KAMCO Research

Brexit & Impact on the GCC: Asymmetric Risks?

June-2016

UK voted to leave EU; surprises markets & sends GBP crashing by over 8%:

The UK's referendum resulted in a vote to leave the EU, as votes to leave were 52%, compared to 48% for votes to remain in the EU, despite vote intention polls in the final days prior to the vote suggesting an edge for the 'remain' camp. The vote came in against the run of play, shocking markets across the globe, while the GBP lost more than 8% on 24th June, as investors looked to exit GBP denominated assets.

Global markets lost over USD 2 Tn as they reprice risk; USD & Gold shine in early trades:

Markets across the globe witnessed substantial declines on 24th June following the vote, as the MSCI World Index declined by 4.9% for the day. The FTSE 100 declined by over 3%, while the broader EU markets such as the STOXX EURO 600 declined by over 8.6% over the day. US markets also saw widespread selling pressure as the DJIA & S&P 500 were down each by over 3%. KAMCO Research believes that the markets were largely repricing risk, rather than anticipating another 2008 Lehman kind of collapse, as most markets recovered sizably from the lows of the day. Gold (+4.2%) & the USD (+2.5%) were key beneficiaries of the market upheaval, along with treasuries, as investors turned risk averse and chose flight to safety trades.

GCC equities could witness near-term selling pressure in "risk-off" trade:

After remaining closed on 24th June due to the weekend, we expert GCC markets to witness similar selling pressure in early trades, as global peers witnessed on Friday. We also expect Brexit related news and its impact on oil to be key focus areas for GCC markets in the near term.

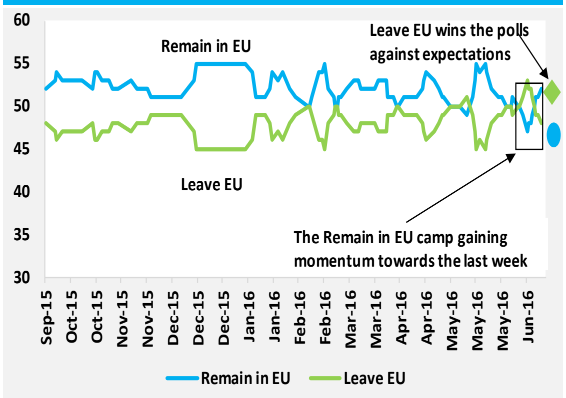
Fed rate hikes unlikely soon; monetary policy to provide countervailing force post Brexit:

Post deferring on a rate hike in June, the Fed was looking at raising rates in the near future. However with the current turn of events in Europe, the USD appreciating, and weak jobs data in the US, we expect the Fed to follow a more accommodative monetary policy in the near term to counter a stronger USD. We also expect most other central banks to use monetary policy tools to provide liquidity, as and when required.

European demand fundamentals & USD pivotal for oil prices & GCC-EU trade balances:

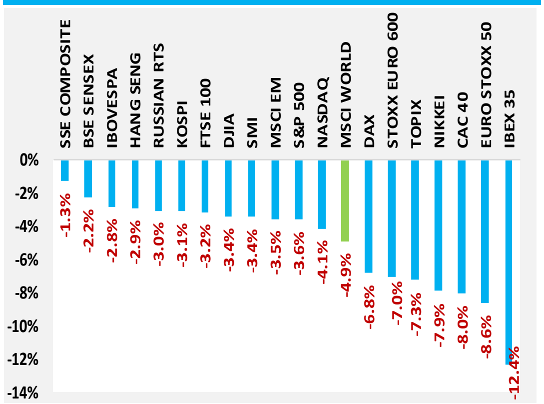
Trade flows between the GCC & the EU remain significant, as the GCC is the EU's fifth largest export market with over EUR 111 Bn of exports in 2015, while oil remains the largest import from the GCC accounting for more than 69% of the global imports. A lower Euro & GBP against the USD sustaining post Brexit would mean improving trade & current account balances for the GCC, which swung into the negative, following the decline of oil prices since 2014. Nevertheless, the occurrence of a significant slowdown in Europe (including UK), similar to recession would affect oil price demand and in turn GCC oil revenue receipts and current account balances further.

Referendum Vote Intention Polls



Source: www.whatukthinks.org, KAMCO Research

Global Market Declines post Brexit - 24th June



Source: Bloomberg, KAMCO Research

Faisal Hasan, CFA
Head - Investment Research
+(965) 2233 6907
faisal.hasan@kamconline.com

Thomas Mathew
Senior Financial Analyst
+(965) 2233 6741
thomas.mathew@kamconline.com

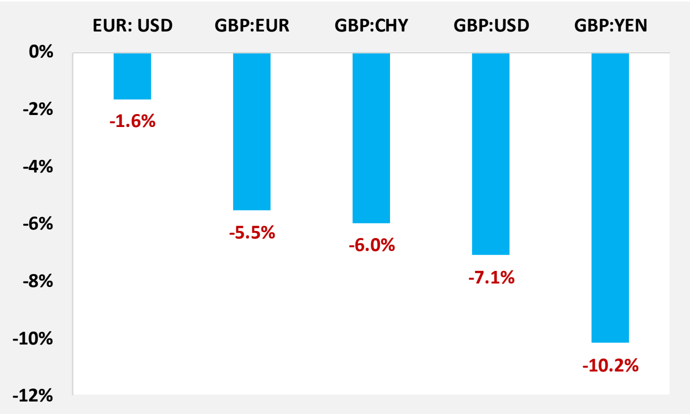
European Markets plunge on Brexit day; China & India most resilient

