

Equity markets

Qatar: Spending cuts and tight liquidity weigh on equities in 2016

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The performance of Qatari equities was lackluster in 2016, though they have done somewhat better thus far in 2017. The Qatar Stock Exchange (QSE) was flat on the year, underperforming its GCC peers. Though Qatar remains the fastest growing regional economy with non-oil GDP growth expected to average 5.5% in the coming two years, compared to a GCC average of 2.9%, government spending cuts and tightening liquidity took their toll on sentiment and corporate results. The market ended the year in better form supported by December's OPEC deal to cut oil output and support energy prices.

Despite rallying in 3Q16, QSE was unable to lock in any gains in 2016. The general index was up a mere 0.1% on the year notably underperforming the regional MSCI GCC price index which advanced 5.1%. The Qatari market, along with other GCC markets, started the year on the wrong foot when oil prices dipped to the low 20's. All GCC markets bounced back as oil prices recovered, but the QSE was unable to maintain momentum, falling behind most of its peers.

An upgrade of the market to emerging market (EM) status by FTSE had a strong though short-lived impact. Qatari equities had a good run in the weeks leading up to the upgrade; but the rally was not sustained and QSE continued with a lackluster performance for the remainder of 2016. The upgrade, which came into effect in September, was set to lure more than \$500 million through passive funds alone; indeed, foreign inflows to QSE saw a notable pick up in the second half of 2016. According to EFG Hermes, net foreign inflows to QSE averaged \$212 million a month compared to \$81 million in 1H16.

The QSE rebounded late in the year on the back of the deal by oil producers to cut oil output, and continues to do better thus far in 2017. The selling of EM assets, partly triggered by the election of Donald Trump in the US, didn't seem to have a significant effect on Qatari equities. Data showed foreign inflows mostly holding up since the election. Market capitalization stood at \$153 billion at the end of December, having added a \$1.6 billion during the year.

Sentiment in Qatar suffered due to a lack of clarity regarding cuts in government spending and declining liquidity. Despite being the fastest growing economy and having one of the strongest fiscal positions in the region, low oil prices of the past two years have taken a heavy toll on confidence and business in the country. Government spending, the lynchpin of the economy, is expected to have contracted for the second year in a row in 2016. Meanwhile, the financial sector was being pressured by declining liquidity with deposits at banks contracting 5% y/y in October 2016.

Financial companies, QSE's largest sector, felt the heat of tightening liquidity. The rising cost of funds squeezed sector margins, with some banks grappling with capital requirement issues. There are 14 banks and financial institutions listed on the Qatari exchange, out of a total of 44 companies. The sector makes up 41% of the total market capitalization.

Chart 1: Price indices

(rebased, 31 Dec 2015=100)



Source: Thomson Reuters Datastream

Chart 2: Oil prices and GCC markets

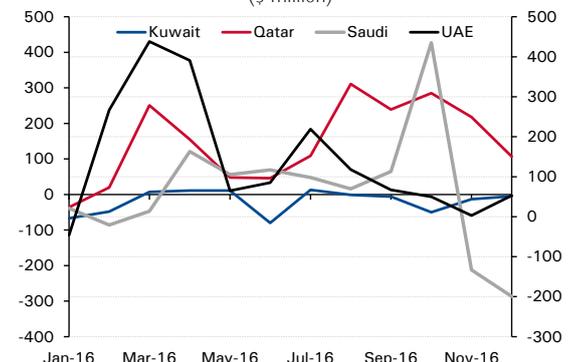
(rebased, 31 Dec 2015=1000)



Source: Thomson Reuters Datastream

Chart 3: Net foreign inflows to equities

(\$ million)



Source: EFG Hermes

Transport is the second largest sector making up 26% with the remainder distributed among five other sectors.

The low oil and gas price environment seemed to hurt Qatari corporates most. Corporate earnings for the first nine months of 2016 (9M16) continued to reflect weakness in the private sector with a sample of listed companies' profits down 11% compared to a year ago, the biggest decline among the four major GCC economies. Moreover, most 9M16 corporate announcements missed analysts' estimates, which contributed to QSE's weak performance in 4Q16. A sample of 18 companies announced profits that were on average 7% lower than forecast.

