Global and regional equities move up in May

Oil price up 50% as lockdown restrictions ease worldwide

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GCC markets moved up during May, gaining 1.3% the month after a sharp rebound in April. Oil markets continued their recovery, clawing back some of their losses for the year.

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

1. **Kuwait Sector Indices: Comparison of declines due to COVID-19 and 2014-16 Oil Price Crash –** The 2020 market crash has been fast and short if the trough of March 2020 holds. Lockdown to prevent the spread of COVID-19 brought about an uneven impact on sectors. A sector-wise comparison with the previous market crash of 2014-16 highlights the difference in COVID-19's impact on sectors and what sets the current crisis apart.

2. **Fund houses revise their long-term capital market expectations - What has changed? –** Major global fund houses have revised their long-term return expectations for different asset classes considering the events and policy decisions surrounding the outbreak of COVID-19. Some asset classes look quite attractive than how they were at the start of the year. Should investors be reconsidering their choices?

3. **Impact of Oil Price Volatility on GCC economies, markets and businesses-** The GCC has seen a number of Real Estate Investment Trusts (REITs) listed in stock exchanges in the past few years. However, the Covid-19 crisis has impacted the GCC Real Estate sector which has in turn impacted GCC REITs. We examine the impact of Covid-19 on GCC REITs listed on stock exchanges.

4. **Implications of COVID-19 on GCC Asset Classes –** Asset classes, be it equities, bond or real estate, are feeling the heat of the measures like lockdown and social distancing. While actual bottoming out of the pandemic or an effective vaccine is essential for a complete recovery, the recent relaxation of lockdowns with governments calling for learning to live with COVID-19 might be favourable in the near term.

5. **Will COVID-19 reduce the appetite for renewable energy projects in the GCC? –** As the economy is at a standstill, the future of renewable energy projects remains unclear. In such circumstances, should GCC governments continue to prioritize these projects or should they defer them until the economy is back on track?

GCC Market Commentary

GCC Market Trends – May 2020

Index	M. Cap (USD Bn)	Last Close	2019 %	May'20	YTD %	S&P correlation**	ADVT* (USD mn)	P/E TTM	P/B TTM	Div. Yield
S&P GCC	359.6	96	8.3	1.3	-18.4	0.339	N.A	14.8	2.0	3.4
Saudi Arabia	2,218.3	7,213	7.2	1.4	-15.2	0.303	1,156.0	17.8	1.8	-
Qatar	125.2	8,845	1.2	0.9	-15.9	0.169	110.1	13.5	1.2	4.5
Abu Dhabi	126.6	4,142	3.3	-2.1	-16.7	0.270	39.0	11.2	1.0	5.7
Kuwait (All Share PR)	93.8	4,996	23.7	0.4	-20.8	0.212	109.4	12.2	1.1	4.1
Dubai	57.7	1,945	9.3	-4.0	-26.7	0.293	74.3	4.9	0.6	5.1
Bahrain	20.8	1,270	20.4	-3.1	-18.6	0.194	2.3	9.1	0.7	0.0
Oman	11.4	3,545	-7.9	0.1	-11.1	0.185	2.3	8.2	0.6	7.6

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

Regionally, the S&P GCC composite index rose by 1.3%, with Saudi Arabia, Qatar, Kuwait and Oman registering gains. Saudi Arabia's Tadawul index increased by 1.4% for the month followed by Qatar whose index gained 0.9%. Abu Dhabi, Dubai and Bahrain lost 2.1%, 4.0%, and 3.1% respectively. Global rating agency Fitch said that GCC countries are expected to post fiscal deficits of 15%-25% of GDP in 2020, with only Qatar's deficit staying in the single digits at 8% of GDP. Saudi Arabia took steps to ease the impact of low oil prices on its budget by announcing that it would be suspending cost of living allowance from June 1, and increase value added tax (VAT) to 15% (from 5%) from July 1. However, the UAE authorities said that it does not have plans to raise its VAT rate beyond 5%. Oman announced an additional cut on its budget by 5% during its latest announcement in May, adding to its earlier announced cut of 10%.

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%	1.3%								-17.4%

Source: Refinitiv

Kuwait markets were positive, with the Kuwait All Share index registering gains of 0.4% in May. Economic activity continued to take a hit as Kuwait's government imposed a 20-day total curfew from May 10th to May 30th in an attempt to curb the spread of COVID-19. However, the restrictions were eased at the end of the month, making Kuwait the third GCC country after the UAE and Saudi Arabia to ease restrictions. The government and the Central bank continued to enact measures to support the economy as domestic banks allocated KD 2 billion to the soft loan portfolio, which is expected to be granted to SMEs, companies and clients affected by the virus outbreak. Meanwhile, Central Bank of Kuwait has asked Kuwait Finance House to reassess its acquisition of Ahli United Bank (AUB), causing AUB's shares listed in Boursa Kuwait to fall by 9.2% for the month. Among sectors, Basic materials was the top gainer among Kuwaiti equities, gaining 5.5%, while Oil and gas sector was the top loser, falling by 4.9%.

Among the GCC Blue Chip companies, SABIC was the top gainer for the month, increasing by 14.6%. Meanwhile, First Abu Dhabi Bank lost 4.0% for the month. The bank had earlier announced that it has put discussions to acquire the Egyptian assets of Lebanon's Bank Audi on hold due to tough market conditions.

