all sectors. However, a handful of names have outshined. The reason why these stocks have outperformed the broader country index and their respective sectoral indices are down to some broad based and company specific factors. As countries are still placed under lockdown, investors are still unsure about the earnings impact that companies could be facing. Therefore, the investment decision has been primarily driven by sectoral views. As all sectors do not face an equal amount of impact, investors prefer to take calls on sectors that are least affected or in certain cases having a positive impact on their businesses.

Large and liquid stocks that have had positive returns in 2020

Company Name	Country	Sector	YTD 2020 Returns	Market Cap (USD Mn.)	ADVT - 1Y (USD 000's)	Debt to Equity	Div. Yield - FY 2019 (%)
International Holding Company	UAE	Food Processing	351%	14,242	2,040.08	0.24	-
Abu Dhabi National Energy Company	UAE	Multiline Utilities	34%	1,156	210.77	15.22	N.A.
Mezzan Holding Company	Kuwait	Food Processing	19%	593	308.44	0.90	3.00
Wahat Al Zaweya Investment & Real Estate Development	UAE	Real Estate	18%	1,801	3,349.59	N.A.	N.A.
Abdullah Al Othaim Markets Company	Saudi Arabia	Food Retail & Distribution	17%	2,279	2,813.49	0.91	3.68
Savola Group Company	Saudi Arabia	Food Processing	17%	5,688	7,033.58	1.60	0.87
Al Meera Consumer Goods Company	Qatar	Food Retail & Distribution	13%	962	1,042.01	0.31	5.56
National Central Cooling Co	UAE	Water & Related Utilities	9%	1,545	369.87	0.64	5.47

Source: Refinitiv; Returns as of April 28 2020 close;

The general trend that is observed across the globe during times of crisis is that equity investors tend to look towards unglamorous but essential names that can offer capital protection to an extent. The case is much similar in GCC markets, with investors largely placing their faith in stocks that are defensive and deal with staple goods. Applying market cap and liquidity filters, we were able to identify stocks that have witnessed appreciation in their price during 2020. Among the top eight companies with the highest gains, five of them are involved in the food processing business while two of them were utility companies, both of which are considered defensive sectors. As demand in these sectors is not expected to fluctuate greatly, investors tend to prefer these names.

The food processing sector is one that has been steadily growing in recent years due to the increase in consumption as a result of the rise in population and high per capita income. Due to the shortage of water resources and unfavourable climatic and land conditions, GCC countries import around 85% of the total food that is consumed by them. As lockdowns are not expected to result in a reduction in consumption and the government willing to support food logistics to keep the supply steady, companies in these sectors are gaining from the windfall.

Among them, International Holding Company has seen the highest growth, with its share price appreciating more than three times since the turn of the year. The drive in share price is primarily due to the company posting very positive numbers in the last quarter of 2019, where its revenues tripled on a year-on-year basis. In addition, with the company expected to not be severely affected in the coming months, the company continues to see fresh buying.

Another noticeable trend among these gainers is that they have a manageably low debt to equity ratio. During times of distress, the general expectation is for companies to pile up debt in order to revive business operations and achieve growth after an extended period of lockdown. Apart from Abu Dhabi National Energy Company (TAQA), most of the gainers have a low debt to equity ratio. The government of Abu Dhabi holds 75% of TAQA, which is a comfort for investors, making them overlook high levels of debt. Apart from a low debt to equity ratio, four among the top eight companies have higher dividend yields than their respective country indices before the start of the crisis. In times of lowering bond yields, stocks that provide steady income are finding favour.

Volatility in GCC equity markets has spiked in recent months to levels that were only previously witnessed during the 2008 global financial crisis. As there is not much clarity on the earnings impact, investors are sceptical when it comes to investing in equity and have stuck to defensive names even if not so. The trend might change when restrictions ease, which could prompt investors to start focusing on fundamentals and invest in quality names from other sectors as well.

