Equity markets

UAE: Equity markets outperform regional peers thus far in 2016

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UAE equity markets have outperformed their regional peers thus far in 2016 (Chart 1). The current environment of low oil prices has fueled concerns regarding the impact that fiscal deficits, spending cuts and reforms will have on growth across the region. The outlook for the UAE is looking more favorable than its peers thanks to a more diversified economy; non-oil growth is expected to average around 4.2% in the coming two years compared to a GCC average of 3.4%.

GCC markets have moved largely in tandem with oil prices since 2014 when oil prices started their decline (Chart 2). Correlations between GCC equity markets and oil prices have been at long-term highs for most of the past two years and the Dubai Financial Market (DFM), with its relatively high foreign participation, is more susceptible. When oil prices took the first of several hits since summer 2014, the DFM suffered the most losses among GCC markets, retreating by 15% over a six month period and underperforming the MSCI GCC, which declined by 12% over the same period. The Abu Dhabi Securities Exchange (ADX), by contrast, saw a decline of only 6%. More recently, when oil prices declined towards the end of 2015 before bottoming in January 2016, Dubai retreated by 29% over a four month period, underperforming the MSCI GCC, which fell 26% over the same period.

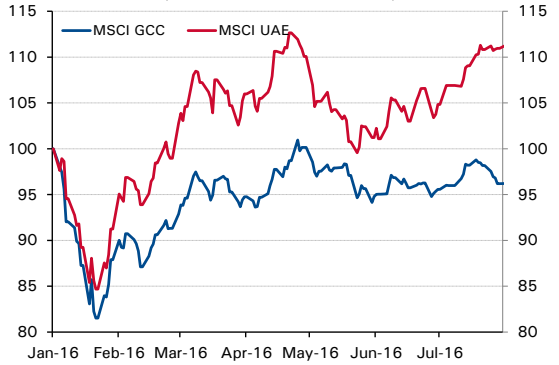
Since oil prices bottomed in January 2016, UAE equities have outperformed other GCC markets. The MSCI UAE is up 10% year-to-date (ytd) while MSCI GCC has retreated by 5%. UAE equities were bound to see a stronger rebound on higher oil prices than neighboring markets, but the outperformance of the UAE has also been driven by improving fundamentals. Oil prices are now hovering around the $45/barrel, well below GCC budgets' breakeven prices, and a prolonged period of low oil prices could force governments to reduce capital spending and benefits which could in turn hurt non-oil growth. In this current low oil price environment, the UAE stands to benefit from its resilient non-oil sector, which we expect to accelerate to around 5.5% and 6% in 2016 and 2017 driven primarily by firmer activity in tourism, financial services and construction.

UAE markets are a prime destination for foreign investors seeking exposure to the oil rich region. UAE markets, and particularly Dubai's exchange, have the most liberal and foreign-investor friendly regulations among GCC markets. Moreover, the 2013 decision by MSCI to upgrade the UAE's markets to emerging market status was a major step forward for the country's vision of being at the forefront of financial market development and has lured in more foreign investment through passive and active funds. The Securities and Commodities Authority's (SCA) 2014 annual report shows a 130% jump in net foreign investment in 2014, with the bulk of the increase going to DFM (Chart 3). According to DFM's latest annual report, foreign investors represented 76% of the total number of new investors in the market in 2015.

UAE equities still have potential for growth given the size of the UAE economy. The combined capitalization of ADX and DFM ranks second regionally behind Saudi's Tadawul. However, with a market capitalization

Chart 1: Price indices

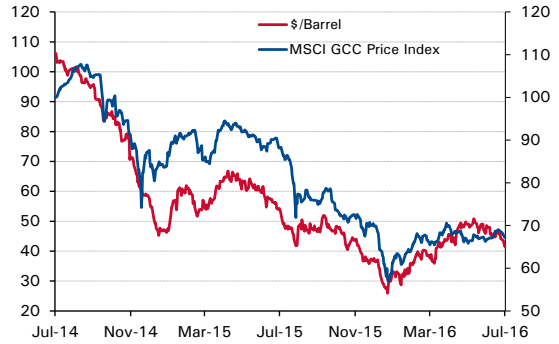
(rebased, 31 Dec 2015=100)