Global Market Trends – May 2020

Equity	Last close	May change (%)	2020 change (%)
S&P GCC	96	1.3	-17.4
MSCI World	2,148	4.6	-8.9
S&P 500	3,044	4.5	-5.8
MSCI EM	930	0.6	-16.5
MSCI FM	803	4.9	-19.0
FTSE -U.K	6,077	3.0	-19.4
Commodities			
IPE Brent($)	38	49.7	-42.7
Gold($)	1,726	2.8	13.8

Source: Refinitiv

The performance of Global equity markets was positive for the second consecutive month, with the MSCI World Index gaining 4.6% in May. U.S. equities (S&P 500) gained by 4.5% for the month despite its GDP shrinking 4.8% in Q1 2020 on a year-on-year basis. The U.S. markets are now down by just 5.8% on a year-to-date basis, which is a much lesser decline than most global markets despite the country's unemployment rate touching its highest since the Great Depression. The UK (FTSE 100 index) markets also stayed positive, gaining 3.0% for the month. The European Union revealed details of its Economic Stimulus Plan through which it would issue EUR 750 billion worth bonds. EUR 500 billion would be distributed to member countries as grants while EUR 250 billion will be available for loans. The plan is pending for approval by parliaments of member nations. Emerging markets were flat for the month, with the MSCI EM increasing mildly by 0.6%.

Oil prices closed at USD 37.8 per barrel at the end of May 2020, which translates to a monthly gain of 49.7%. The volatile commodity surged during the month as several countries eased their lockdown measures. Saudi Arabia also announced that it would reduce its crude oil production further by 1 million barrels per day from June 2020. Gold prices continued to rise steadily, increasing 2.8% in May, while Silver prices surged by 18.8% during the same period.

1. Kuwait Sector Indices: Comparison of declines due to COVID-19 and 2014-16 Oil Price Crash

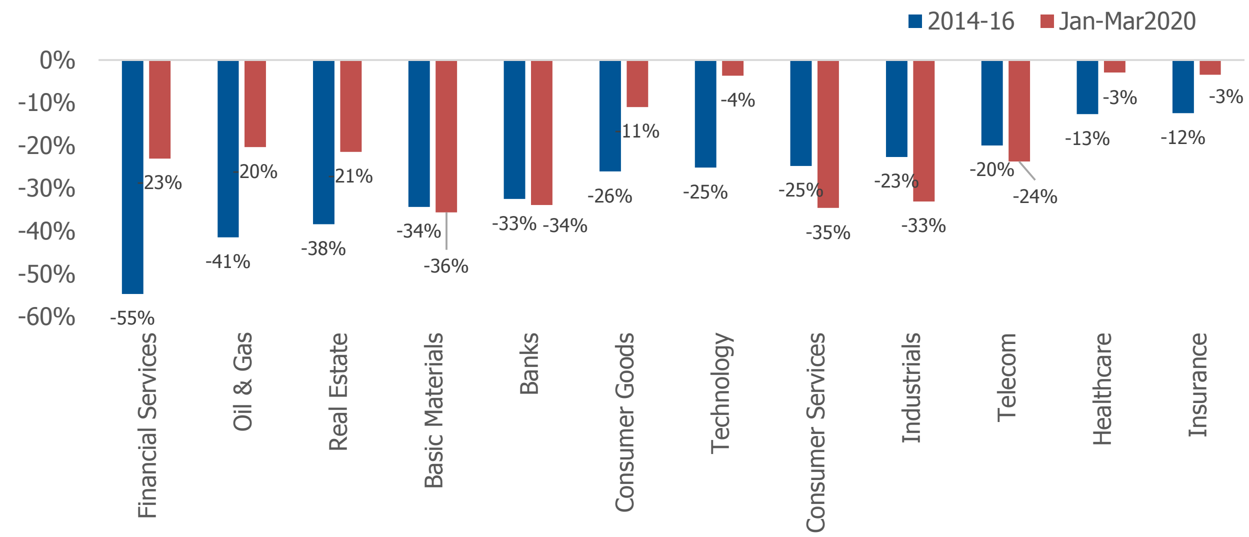
The 2020 market crash has been fast and short, if the trough of March 2020 holds. Lockdown to prevent the spread of COVID-19 brought about an uneven impact on sectors. While some sectors like airlines came to an absolute standstill, some sectors like technology stand to gain from the lockdown. These differences have reflected in the performance of equities too. A sector-wise comparison with the previous market crash of 2014-16 highlights the difference in COVID-19's impact on sectors and what sets the current crisis apart.

Origin

Performance of sectors in bear markets depend on what caused the market crash. In 2016, oil prices had crashed by about 75% from their peak in 2014. This was mainly because of the supply glut caused by the U.S. shale oil production. As a country with oil-based economy, that had affected Kuwait's equity markets too. The bear market was caused by a structural issue, causing a general economic downturn, affecting all sectors.

The decline in equities in 2020 was event-driven caused by - a) lockdowns implemented to contain the spread of COVID-19; b) decline in oil prices due to demand erosion on the back of lockdown and travel restrictions.

Comparison of performance of Kuwait's Sector indices in market crash of 2014-16 and 2020



Source: Refinitiv; Note: Customer Services includes Hospitality, Airlines; Basic Materials includes Construction; Industrials includes Logistics; Time period for 2014-16 peak to trough decline – September 2014 to January 2016.

Sectors better off compared to 2014-16

Being essentials, consumer goods have seen less impact. As COVID-19 is a health crisis, the healthcare sector is bound to be a thrust area and is expected to see higher growth going forward. Financials services' deeper fall in 2014-16 seems to be because of the higher valuations at that time.

The incorporation of technology in businesses has continued to increase and has come to be considered indispensable. Its importance has shot up further in a COVID-19 world. From smooth working from home, e-driven business/bureaucratic processes to data governance and cyber security, technology has become ubiquitous. All these make it an all-weather sector for current times.

Though the oil prices have fallen in recent times too, the sector index has not fallen by as much as the previous crash. The reason could be that while the 2014-16 crash was systemic in terms of a supply glut with increase in shale oil production, the present fall has been caused by demand destruction that is driven by an event. In general, systemic issues tend to have a harder impact and slower recovery than external events.[1] The fall in prices so far has been of slightly less magnitude too. In the 2014-16 crash, the oil prices had fallen by 75% from peak to trough, whereas in the current crisis they have fallen by 65%.