5. GCC fiscal deficits and financing post COVID-19

The economic repercussions of the impact of novel Coronavirus and the subsequent breakdown of OPEC+ supply cut agreement is unprecedented for the gulf economies. The sudden freeze in economic activity due to various measures such as travel restrictions (curbs on flights, public transportations and taxis), closing of schools, universities, shopping malls, commercials establishments, and curfew imposition to prevent the spread of virus has created a demand shock. Transportation sector that accounts for approx. 50 percent of global oil demand by end-use category has been impacted by such measures that have been implemented in various degrees across countries. Subsequently, oil markets faced with excess supply, and reduced demand has tumbled to historic low price levels.

As a result, the outlook for GCC economies that majorly rely on petrodollars has deteriorated at a rapid pace. IMF in its latest report has reduced the overall growth expectations for the GCC region by 520 basis points; it now expects the economy to contract by 2.7 percent from an earlier value of 2.5 percent growth for 2020. To assuage the economic impact, the extent of which is currently unknown, GCC countries have unveiled various fiscal and monetary measures. The fiscal measures presently amount to approx. USD 60billion.

GCC economies are staring at economies due to lower oil prices and COVID-19 impact

Country	October, 2019 Projections	April, 2020 Projections	Difference
Bahrain	2.1	-3.6	5.7
Kuwait	3.1	-1.1	4.2
Oman	3.7	-2.8	6.5
Qatar	2.8	-4.3	7.1
Saudi Arabia	2.2	-2.3	4.5
United Arab Emirates	2.5	-3.5	6.0
GCC	**2.5**	**-2.7**	**5.2**

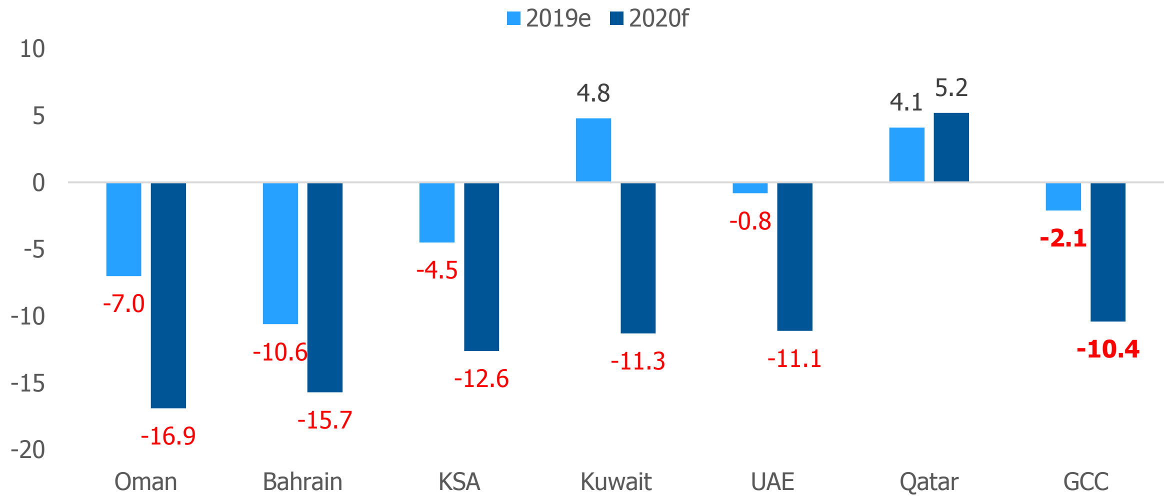
Source: IMF; Data from April REO, 2020

On expectations of lower fiscal revenues, GCC governments has revised their budgets, cut down on non-essential spending and scaled back capital expenditures in various degrees. Saudi Arabia has stated that it would reduce spending by SAR 50billion (USD 13.3billion or 2 percent of its GDP) in non-priority areas of 2020 budget. Dubai government is set to reduce capital spending by atleast 50 percent. While, Qatar is set to postpone awarding of USD 8.2 billion worth of project contracts on account of coronavirus outbreak. Similarly, Bahrain has announced that it would reduce non-priority government agencies expenditure by 30 percent, Oman authorities have announced that they will reduce their spending by 10 percent in 2020 (5 percent of GDP) and halt new capital outlays[5].