All European key equity indices witnessed significant single day declines post UK's referendum vote to leave the EU, with Spanish index IBEX 35 declining the most by 12.4%, followed by the CAC 40 (France) which went down by 8%. German DAX also lost significant ground, receding by 6.8% as compared to the previous day, as Banks, Real Estate came under significant selling pressure during trading hours of the day. China's SSE Composite was the most resilient declining by only 1.3%, followed by the BSE Sensex (India) which went down by 2.2%. The NIKKEI 225 index of Japan was amongst the main laggards globally, declining by over 7.9%, as investors sold positions in equities and moved towards safer assets such as the Japanese Yen.

GBP falls to 30 year lows (USD 1.3224); EM currencies under pressure

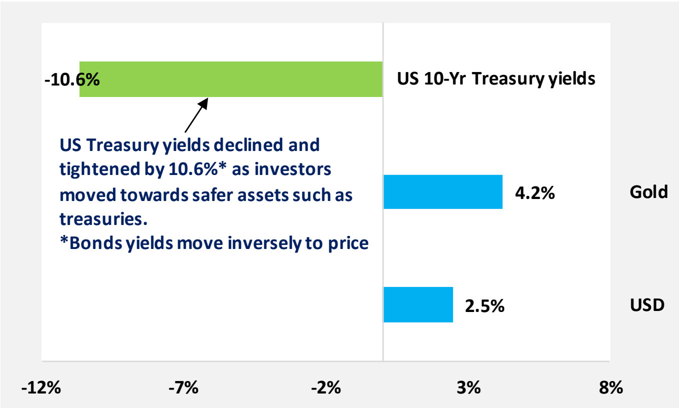
The GBP plunged against all major currencies, as investors looks to exit GBP denominated assets and unwind GBP long positions. Yen & USD currencies rose the most against the GBP, gaining by over 10.2%, and 7% respectively, while Swiss CHY also gained 6% against the GBP, as all major safe haven currencies gained, as investors took the flight-to-safety route. The Euro declined by 1.6%, significantly lower than the GBP, while overall USD strength also led to emerging market (EM) currencies witnessing significant declines.

Currency movements post Brexit -24th June



Source: Bloomberg, KAMCO Research

Key assets which gained post Brexit -24th June



Source: Bloomberg, KAMCO Research

Gold & USD thrive in flight-to-safety trades

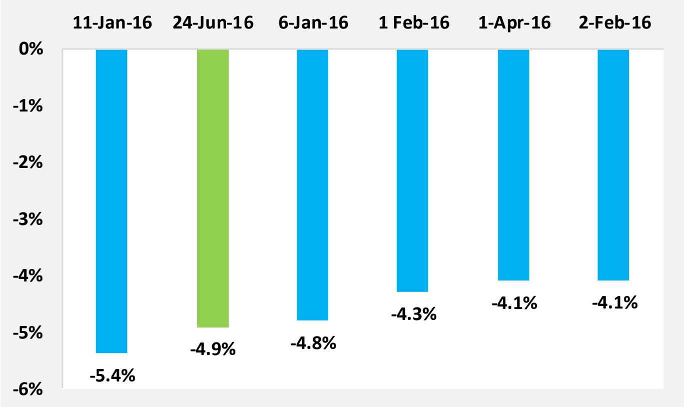
Investors rushed to safer assets post the event, fearing larger declines going forward. Key beneficiaries were Gold, as it surged by over 4.2% in a single day, while Gold Futures closed at its highest level in nearly two years, as August expiry Gold reportedly jumped by over 4.7% to over USD 1320/ounce. The USD index rose by 2.5% over its previous close to 95.54 points. Treasury securities witnessed significant buying demand, as yields compressed to multi-year lows. The 10-year US note yield declined by 10.6% to 1.5599%, in a single day's trade as a result of the significant interest. The yield on the 10-year U.K. note also plummeted 26.7 basis points to 1.096%, its lowest yield ever, signifying trades in favour of safer assets from investors. These trades in favor of safer asset classes are expected to continue over the near term until confidence is restored to the market and outlook is more certain, which would lead to firmer prices for riskier assets.

Oil posts second highest single day declines in 2016 post Brexit

Price for Brent Crude Oil declined by almost 4.9% or over USD 2.5/bbl to around USD 48/bbl. The decline was the second largest decline for 2016, post 11 January 2016, when oil prices tanked by over 5% due to concerns over China. Concerns over Europe's economy and future oil demand and a strengthening USD were key drivers behind the decline of oil, following the referendum vote.