Real Estate is another sector that has seen lesser fall in prices. While closure of businesses and reduced income levels would affect real estate in terms of sales and rent payments, the sector index's fall has been less than that of 2014-16. This could be because though the sector was stable while entering 2020[2], it has not been at its peak as it had been in 2014. That could explain the decline of lower magnitude. Expectation of a smooth recovery after COVID-19 and resumption of business as usual could have also contributed to the lesser fall. The downside for the sector would be reduction in demand due to near term uncertainty over COVID-19 and expat repatriation.

Sectors worse off compared to 2014-16

Consumer services and Industrials have fallen by a greater margin than 2014-16. These are the sectors that have been particularly affected because of the lockdown. Supply chain disruptions and demand erosion affects sectors like logistics that constitute industrials. Travel restrictions have impacted consumer services comprising of hospitality and airlines. Implementation of social distancing in the near term might continue to weigh on the consumer services sector. Banks' exposure to all sectors including the ones that have more affected by lockdown have caused the sector to fall by a slightly greater margin. Availability of construction materials, work stoppage to contain coronavirus spread have affected construction sector, contributing to the decline in basic materials.

The reasons for the difference in declines in sectors could be attributed to the nature of the crisis -2014-16 being structural and that of 2020 being event driven – and the lockdown measures. The question of whether markets have bottomed out persists, given the uncertainty over the coronavirus scare and the nature of economic recovery. But be it further fall or recovery, the trend in the impact on sectors is likely to hold.

[1] Goldman Sachs Research
[2] IMF

2. Fund houses revise their long-term capital market expectations - What has changed?

The unprecedented turn of events in recent times has drastically changed the outlook of the global economy in the near term. The economic disruption caused by COVID-19 has triggered global central banks and governments to act, changing the whole landscape for financial and real assets both in the short and long term. Things look much different now as compared to the end of 2019. Several asset classes witnessed a sharp sell-off and a subsequent recovery in recent months. Everything from valuations, macroeconomic indicators and risk appetite have changed within a short span of time. While the impact of COVID-19 is expected to wane away in the next few years, the global fund houses have revised their long-term capital market expectations for 2020 in light of the new reality.

The views of global fund houses slightly differ, the commonalities suggest that there is much more optimism in selected equity and private assets compared to fixed income due to the current low rate scenario. J.P. Morgan does not expect the current recession to significantly affect the growth in the long run as most of the current losses have been taken on to the government's balance sheets. Household spending and corporate financial health is not expected to suffer a major deterioration in the long run, therefore their change in forecasts are much more reliant on valuations and current prices. Blackrock believes that the near-term impact (a three-quarter timeframe) of COVID-19 on economic activity to be much severe compared to the global financial crisis. However, with appropriate policy response and execution, the impact over the long term could be much less extreme compared to the global financial crisis. Invesco considers a U-shaped recession as their Base case but is less optimistic about long term returns for most asset classes as compared to pre-COVID-19 expectations.

Changes in 10 Year return expectations of Global fund houses

Asset Class	JP Morgan		Blackrock		Invesco		Research Affiliates		Average		Effect of COVID 19
	Pre-COVID 19	Post-COVID 19	Pre-COVID 19	Post-COVID 19	Pre-COVID 19	Post-COVID 19	Pre-COVID 19	Post-COVID 19	Pre-COVID 19	Post-COVID 19	
Equities											
U.S. Markets	5.6%	7.2%	5.2%	6.9%	6.5%	6.2%	4.6%	3.1%	5.5%	5.9%	▲
Emerging Market	9.2%	10.5%	7.5%	8.2%	9.5%	7.0%	9.2%	11.0%	8.8%	9.2%	▲
Global	6.5%	8.1%	-	-	7.1%	6.0%	4.9%	6.1%	6.2%	6.7%	▲
Fixed Income											
U.S. Aggregate	3.1%	2.8%	1.7%	1.2%	3.8%	1.6%	1.9%	0.7%	2.6%	1.6%	▼
Emerging Market	5.1%	6.7%	3.5%	6.3%	5.2%	5.8%	3.5%	3.6%	4.3%	5.6%	▲
Global	2.5%	2.4%	-	-	3.7%	1.7%	2.0%	1.2%	2.7%	1.8%	▼
Alternatives											
U.S. Real Estate	5.8%	6.6%	5.6%	5.9%	5.5%	5.3%	-	-	5.6%	5.9%	▲
Global Real Estate	-	-	-	-	6.3%	6.1%	3.2%	3.8%	4.7%	5.0%	▲
Commodity	2.5%	4.5%	-	-	6.7%	3.1%	3.7%	4.1%	4.3%	3.9%	▼
Hedge Fund	4.8%	5.7%	6.0%	6.3%	4.7%	6.1%	-	-	5.2%	6.0%	▲
Private Equity	8.8%	9.8%	13.0%	11.3%	8.1%	-	-	-	10.0%	10.6%	▲
Cash											
US Dollar	1.9%	1.6%	-	1.2%	-	-	-	1.2%	1.9%	1.3%	▼

Source: Respective company websites/reports

Equities

Expected returns of equity markets have largely risen due to the drop in price levels during recent months. However, the revisions have only been mild due to expected deterioration in earnings over the next few years. The reversion of earnings growth back to pre-COVID 19 levels is expected to be gradual. Based on prior recessions, earnings growth is likely to contract in the first year before recovering in the third year and eventually reverting to its long-term average growth rate by the fifth year. U.S. equities have remained expensive compared to other developed markets. Yet they are expected to continue setting the pace for global equity markets due to their strong fundamentals and bias towards technology stocks. Major fund houses J.P. Morgan and Blackrock expect valuations to return to their peak once normalcy resumes. The recent fall in index levels have prompted both fund house to sharply increase their expected returns in U.S equities for the next 10 years. Invesco, whose long-term return expectations for U.S. equities were higher than other major fund houses before COVID-19 outbreak, has reduced their expected returns mildly, but continue to favour U.S. markets over others. Among emerging and other developed markets, the economies that are more self-sufficient and isolated to others are expected to perform better than those that heavily rely on external demand. Emerging market return expectations have been revised upwards by most fund houses, while their risk also remains significantly high. The fall in valuations and the relative underperformance of emerging markets in the past five years have led to higher expectations for the next 10 years.