Further, due to lower oil income receipts and increasing expenditures to combat the covid-19 pandemic, the fiscal deficit for the GCC countries is expected to widen from 2.1 percent of GDP to 10.4 percent of GDP. In terms of value, the deficit that stood at USD 34billion for 2019 is expected to be at USD 143billion for 2020, a rise of 320 percent[6].

[5] Bloomberg
[6] IMF

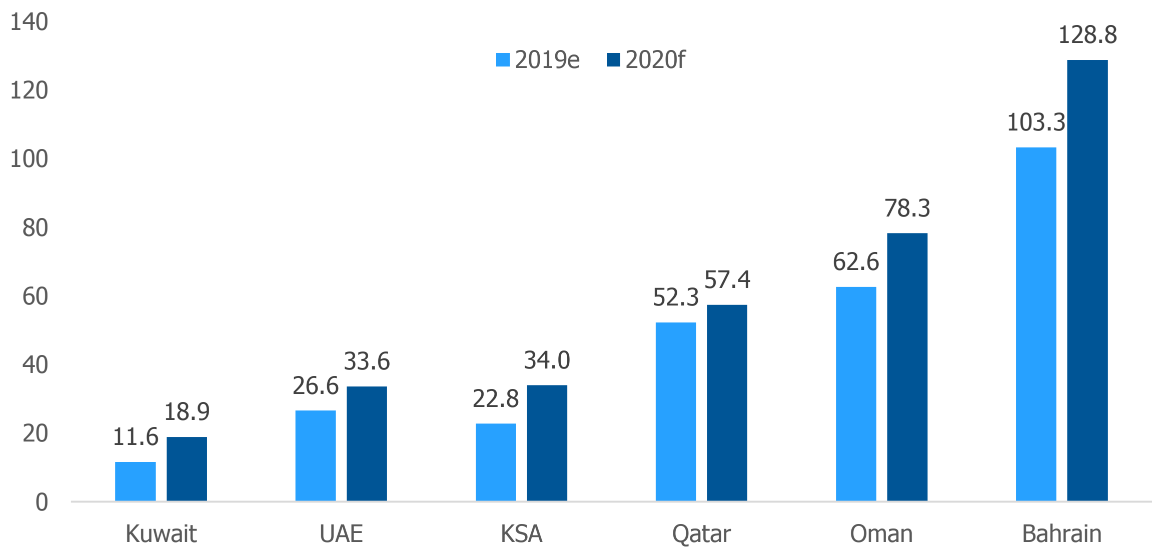
Fiscal deficit is set to widen on back of lower oil receipts



Source: IMF; Data from April REO, 2020

To balance the deficits, the governments could either dip into their accumulated fiscal reserves or issue additional debt. As the interest rates are at record lows and with many GCC countries having low debt compared to their emerging market peers, it would be a prudent choice to tap international debt markets for capital. Whilst, Kuwait, UAE, KSA and Qatar command robust reserves and have low debt, could tide over the situation easily; Bahrain and Oman that do not have robust reserves similar to their GCC counterparts could witness pressure in consolidating their finances.

Debt levels of GCC countries are set to accelerate at record pace



Source: IMF; Data from April REO, 2020

Fitch ratings agency recently noted that the ability of Oman to issue additional debt is constrained and that it could come at a high cost. Fitch recently downgraded Oman to 'BB' from 'BB+' with a negative outlook that could push Oman further deep into the 'junk' territory. The report added, the financial position of Oman is precarious and that it could threaten its ability to maintain the currency peg. Though Bahrain has higher debt level than Oman, GCC countries have pledged USD 10billion of financial support to help it tide over the situation.

GCC Sovereign issuances reach record high in April

In the start of April, Qatar issued USD 10billion of debt in three tranches of five, ten and thirty years period. Due to its financial profile, it was able to receive orders worth up to USD 45billion; however, the pricing was 40 basis points (bps) over its existing curve. Abu Dhabi – prime credit in the region, followed up with USD 7billion of bonds in three tranches and it was able to garner orders for USD 44billion at a pricing of 30bps over its existing curve.

