

2018

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WAHA CAPITAL

IEWS

A New Year of Opportunity for Middle East Investors

A commentary by Waha Capital
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As a new year begins it's a good time to take stock and assess the prospects of our home region in the coming months. Many outlooks tend to emphasise the risks the Middle East faces. While it's true there's no shortage of causes for concern, regionally and globally, we also see many reasons for optimism, and are confident 2018 will be a year of significant opportunities across the Middle East for careful investors that deploy the right expertise and approaches. Here are some of the main trends we'll be watching and taking into account in the year ahead:

A RETURN TO RELATIVELY STABLE GROWTH

The times of painful reforms and austerity measures undertaken by major regional economies have been largely absorbed and should help put public finances on more sustainable footing. Stronger oil prices should also encourage governments to begin spending again, albeit in a more disciplined way. Importantly, many businesses have also adjusted to the new economic normal, becoming more competitive in the process. All this should help economic growth regain momentum. Oxford Economics, for example is forecasting a 2.7% rise in GCC GDP this year, versus just 0.3% last year.¹

NO COLLAPSE IN CONSUMPTION

On the one hand, the introduction of a regional value added tax (VAT) and higher inflation could impact consumer spending in 2018. On the other, VAT proceeds should enable greater investment in public services that are important to consumers, like transport and healthcare, and the new tax has also been highlighted as potentially the year's biggest contributor to job creation.² The region's young, digitally savvy population also represents a source of demand that's only beginning to come into its own – online payment provider Payfort, for example, estimates the regional e-commerce market will double by 2020.³

CONTINUED DIVERSIFICATION

The efforts to diversify regional economies should continue to bear fruit. In the UAE, for example, the central bank expects the growth of the non-oil sector to hit at least 3.5% this year, up from 3.1% in 2017,⁴ while Saudi Arabia is also moving ahead with ambitious reforms and plans to create new economic zones like the US\$500 million smart mega-city Neom.⁵ Ongoing investment bodes well for sectors like infrastructure, healthcare and education. This diversification is also evident in the region becoming more entrepreneurial. The value of SMEs in the GCC is tipped to more than double over the next five years, to US\$920 billion.⁶ Perhaps nowhere will the potential and pace of change be more evident than in digital services. The fintech sector alone is expected to nearly triple in size by 2020 as more startups are launched to cater to a young, tech-savvy population, and investors follow.⁷ We're expecting exciting things and more home-grown innovation to emerge from markets like the UAE this year.

expected growth of non-oil sector

3.5% in 2018

up 3.1% from 2017

GROWING NEEDS, AND OPPORTUNITIES, AROUND PRIVATE DEBT AND EQUITY

As small and mid-sized companies assume a greater economic role, more will run up against the reluctance of banks to lend. Many will find it difficult to secure the funding they need to make their plans and strategies a reality from traditional sources. This will create a clear need for private investment, in the form of debt or equity, to fill the gap, and present a means for investors to participate in some of the most dynamic segments of the regional economy. Some industry participants estimate non-bank lending could reach US\$1 billion over the next few years, including everything from mezzanine debt to preferred shares and convertible bonds.⁸

That said, this opportunity will come with risks. Since not every possible investment will be advertised and not every company will thrive, successful investing will depend on having deep local market knowledge and connections. It will also be important for investors not to get swept up in the 'hype' that at times surrounds sectors like fin-tech, and instead evaluate firms in a wide range of industries to zero in on those with solid management, sustainable business models and the desire to form long-term partnerships. Financial backers will also require the ability to structure their investments to support each enterprise according to its individual needs and stage in the business growth cycle.

GREATER LIBERALISATION

As regional economies diversify and the need for private investment becomes clearer, we're likely to see more efforts to open markets and encourage foreign investor participation. One of the more exciting prospects this year is Saudi Arabia, where the Capital Markets Authority has recently taken more steps to ease foreign access to the local stock market, slashing the threshold for qualified foreign investors from US\$1 billion to US\$500 million.⁹ Ongoing reforms have brought nearer the prospect of Saudi Arabian stocks inclusion in key emerging markets indexes, which should trigger significant investment inflows.

Needless to say, we'll also be closely watching the potential risks the region faces. These range from higher than expected inflation, to weaker than expected oil prices, political instability and sudden policy tightening in developed markets, which could trigger a flight from the Middle East along with other emerging market assets.

Nonetheless, these concerns apply equally to many other markets. And as the trends outlined above show, short-term volatility is unlikely to change the broader overall picture of a rapidly evolving region that, especially in a low-yield, low-growth global environment, is a place of relatively untapped potential for the informed investor. In 2018 we should see more of that potential realised.

1 https://www.zawya.com/images/features/GCC%20year_ahed_2018.pdf

2 <http://gulfnnews.com/business/economy/vat/over-5-000-jobs-will-be-created-in-gcc-after-introducing-vat-1.2104113>

3 <https://news.sap.com/mena/2017/09/24/middle-east-e-commerce-market-to-double-to-usd-69-billion-by-2020/>

4 <http://gulfnnews.com/business/economy/diversification-to-boost-uae-s-non-oil-growth-in-2018-1.2091498>

5 <https://www.ft.com/content/fd4b10c0-b8b7-11e7-8c12-5661783e5589>

6 <https://www.menaherald.com/en/business/events-services/mena-research-partners-small-and-medium-enterprises-gcc-region-expected>

7 <http://startupbahrain.com/newsfeatures/investments-middle-east-fintech-sector-set-grow-270-2020/>

8 <http://in.reuters.com/article/us-mideast-debt/funding-squeeze-hastens-take-off-of-non-bank-lending-in-middle-east-idINKN1B10FA>

9 <https://www.thenational.ae/business/saudi-arabia-s-cma-amends-rules-to-make-foreign-access-to-local-stock-market-easier-1.694433>