Fixed income

The strength of government and corporate balance sheets, recovery of economic growth and future demand will be key determinants of fixed income performance in the coming years. Government bond returns have fallen and in most cases are now negative in real terms. Although duration is set to remain in demand while the world is in recession, fund houses are not very optimistic on developed market bonds in the long term. The likelihood of corporate defaults in expected to be above average for the next 3-4 years. Furthermore, Blackrock believes that the case for nominal developed market government bonds has diminished. Inflation-linked bonds may become the preferable risk absorbing asset, if de-globalization and supply chain changes pick up pace, governments ramp up support and inflation begins to emerge.

Alternatives

Hedge funds remain attractive on a risk-adjusted basis due to their ability to provide alpha beyond their exposure to traditional asset classes. Likewise, the outlook of private equity remained high due to their ability in terms of alpha generation in the medium to long term. Dry powder of private equity funds can be deployed at much lower entry multiples now due to the fall in valuation of businesses. Major fund houses have revised the expectations for real estate upwards but remain cautious. Despite a strong rally in Gold during recent months, the return expectations are largely unchanged. The weaker dollar and an eventual rebound in inflation to support returns for gold in the long run. Weakening of demand for oil and other commodities has led global fund houses to tone down their expectations for a basket of commodities.

3. Impact of Covid-19 on GCC REITs

The GCC has seen a number of Real Estate Investment Trusts (REITs) listed in stock exchanges in the past few years. This accelerated after Saudi Arabia's Capital Markets Authority (CMA) approved the listing of REITs in 2016 as a part of the National Transformation Program (NTP) and Saudi Vision 2030. Due to the economic crisis in the wake of the covid-19 pandemic, many of the listed REITs have seen a steep decline in their share prices and market capitalisations. Saudi Arabia's Tadawul REIT Index has fallen 13.5% for 2020 compared to an 18.4% fall for the S&P GCC Composite index. In this article, we examine the impact of Covid-19 on GCC REITs listed on GCC stock exchanges.

Weak Real Estate Sector hits Dubai listed REITs

Dubai real estate market has been oversupplied for many years and hence both prices and rents of apartments, villas and commercial buildings have come down since the peak in 2014 and further deteriorated due to the Covid-19 crisis. According to ValuStrat, sale of apartments and villas declined by 50% (MoM) in April compared to March 2020. This after March 2020 sales was down 42% (YoY) from that of March 2019. While property prices and rents fell by 10% for the first quarter of 2020. The UAE government has also requested property owners to waive rents for commercial and retail tenants who were affected by the lockdown. This has directly impacted REITs listed in Dubai, Emirates REIT and Enbd REIT. Their share prices have fallen by 64% and 28%, respectively for the year till date. The fall has been so drastic that both the Dubai-listed REITs are trading at well below their Net Asset Value. According to their annual reports, Emirates REIT reported a loss of USD 25 million for 2019 and Enbd REIT reported a loss of USD 9.4 million due to the exposure to the UAE real estate market. This indicates that the REITs were in trouble before the Covid-19 crisis hit, which further exacerbated the situation. Both the REITs are also in negotiations with tenants of properties in the portfolio over rent waivers. Both have suspended dividend payments for 2020 due to the weak UAE Real estate market. This has meant that foreign investors have sold both of them in the markets, particularly Emirates REIT leading to its market capitalisation falling to USD 61 million.

Key Financials of Top 5 GCC REITs by Total Assets

REIT	Net Income (2019) in USD	Market capitalisation in USD	Total Assets in USD	YTD Return
Emirates REIT	-25 million	61 million	1058 million	-64.3%
Enbd REIT	-9.3 million	85 million	470 million	-28.4%
Jadwa REIT Saudi	20.4 million	471 million	447 million	3.4%
Riyad REIT	18.8 million	360 million	635 million	-6.5%
Al Rajhi REIT	14.9 million	358 million	634 million	-12.1%

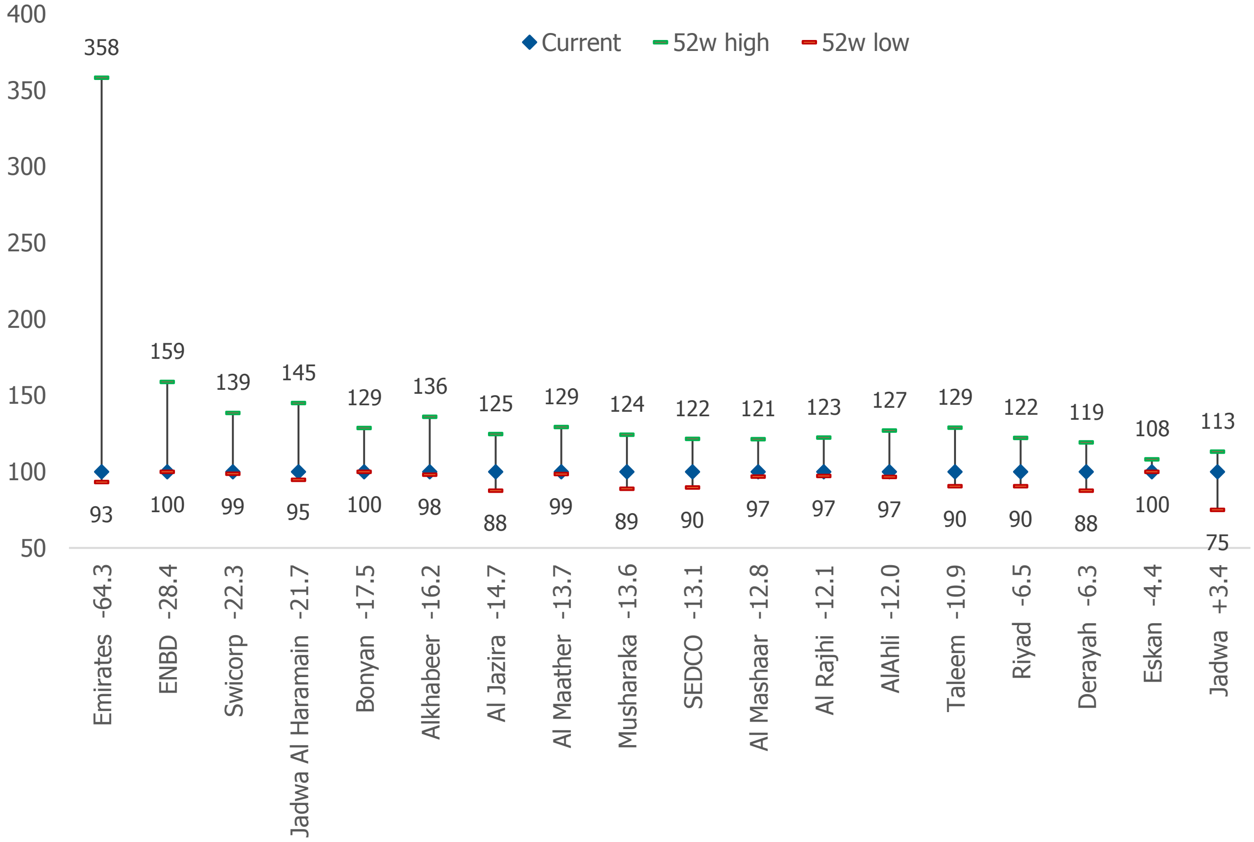
Source: Refinitiv; Data as of May 27, 2020.