Following the successful debt issuance, Saudi Arabia raised USD 7billion in three tranches to bolster its finances. Saudi Arabia earlier in March raised its debt ceiling from 30 percent of GDP to 50 percent of GDP. It raised USD 2.5billion in 5.5-year bonds at 260bps over U.S treasuries, USD 1.5billion in 10.5-year bonds at 270bps over U.S treasuries and USD 3billion in 40-year bonds at 4.55 percent. The 40-year bonds is the longest-dated issue in dollars by a gulf borrower[7]. It is be noted that Saudi Arabia raised USD 5 billion at the start of the year.

In the case of Kuwait, parliamentary authorisation to issue or refinance debt expired in 2017. The government has not been able to secure approval for borrowing yet. Reserves in Future Generation Fund (FGF) that stand at approx. USD 468billion (or 346 percent of 2019e GDP) cannot be used for funding without approval while General Reserve Fund (GRF) whose assets amount to USD 77billion (57 percent of 2019e GDP) and are utilized to meet the financing needs of the government are depleting.

Possible financing mix to cover deficits

Country	Expected Deficits in 2020	Expected Debt Issuance	Reserves Utilization	Debt raised so far
KSA	84	46	38	Raised USD 12bn
UAE	38	8	30	Raised USD 7bn
Kuwait	12	5	7	Debt law under progress
Oman	11	3	8	Yet to tap
Bahrain	6	5	1	Yet to tap
Qatar	na	na	na	Raised USD 10bn
Overall	**151**	**67**	**84**	

Source: Marmore Research, IMF; Note: Qatar fiscal position is expected to be in surplus

We expect GCC sovereigns to issue debt worth USD 67billion in 2020 compared to USD 52.9billion last year. However, last year USD 37.4billion was raised in international debt market and the rest was issued domestically. For 2020, we expect the majority of issuances to be in international debt markets. This would be accompanied by USD 84billion in drawdown from their reserves to cover the deficits in 2020 compared to drawdown of USD 15billion last year[8]. Thus, the financing mix is expected to decisively shift towards reserve drawdown from debt issuance to cover the deficits.

[7] Reuters
[8] Fitch Ratings

6. COVID-19's direct and indirect impact on GCC banking sector

The Current economic crisis due to the COVID-19 pandemic is likely to impact many sectors, none more so than Banking. The Banking sector will be directly impacted by lower profitability, increased non-performing loans (NPLs), deterioration in capital adequacy etc. and also indirectly impacted by the effect of the various lockdowns and restrictions on the other sectors to which GCC banks are exposed which would impact their operations and profitability in the long run.

Direct Impact due to COVID-19

The operations of GCC banks have been hit due to limited branches operating and increased adoption of digital channels. The suspension of travel, hospitality and leisure activities will see a decrease in credit card usage though increase in online purchases could make up for it to some extent. ATM usage is likely to go up as customers eschew bank visits. As mandated by regulators, GCC banks have waived processing fees and charges for certain transactions. Mortgage and personal financing will see a hit due to changing consumer behaviour during the lockdowns. Banks will need to review their existing processes and increase digitization and automation.

Operational Impact on GCC Banks due to coronavirus

	Branches Operating	Card Usage	Fees and Charges	Personal Banking	Digital Channels	ATM Usage
Level of Impact	**Negative**	**Negative**	**Negative**	**Negative**	**Positive**	**Positive**

The direct financial impact will be a reduction in profitability due to lower Net Interest Margins (NIM) and higher provisioning for bad loans. The sizable cut in interest rates by all the GCC central banks since the start of the crisis will reduce NIMs since the gross yields earned on loans will decline more than the interest paid on deposits, and also the rate cut is unlikely to significantly increase credit volumes in the difficult environment right now. The sharp fall in oil prices and reduced activity due to COVID-19 will exert significant pressure on the real estate, trade, retail, transportation, and hospitality sectors. High provisioning for interest and loan exposures to several of these large business segments of the banks will result in losses for the banking sector which are likely to peak in second quarter of 2020 and will also result in losses for the full year of 2020.