Source: Thomson Reuters Datastream

Chart 2: Oil prices and GCC markets

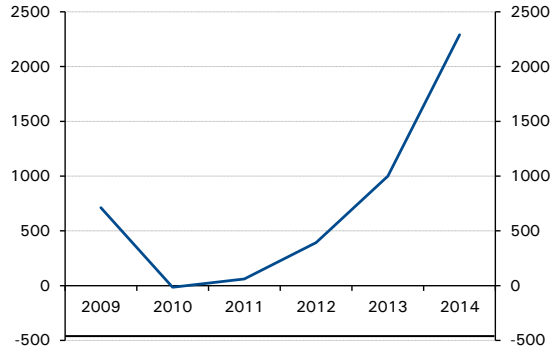
(rebased, 31 Dec 2013=1000)



Source: Thomson Reuters Datastream

Chart 3: Net foreign investment in UAE equities

($ million)



Source: Securities and Commodities Authority

to non-oil GDP ratio of 78% as of end 2015, UAE equities seem underpriced compared to some regional markets. UAE markets seem even more underpriced if market valuation is based on our 2016 GDP forecasts (Table 1).

UAE markets are very liquid compared to other regional markets. With an average daily turnover of $200 million, UAE markets are second only to Saudi's very liquid Tadawul. There's also a notable difference in activity between DFM and ADX with the former accounting for more than 70% of the turnover.

The combined capitalization of ADX and DFM stood at $223 billion at the end of July, with Abu Dhabi's market making up 60% of the total. There are 128 companies listed on the exchanges with an average market capitalization of $1.7 billion. The companies are distributed across ten sectors (Chart 4). Banking, telecom and real estate make up 85% of the total capitalization of the UAE's markets. Banks and telecom are the largest sectors in ADX with each making up more than 40% of the total market value. Banks and real estate companies dominate the DFM, each making up 35% of market capitalization.

The UAE has been among the most active in the region on the IPO front. At least four new companies have been listed over the past two years. The listings were in various sectors. The UAE also has the most vibrant mergers and acquisitions (M&A) activity and accounts for at least 40% of regional deals.

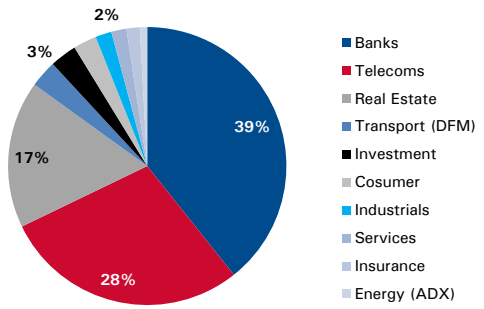
UAE equity markets, especially the DFM, continue to be the most dynamic in the region. High turnover, increasing foreign and institutional participation, new listings, and an active M&A market make DFM one of the more exciting regional markets. With the current low oil price environment, focus in the region will now be on the non-oil sector. The outlook for the UAE's tourism, transport and real estate sectors continue to be favorable especially in light of the upcoming Expo 2020. In the short term, the focus will be on the possible merger of National Bank of Abu Dhabi and First Gulf Bank, which would create the largest bank in the region.

Table 1: GCC market valuations

	Market capitalization to GDP (%)	
	Based on 2015 non-oil GDP	Based on 2016f non-oil GDP
Bahrain	66	64
Kuwait	119	109
Oman	47	44
Qatar	146	134
Saudi	86	80
UAE	78	73

Source: Thomson Reuters DataStream, NBK estimates

Chart 4: Market capitalization by sector



Source: Thomson Reuters DataStream

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