Saudi Arabia Listed REITs have fared better

Saudi Arabia currently has 16 REITs listed in the Tadawul stock exchanges. Of which, only 2 have seen a fall greater than 20% for 2020. The REIT with the largest market capitalisation, Jadwa REIT Saudi Fund had seen a substantial fall earlier, but has since regained much of the losses and is up 3.4% for the year. This was after an announcement by Jadwa REIT that it was suspending management fees for 2020 and also looking into requests from tenants for temporary rent reductions. Saudi-listed REITs with available data reported profits for 2019 and entered the Covid-19 crisis in a better position than the Dubai-listed REITs. As a result, the fall in stock markets has been less severe but still significant with many trading at close to their 52-week lows.

The Exhibit below compares the current share price of GCC REITs with their 52 Week highs and lows. REITs in Kuwait and other GCC exchanges are not included because they have not been listed in exchanges or traded in the past 52 weeks.

Current Share prices of GCC REITs compared with 52 Week highs and lows



Source: Refinitiv; Data as of May 27, 2020.
Note: Current values rebased to 100. 52 week high and low are shown relative to current price
Year-to-date price performance shown along with X-axis labels

Conclusion

The Real estate industry has been hit hard by the covid-19 crisis which has in turn affected the profitability of REITs. REITs listed in Dubai with exposure to Dubai's real estate sector have been particularly affected. Saudi Arabia listed REITs with better fundamentals like Jadwa REIT have seen interest from investors in recent weeks. However, with the number of Coronavirus cases rising in the GCC, a clear picture can emerge only if the pandemic is controlled to some extent. Until then, GCC REITs are expected to see muted gains.

4. Implications of COVID-19 on GCC Asset Classes

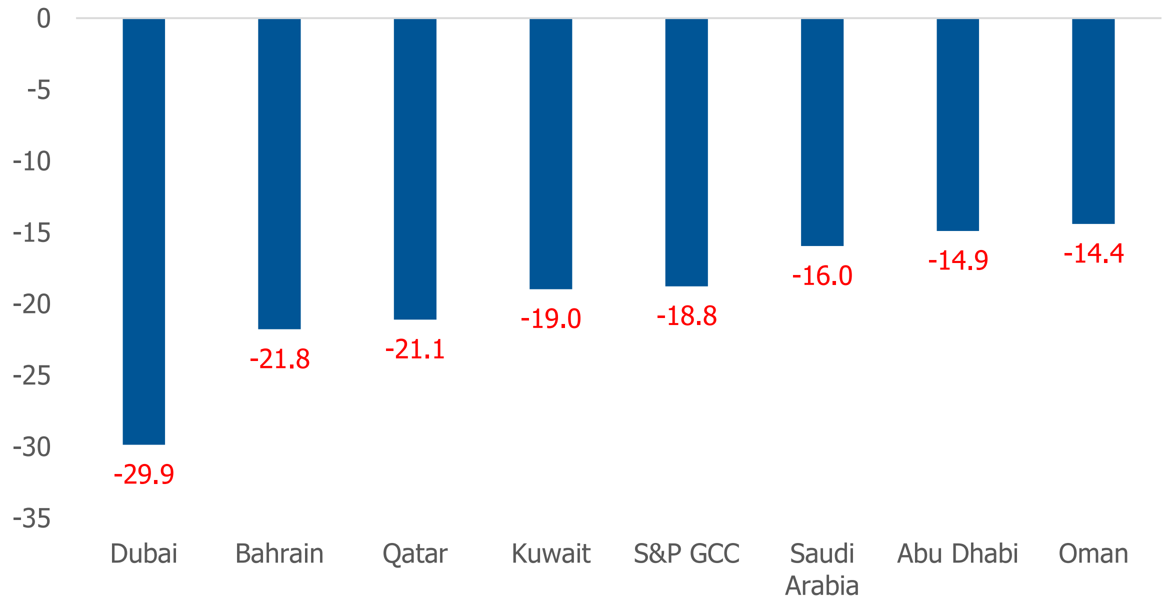
COVID-19 has rendered economic outlook and companies' performance projections for 2020 meaningless in a single stroke. Heightened uncertainty has become an everyday reality in the current times. As the coronavirus scare continues, the world is faced with multidimensional issues and tough questions, be it finding an effective treatment for the virus, zeroing in on an optimal quantum of stimulus or deciding the right time to lift lockdowns. With measures like social distancing and lockdowns affecting day-to-day lives of people, asset classes are feeling the heat too.

