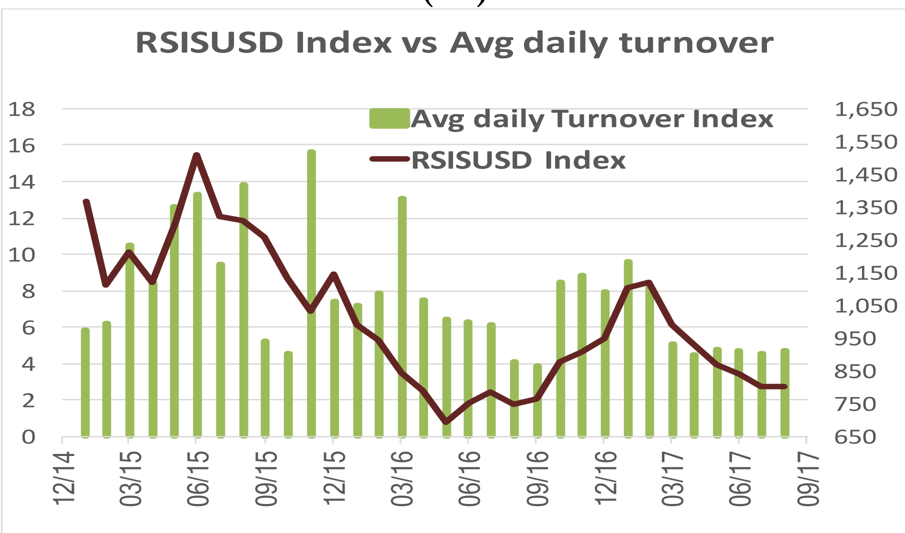
Stock Market review for August: Realignment of regional interests in post-ISIS Iraq

Ahmed Tabaqchali, 01 September 2017

The equity market was mostly subdued through the dog days of summer but the big development to note is the realignment of interests of regional players in a post-ISIS Iraq with major implications for the Iraq investment story.

The equity market, as measured by the RSISUSD index, ended the month up +0.2% after trading in a tight range following the July sentiment turnaround, in which extremely depressed bank valuations drove locals to step up and absorb foreign selling as highlighted in last month's piece on Iraq Business News. However, turnover continued to be low in-line with the last few months (see chart below) while foreign activity was mostly subdued with some re-emergence of selling in banks in the last few days but, at least for now, that has lost its ability to depress the overall market. The low turnover continues to emphasize the early phases of the liquidity recovery in the economy and the market.

Avg. daily turnover Index on the Iraq Stock Exchange (ISX) (green) vs RSISUSD Index (red)



(Source: Iraq Stock Exchange (ISX), Rabee Securities, Asia Frontier Capital)
(Note: Regular trading and excludes transactions by insiders/strategic holders whether local or foreign)

However, the most significant development is the broadening of the realignment of interests of regional players in dealing with the root causes of the conflict, i.e. the deep economic and political disenfranchisement, that were such fertile grounds for the rise of extremism. Following the military resolution to contain the common threat, these would be long-term solutions which will involve significant investments in infrastructure to bring much-needed developments and create prosperity.

The first to emerge is the Iraq-Saudi Arabia alliance, currently under negotiation, in which Saudi Arabia is to take the lead in funding the reconstruction of the liberated areas, i.e. the western part of the country from Mosul, spreading into Anbar and beyond. The significance is not simply the resumption of diplomatic links with Saudi Arabia that were severed in the first Gulf war in the 90's, but the economic revitalization of the liberated areas first through trade and then reconstruction. Anbar, including the surrounding areas in Nineveh and Salah Ad-Din, disenfranchised since 2003, have long been the seat of resentment and a source of extremism, thus their rehabilitation would go a long way towards the return of stability to the country.

While, it's still early days with no announced details of the alliance, apart from the flurry of visits and the news that the UAE would join in funding, yet the first steps taken so far are significant for the liberated areas. They started with opening of the Iraq-Saudi Arabia border crossing, the Iraq-Jordan border crossing and finalizing security measures to secure the highway connecting Baghdad to Amman. Another major trade artery being secured is that linking Iraq to Jordan's port of Aqaba. The resumption of trade-links with their associated economic activities provide a huge boost to the local economies which should contribute meaningfully to the healing process. The reconstruction, even if the alliance is more modest than hoped for, will build upon and magnify the economic revival until it becomes self-sustaining.

While, the Iraq-Saudi Arabia rapprochement might be portrayed as part of the Iran-Saudi Arabia rivalry, it is more logical to view it as part of this realignment of regional interests as supported by the recent thawing in the relationship between the two that started with a handshake between their foreign ministers in early August at the Organisation of Islamic Co-operation's gathering in Istanbul, confirmed by Iranian pilgrims attending the Hajj for the first time in two years and by reports that the two could exchange diplomatic visits after the Eid.

The Kurdish Regional Government of Iraq (KRG) concluded a series of agreements with a number of Exploration & Production (E&P) companies operating in the region (DNO ASA, Genel Energy & Pearl Consortium). The agreements settled: (1) outstanding receivables of about USD 1.5 bn in return for increased field ownership & relief on certain obligations; and (2) a USD 2.2 bn legal liability in return for cash and increased acreage. The deals provide the companies with increased financial and strategic flexibility to ramp-up production while addressing investor concerns on the Kurdish Region of Iraq (KRI). In return, the settlement will have a positive effect on the KRI economy crushed by multiple financial crisis since 2014. At the same time reports have circulated that the KRG is settling a dispute with the Central Bank of Iraq (CBI) by returning about USD 2 bn to the CBI, from about USD 5 bn of commercial banks' deposits held at the CBI branches in the KRI frozen by the KRG since 2015. While, there are many views on the proposed KRI referendum later in September, the settlement with the CBI argues for a grand bargain in the making between the KRG and the Federal Government of Iraq (FGI). Arguably, the oil settlements were made possible by flexibility gained by the entry of Rosneft in the KRG through: (1) a long-term forward oil sales deal part of a total USD 3 bn forward sales agreements signed with a number of oil traders in February; and (2) a deepening agreement on E&P in June, which together would support the view that a KRG-FGI bargain has international support or mediation.

While these developments will not have an immediate impact on the equity market, never the less, combined their positive impact on the economy should add fuel to the expansionary economic effects produced by the reversal of the forces (escalating costs of war & collapsing oil prices) that crushed the economy and squeezed liquidity over the last 3 years. Ultimately, this will be reflected in increased liquidity in the equity market, but it is important to note that the market's hoped-for recovery will likely be in fits and starts with plenty of zig-zags along the way as liquidity is still scarce with a time lag before it can filter down into the economy.