Despite their underperformance, Qatari equities remain among the most overvalued in the region. With an average P/E ratio of 14.2, QSE is the third most expensive market in the GCC. This helped the QSE become the second largest GCC stock market, having surpassed Kuwait's stock market in size in 2010. With a market capitalization to non-oil GDP ratio of 83%, the Qatari market seems overpriced compared to GCC peers.

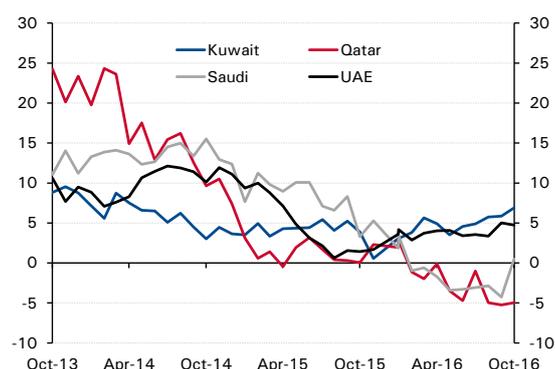
Market liquidity fell sharply as funds were directed away from equities toward bonds. The average daily turnover was \$77 million in 2016, down 27% from 2015. With banks turning to fixed-income markets to issue Basel III-compliant perpetual and other bonds, and GCC governments tapping debt markets to finance deficits, some liquidity was directed away from regional equities. However, as governments look to raise more debt internationally rather than depend on domestic borrowing, activity in equity markets has seen a pickup.

Despite a weak performance in 2016, QSE continued to lead in capital market development. According to the World Economic Forum's 2015/16 Global Competitiveness Report, Qatar ranks first in the Arab world in terms of efficiency of financial market development, availability of financial services, ease of financing through equity markets, and regulation of securities exchanges. Efforts to develop Qatar's financial and capital markets, which are part of Qatar's National vision 2030, paid off with FTSE recent upgrade and similar upgrades by MSCI and S&P in 2014.

Focus in 1Q17 will be on annual earnings announcements which have so far missed analyst estimates. Nevertheless, the market is up 1.5% year- to-date (ytd, February 3). In the medium term, investors will continue to monitor government's fiscal and reform plans for the coming years, as well as oil price developments. Internationally, with a new US administration, investor focus will be on the US, as they seek to ascertain the shift in key economic policies and their implications for capital markets globally.

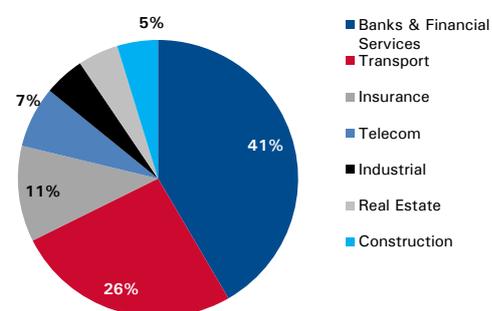
Chart 4: Deposits at banks

(% y/y)



Source: Central Banks

Chart 5: Market capitalization by sector



Source: Thomson Reuters DataStream

Table 1: GCC markets indicators

	General Index (% y/y)	Market cap (\$ bn)	Price/earnings per share	Average daily turnover (\$ mn)		Growth in profits (% y/y)
				2016	9M16	
		31-Dec-2016		2016	9M16	
Bahrain (Bourse)	0.4	19	11.2	2	-5	
Kuwait (Boursa)	2.4	84	15.8	46	-6	
Oman (MSM)	6.3	22	11.5	9	5	
Qatar (QSE)	0.1	153	14.2	77	-11	
Saudi (Tadawul)	4.7	447	17.6	1,194	-5	
Abu Dhabi (ADX)	5.6	223	12.4	237	-1	
Dubai (DFM)	12.1					
GCC		951	-	1,553	-	

Source: Thomson Reuters Datastream, Thomson Reuters Eikon

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