Equities

As one of the quickest asset classes to price in developments, equities have seen a huge slump. The spread of virus and associated lockdowns have affected production, supply chains and demand across countries and sectors. Travel restrictions and lockdowns across the world has hurt oil demand. While oil demand for 2020 is expected to drop by 10.8 million barrels per day(bpd), the demand for jet fuel is expected to drop by 2.4 million bpd, demand for road fuel is expected to drop by 5.3 million bpd.[3] This demand destruction pushed oil prices to historical lows.

For GCC, these lower oil prices add to the impact of coronavirus. In addition to affecting the oil based sectors, low oil prices would cause government revenues to fall and in turn reduce government spending on non-oil sector. These factors precipitated fears about economic growth in general and corporate earnings in particular, pushing stock prices down. Of the GCC countries, Dubai is most at risk with 32% of its GDP coming from sectors affected by social distancing.[4] This has reflected in its equity performance too.

Year to Date Performance of GCC Markets (%)



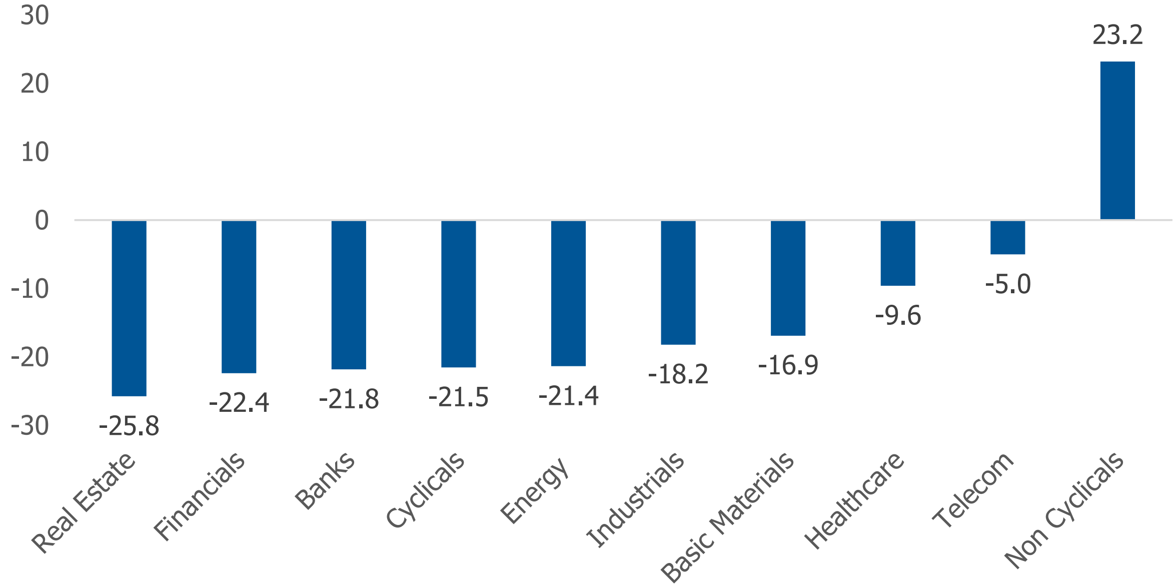
Source: Refinitiv; Data as on 12th May 2020.

Social distancing and lockdowns have affected almost all sectors, the difference being only in the degree of impact. Travel and Tourism and Energy have taken a direct hit because of the travel restrictions and postponement of events. Possibility of spike in infections as lockdowns ease poses a risk for these sectors. With credit exposure to multiple sectors, banking would be considerably impacted by probable deterioration

[3] Rystad Energy
[4] MUFG

in asset quality and measures like deferment of loan repayments. Comprising of companies involved in essentials such as food processing, consumer non-cyclicals appears as bright spot amongst other sectors.

Year to Date Performance of GCC Sectors (%)



Source: Refinitiv; Note: Data as of 24th May 2020. Cyclicals includes Hospitality, Tourism; Basic Materials includes Construction; Industrials includes Aviation, Logistics. Non-cyclicals include food processing etc.

Before the virus' onset, the market valuations in GCC had recovered from 2016 lows.[5] The P/E ratio of the GCC price return index fell from a value of 14.4 as of 1st January 2020 to 10.8 in mid-march, on the back of market wide sell-off due to COVID-19. However, the stimulus measures by GCC central banks and governments and plans to ease lockdown have caused an uptick in stock prices and in turn in valuation. While the current P/E ratio at 13.04[6], remains slightly lower than value at the beginning of the year, it is based on the healthier corporate earnings of the last 12 months. As the impact of COVID-19 on underlying corporate earnings picture continues to remain grim and uncertain, it remains to be seen if the valuations could sustain at current levels.

Concerns of limited policy space to cushion COVID-19 impact and economic slowdown increase foreign capital outflows, contributing to the fall in equity markets. For example, in March 2020, foreign equity outflows from Saudi Arabia amounted to USD 722 million.[7]

Bonds and Sukuk

While preference for bonds over equities in uncertain times and interest rate cuts by central banks of countries are support factors for bonds in general, credit strength and perception of risk associated with each borrower would determine demand for their bonds.

For example, considered as a strong borrower, the U.S 10-year Treasury yield has dropped from 1.88% on 1st January 2020 to 0.69% on 12th May 2020. In GCC, the oil price crash has increased the perception of the region's credit risk. This had reflected in the widening of 5-year CDS spreads and fall in prices of sovereign bonds in mid-March.