Monetary policy action by GCC Central Banks in response to COVID-19

Country	Saudi Arabia	Qatar	Kuwait	Bahrain	Oman	UAE
Interest rate cut (bps)	**125**	**100**	**125**	**125**	**75**	**125**
Liquidity Support	$13.3 billion	$2.75 billion	$2 billion	$10 billion	$20 billion	$70 billion

Source: IMF, Central Banks

Indirect Impact due to exposure to vulnerable sectors

The GCC economy has been hit by the double whammy of low oil prices and the coronavirus which has led to the shutdown of much of the non-oil economy. GCC Banks have highest exposure to the real estate sector which is hit by falling prices and rents as new capacity continues to be added to already over-supplied markets. The Share of Real estate loans out of overall loan book is Kuwait (28%), Qatar (27%) and UAE (29%) banks. In the case of UAE, any disruption to Dubai Expo 2020 which is already postponed, would impact its banking sector. Many GCC banks are exposed to Dubai Expo 2020-related projects in infrastructure, real estate and construction segments. UAE banks are also exposed to NMC Health Plc to the tune of USD 2 billion, though its troubles preceded the COVID-19 crisis. The closure of hotels and shopping malls has significantly impacted the hospitality and Retail sector. Various GCC governments have announced relief packages like postponement of principal and interest payment for 3-6 months for these affected sectors. While these measures could provide short term relief, they may simply delay the recognition of impaired loans and understate the real extent of problem loans. Cash-flow generation by corporates will slow down leading to loan restructuring in the coming quarters.

Banking sector soundness in the GCC (in percent)

Country	Capital Adequacy Ratio		Non-Performing Loans		Loan Loss Provisions		Return on Assets	
	2008	**2019**	**2008**	**2019**	**2008**	**2019**	**2008**	**2019**
Saudi Arabia	20.6	20.2	2.1	1.9	143	180	2.1	2.4
Qatar	15.5	19.0	1.2	1.3	85	150	1.2	1.7
Kuwait	16.0	17.6	3.1	1.8	85	230	3.1	1.5
Bahrain	18.1	20.9	2.3	5.5	83	100	1.3	1.5
Oman	15.9	16.2	3.2	2.7	105	80	3.2	1.6
UAE	13.3	17.9	2.5	5.7	100	100	2.5	1.8

Source: IMF, Marmore Research

Capacity of GCC banks to absorb losses

Most GCC banking systems have adequate capital buffers to absorb unexpected losses compared to the Global Financial Crisis in 2008(refer table above). According to S&P Global ratings, GCC banks could absorb up to a $36 billion in losses before starting to deplete their capital base. Loan Loss Provision Coverage Ratio (LLP) has also improved for GCC banks since 2008 with Kuwait Banks having a LLP of 230% for 2019. Further, the GCC central banks have acted swiftly and relaxed capital adequacy and liquidity requirements in anticipation of rising bad loans in the coming months. Most banking systems also benefit from a high to very high likelihood of government support if needed. The fall in Oil prices has impacted the extent of the government support which is possible and the respective sovereign credit rating. On this basis, Bahrain (rated BB- by Fitch) and Oman (rated BB by Fitch) are most vulnerable due to their below investment-grade sovereign credit ratings. Kuwait, UAE and Qatar are best placed due to their higher sovereign rating (rated AA by Fitch ratings).

Conclusion

The GCC banking sector is expected to see significant operational and financial impacts directly as a result of lockdowns and indirectly due to the stress in the wider economy. On the operational front, this will result in adoption of digital channels which are likely to continue even after the crisis ends and change the face of banking. On the financial front, due to adequate capital buffers and the possibility of government support, the current crisis is expected to remain more of a profitability shock rather than a capital or solvency issue for GCC banks.

Disclaimer

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