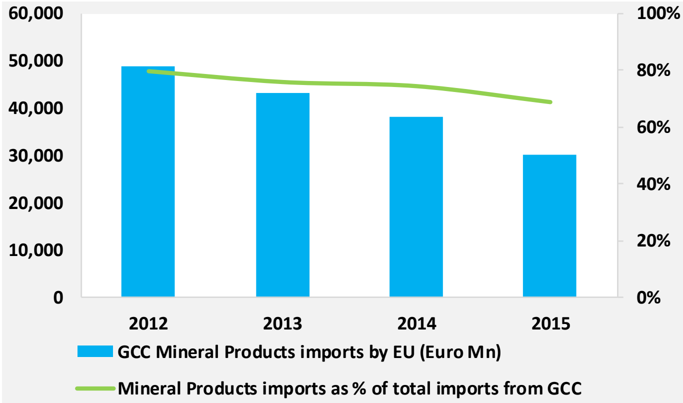
Supply side economics have largely dominated crude oil price moves in 2016, while the price action post the Brexit, largely is attributed to concerns over Europe's demand-side fundamentals, apart from a strengthening USD, which could both prevent higher oil prices going forward, if trends were to continue.

Days of highest oil price declines in 2016



Source: Bloomberg, KAMCO Research

EU Mineral imports (including oil) from the GCC

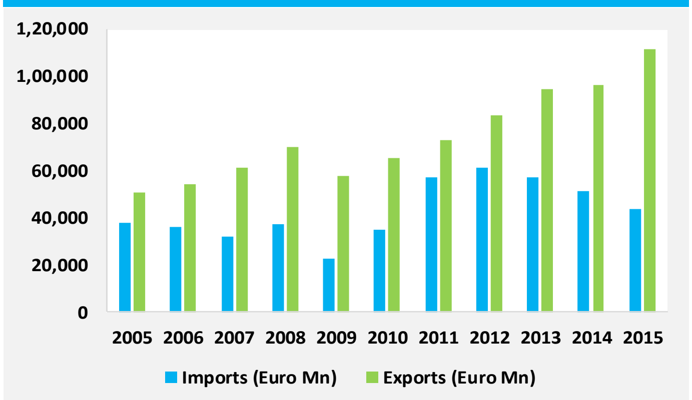


Source: Bloomberg, KAMCO Research

GBP fall to have a positive impact on GCC current account balances in 2016

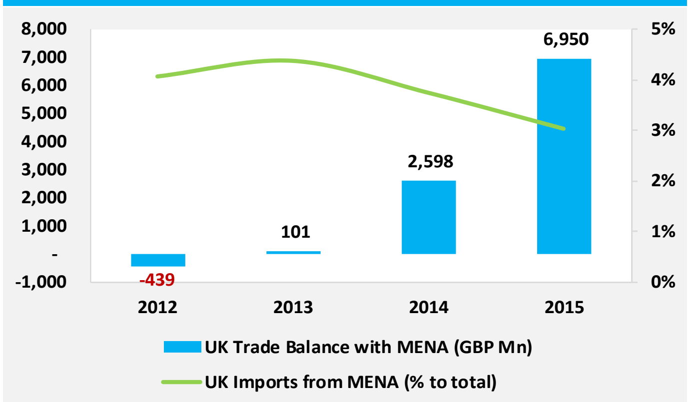
The EU is the GCC's biggest trading partner, with trade flows totalling EUR 155.5 Bn, or 14.7% of the GCC's global trade. Nevertheless, GCC exports to the EU has declined over the years primarily due to the drop in oil prices, while exports have increased over the same period. UK's reliance on the GCC region are significantly lower, and following Brexit, the UK could potentially ink beneficial bilateral trade deals with GCC governments, similar to the Double Taxation Agreement signed with UAE in 2015. The EU has been unable to reach a Free Trade Agreement with the GCC, despite negotiations going back to 1988 which are currently stalled. Falling EUR & GBP exchange rates against the USD would also translate into a positive impact on trade balances & current account balances for the GCC, as GCC currencies are either directly or loosely pegged to the USD.

EU trade balance with the GCC



Source: GOV.UK, KAMCO Research

MENA imports to UK & Trade Balance



Source: GOV.UK, KAMCO Research

UK property to look attractive to GCC investors; hospitality to benefit

Due to the depreciation of the GBP against the USD, the UK property market is likely to look attractive for GCC investors. Moreover, short term uncertainties around the economic future of the UK is likely to put additional pressure on residential property prices , which should aid investors from the GCC region. Nevertheless, while residential markets are likely to look attractive to GCC investors, commercial markets-office and retail are likely to attract lesser degree of interest, as corporate occupiers come to terms with the business implications of UK's exit from the EU over the next few years. Hospitality into the UK would also become more affordable owing to the depreciation of the GBP against other currencies.

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KAMCO Investment Company - K.S.C. (Public)
Al-Shaheed Tower, Khalid Bin Al-Waleed Street- Sharq
P.O. BOX : 28873, Safat 13149, State of Kuwait
Tel: (+965) 1852626 Fax: (+965) 22492395
Email : Kamcoird@kamconline.com
Website : http://www.kamconline.com