[5] P/E ratio of GCC Price Return Index: 1st January 2020 – 14.4; 2016; 21st January 2016-9.1
[6] As of 24th May 2020
[7] Preliminary Data from IIF

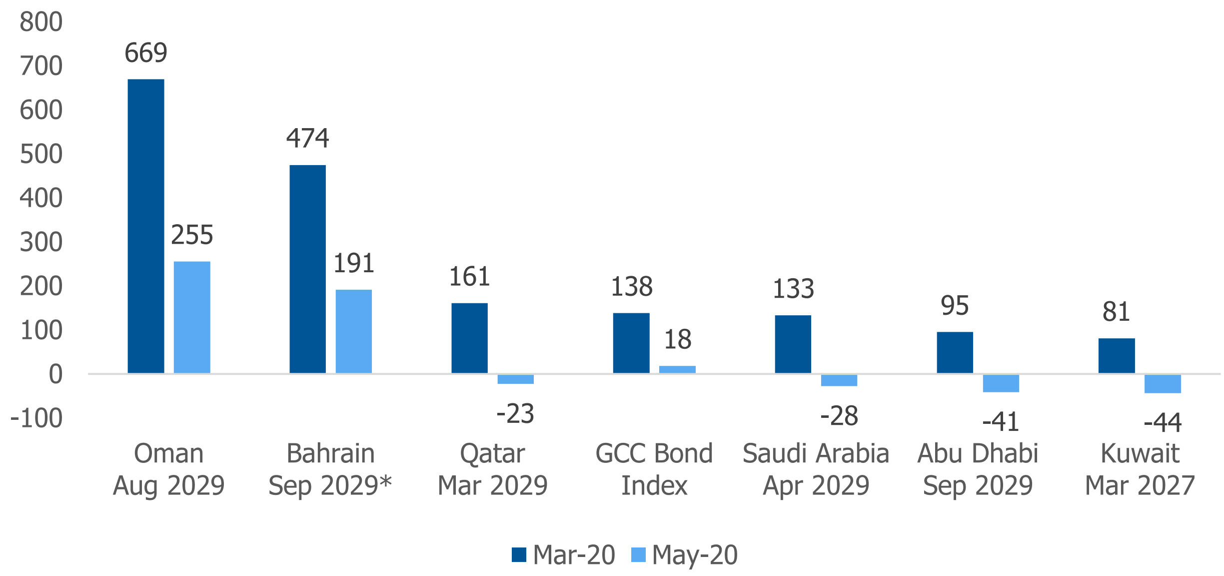
5-year CDS Spreads (in bps)

	Current	19th March 2020	2019
Saudi Arabia	144.3	232.4	58.5
Abu-Dhabi	96.1	155.0	34.8
Dubai	234.3	324.6	91.0
Kuwait	84.0	84.0	46.7
Qatar	99.3	181.0	36.8
Oman	359.5	637.0	266.0
Bahrain	480.4	496.3	167.1

Source: Refinitiv; Note: Bahrain's CDS reached a high of 508 in the first week of May.

The bond yields for GCC countries have narrowed recently, supported by improvement in oil prices and introduction of austerity measures. For Bahrain and Oman, yields remain above 2019 levels because of concerns over their weak fiscal positions. Further yield movements would hinge on recovery in oil prices and governments' implementation of austerity measures. A favourable outcome on these factors would improve the GCC countries' fiscal position and credit strength.

YTD Change in Yields of 10-year Sovereign Bond and the S&P GCC Bond Index for Corporates (in bps)



Source: Refinitiv; S&P; Note: Bahrain – 12-year bond; Dates: 19th March 2020; 24th May 2020

As revenue declines on the back of fall in oil prices, debt maturities add to financial concerns. For example, by the end of 2020, Dubai and its government-linked firms face USD 9.2 billion of debt repayment[8]. The table below showcases the upcoming bond repayments for Saudi Arabia and UAE.

Bond Redemption (All Currency) in 2020-22 (USD Billion)

Saudi Arabia	Government	Financial Corporates	Non-Financial Corporates	Total
2020	11.28	0.67	1.11	13.06
2021	6.36	0.00	0.57	6.92
2022	16.65	0.50	8.34	25.48
Total	34.28	1.17	10.02	45.47

[8] Capital Economics

UAE	Government	Financial Corporates	Non-Financial Corporates	Total
2020	0.75	10.28	3.07	14.10
2021	3.64	11.61	6.52	21.76
2022	3.65	12.97	0.28	16.90
Total	8.04	34.86	9.86	52.76

Source: IIF

Low oil prices and stimulus measures to handle COVID-19 have brought GCC governments' fiscal position under pressure, necessitating borrowing. This might increase sovereign issuances.

Investment grade corporate bonds yields have widened by a smaller margin than sovereigns like Bahrain, which have lower credit rating compared to their peers. While investment grade corporate bonds might continue to be viewed favourably, fear of defaults might drive investor exit from high-yield bonds. For example, while the S&P GCC Sukuk Index yield has narrowed by 24 bps, S&P GCC High Yield Sukuk Index's yield has widened by 198 bps.[9]

Real Estate

The spread of the virus, lockdowns and job losses might lead to decreased demand for real estate sector in the near term. In countries like UAE, where oversupply had been a concern before the virus outbreak, the impact might be compounded.

Covid-19 Implications on Real Estate Asset Class

Category	Impact
Residential	Job losses and furloughs might lead to reduced income, affecting real estate purchase plans and ability to pay rents. For non-nationals, job losses might result in their repatriation. This would affect demand for real estate.
Commercial (Office and Retail)	Social Distancing and lockdowns have caused closure of malls, offices and other commercial spaces. Rent deferral or freeze might weigh on landlords' revenues, rental yields and erode credit quality. Expansion plans might also be postponed. Trends sparked by COVID-19 like work from home at scale and increased online shopping might impact demand for office and retail spaces in the long run.
Industrial	Demand for industrial space may be muted until end-user demand for products picks up.
Logistics and Warehousing	The fillip to e-Commerce from lockdowns might translate to higher demand for logistics- warehousing space.
Hospitality	Travel restrictions would affect occupancy rates in the segment.

