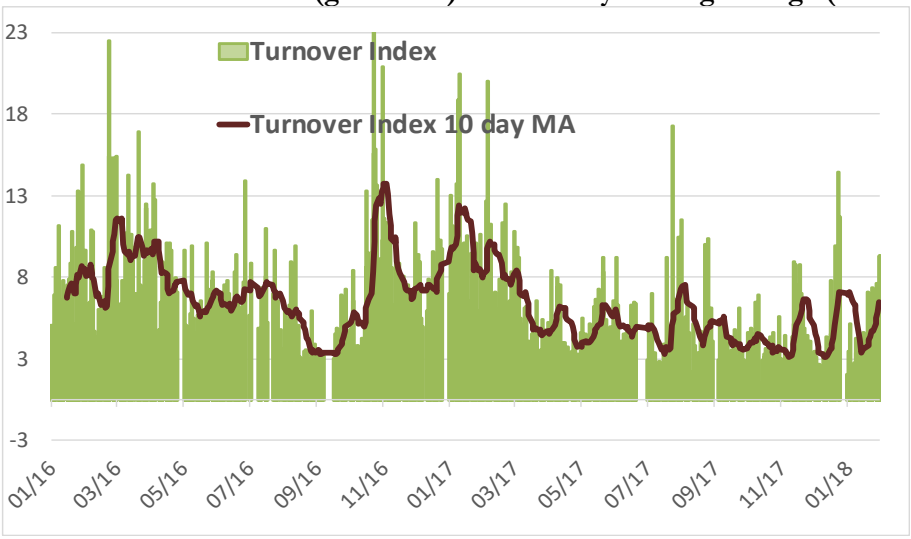
# Market review: A tale of two halves & liquidity

**Ahmed Tabaqchali, 02 February 2018**

The market in January was a tale of two halves. The first half started with a whimper with turnover declining 40% from December's levels and prices drifting lower taking the market, as measured by the RSISUS Index, to a decline of over -4% by around mid-month. The second half was almost the opposite with prices recovering steadily and turnover doubling from that of the first half. The market ended the month +4.8%.

However, the average daily turnover for the full month was anaemic at 90% of the average of that of the last 12 months, itself a low figure to start with. This argues that the recovery is in the early tentative stages, but supports the case that the correction that began in March of last year had run its course by October, and that the market could play catch up as discussed in the outlook for 2018.

**Turnover Index on the ISX (green line) vs its 10-day moving average (red line)**




*(Source: Iraq Stock Exchange (ISX), Rabee Securities, Asia Frontier Capital (AFC))*

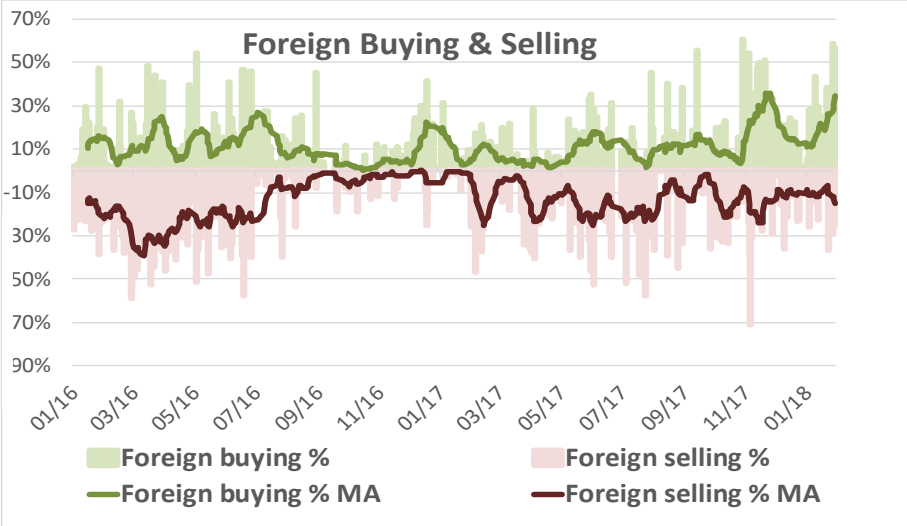
Early, but narrow, market leadership by high-quality names such as mobile operator Asiacell (TASC) and Pepsi bottler Baghdad Soft Drinks (IBSD), up +13.3% and +21.3% for the month, was behind the recovery in turnover and in the market's overall performance. While, most of the source of funds were a continuation of the reinvestment of dividends, nevertheless there were clear signs of new foreign inflows, small yet consistent, into the equity market and mostly into these two names over the last two months.

Fundamental reasons fuelled the buying, in the case of IBSD it was expectations for a positive outlook on the back of continued strong performance throughout the ISIS conflict. IBSD had year-year sales growth of 12%, 10% & 14%, with gross margins of 22.3%, 21.6% & 19.5% for 2017, 2016 & 2015 respectively. For TASC it followed a declaration of a 14% dividend yield while priced at under 2x trailing 12 months EV/EBITDA with signs of improving fundamentals as the company shows signs of recovery from the triple whammy that the ISIS conflict brought: A loss a third of the country accompanied by subscriber losses and higher operating costs, decreasing ARPU's (average revenue per

user) that accompanied the roll out of 3G in 2015, and finally weakened consumer spending made worse by the introduction of VAT on SIM cards in 2016.