Source: Marmore Research

Given the magnitude of the global humanitarian challenge and the end for pandemic nowhere in sight, the asset classes might take time to recover. The actual bottoming out of the pandemic or an effective vaccine would provide the much needed optimism and boost for the markets. However, the recent relaxation of lockdowns with governments calling for learning to live with COVID-19 by implementing safety measures might be favourable in the near term. When the crisis does bottom out, government measures and credit conditions would support recovery.

[9] As on 21st May 2020

5. Will COVID-19 reduce the appetite for renewable energy projects in the GCC?

The outbreak of COVID-19 has deeply impacted global economies, pushing them into a recession. As health and economic concerns continue to mount, the near-term outlook for renewable energy projects look weak. GCC countries have taken a strong hit in the revenue side of their books due to the sharp fall in oil prices during 2020. The shortfall in revenue and rise in deficits are expected to have a strong near-term impact on project awards in the renewable energy space. GCC countries, which are predominantly dependent on fossil fuel for energy generation, have exhibited their commitment in gravitating towards renewables by laying ambitious targets for the next 10-15 years. However, project awards in recent years has been sluggish, with several of them facing delays. The slump in oil prices since 2014 has weighed in on GCC countries' capital expenditure, causing the slowdown in awarding new projects. As project activity showed signs of recovery during the start of 2020, the outbreak of coronavirus has turned the tables upside down.

GCC Renewable energy capacity – Current and 2030 targets (in MW)

Country	Concentrated Solar Power (CSP)		Photo Voltaic (PV)		Wind		Waste-to-energy		Total	
	2018	2030 Target	2018	2030 Target	2018	2030 Target	2018	2030 Target	2018	2030 Target
Bahrain	5	70	-	590	1	20	-	20	6	**700**
Kuwait	19	1,000	50	6,800	10	200	-	-	79	**8,000**
Oman	8	770	-	3,410	-	1,210	-	110	8	**5,500**
Qatar	5	600	-	2,400	-	-	38	100	43	**3,100**
Saudi Arabia	89	9,500	50	11,250	3	3,500	-	750	142	**25,000**
UAE	487	6,000	100	23,100	1	300	1	600	589	**30,000**

Source: IRENA

GCC countries had set lofty targets for ramping up their renewable energy capacity in the coming years as part of their long-term visions. For instance, Kuwait and Saudi Arabia have set a target of 15% and 30% of their respective power generation to come from renewable and other clean energy sources by 2030. Their renewable energy share stood at 0.4% and 0.2% respectively as of 2018 end. The crisis triggered by the pandemic is expected to delay the award of projects in the near-term, leaving the already ambitious renewable energy targets of GCC countries much harder to achieve now.

Potential problem areas in the short term are many. Suppliers for equipment such as low-cost PV (Photo-voltaic) modules, solar cells, turbines, and other equipment are largely based out of China and Europe. Until normalcy resumes in manufacturing and logistics, free movement of components will face disruptions. Another difficulty lies in engaging migrant labour, as restricted movement of workers between countries will pose a significant challenge. New protocols such as social distancing in work environment could also serve up to delay the progress of ongoing projects. Depending on how the pandemic is being handled by governments across the world, the speed of recovery could vary.

Once near-term disruptions wane, renewable projects that were earlier in pipeline would normally be expected to resume. However, there is a risk of renewable projects being side-lined, with other objectives taking precedence. Primary reason to this is that GCC countries have sufficient oil and gas resources, and existing installed capacity for fossil fuel power generation. With generation of power from renewable resources being seen more as a long-term objective, it runs a risk of not being given importance. But there is a pressing need for GCC countries to focus on clean energy. The UN sustainability goals indicates that countries should move towards more affordable and clean energy. GCC lags most developed countries in their transition towards renewables and has a long way to go in order to meet its sustainability goals for power generation. GCC region has higher CO_2 and particulate emissions than the global average due to refinement and combustion of fuel, potentially leading to adverse health effects in the long run.

When oil prices are high, there is an inclination to proceed with renewable energy projects as high-priced oil could be a lucrative commodity for export. However, when oil price are low, the incentive to move towards renewable energy is less due to narrower profit margins from export and higher investment costs for renewable projects. But from a long term-perspective, with renewable energy generation cost falling and peak oil demand yet to come, moving towards renewables sooner would free-up more resources for export. With climatic conditions in the GCC favoring solar power generation and projects becoming more cost effective, the case for transition is much stronger now.

The revival of renewable energy projects needs strong government support both from a financial and policy perspective. Near-term shocks emanating from COVID-19 need to be absorbed without deferring capital expenditure. Upcoming renewable infrastructure projects is expected to drive new employment opportunities and save fossil fuel for export purposes. Financial support must be provided to ongoing projects through the easing of lending norms and provision of support through subsidies would help project stakeholders avoid cost overruns. In countries like Germany, the provision of subsidies for a period of 20 years has helped renewable energy operators stay profitable. After the period, margins are lesser. Therefore, GCC countries must look at much more sustainable models of renewable power generation that turns profit after a stage when subsidies are removed.

According to the IEA, global energy investments in the year 2020, which was earlier predicted to grow by 2%, is now poised to see a decline of 20% due to the outbreak of COVID-19. However, the positive news is that renewable energy investments have been much more resilient when compared to those of fossil fuel. Although the near-term trend suggests that the awards for renewable energy project will take a back-seat, there are strong global cues indicating that the push for clean energy will only increase after the crisis. Environmental and health concerns surrounding recent events have presented a strong case for moving towards cleaner sources of energy generation and improving energy efficiency. Investors have also been showing more appetite towards financing sustainable projects, with the green finance market witnessing sharp growth in the past five years. As the global energy landscape prepares itself for a transformation, GCC countries need to ensure that they are not left behind. Although COVID-19 has more or less forced the hand of GCC governments to pause activity in the renewable projects space over the short-term, governments need to prioritize renewable energy investments in the long run and continue to move towards their clean energy goals.

Disclaimer

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