Foreign selling continued along the same levels witnessed over the last few months and as such the revival in foreign inflows is still in the nascent early stages. Yet, overall foreign buying on the ISX for the few months up to end of January, as a percentage of buying has been increasing consistently and is more meaningful than that of a similar period up to January of 2017. As a comparison, the market was up +29% in July 2016-Januray 2017, while it was up +9% in July 2017-Januray 2018. However, the overall level of turnover is still low and thus requires a return of liquidity for the recovery to sustain itself.

**Index of foreign buying (green) & selling (red) as a percentage of buying & selling respectively on the ISX**



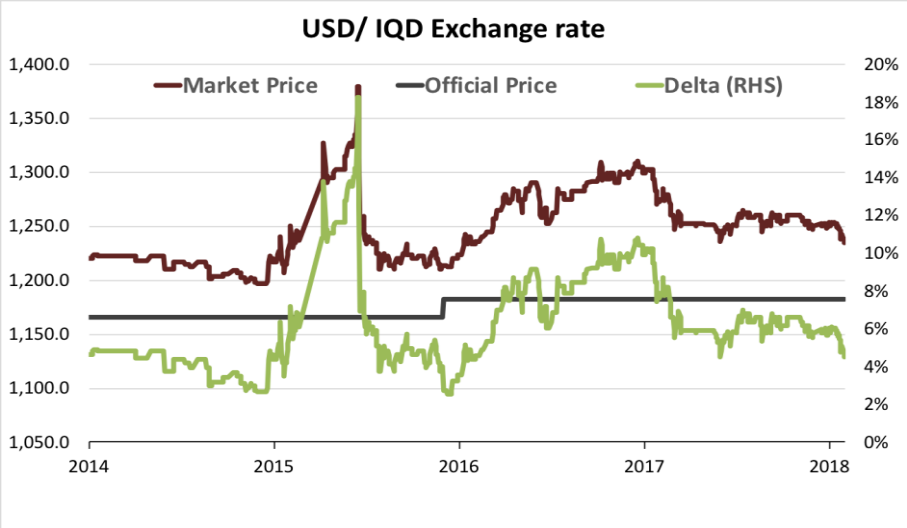

*(Source: Iraq Stock Exchange (ISX), Asia Frontier Capital (AFC))*

There are increasing signs of a beginning of an increase of liquidly in the economy as implied by the performance of the Iraqi Dinar (IQD) vs. the USD. Given the dollarization of the economy, it follows that the strength or weakness of the IQD is a function of demand-supply balance for IQD and not a specific USD weakness or strength. During the month, the market price of the IQD vs the USD, improved by about +1.5% lowering the premium over the official exchange rate to 4.5% from just under 6% at the end of 2017, and bringing it closer to the normal range of 2-4%.

A great deal of this recovery is related to the recovery in oil prices and thus government finances that began in November 2016, as evidenced by the gradual decline of the premium over the official exchange rate from 10% in November 2016 to about 5-7% throughout most of 2017. The first visible beneficiaries were foreign reserves, which increased to USD 49.0bn by end of November 2017 vs USD 45.2bn at end of 2016, and the IMF's estimates of USD 41.5bn by end of 2017.

Arguably, the changed dynamics of the oil market, with a likely medium-term range of USD 55-60/bbl for Brent, should result in a sustainable positive effect on government finances. Combined with the positive effects of the declining costs of war, they argue for a return of liquidity to the economy and money supply should begin to reflect this over the coming months.

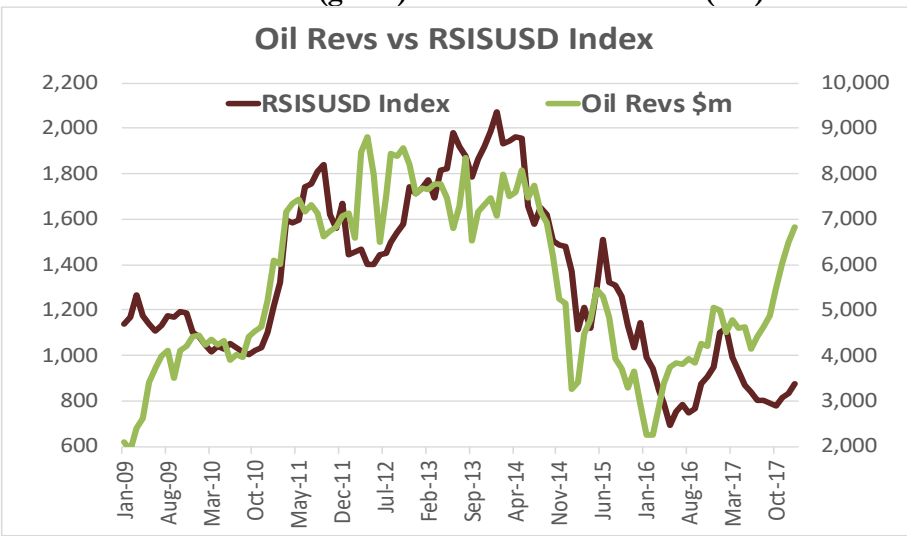
**Iraqi Dinar (IQD) exchange rate vs the USD Jan 2014 – Jan 2018**




*(Source: Central Bank of Iraq, Iraqi currency exchange houses, Asia Frontier Capital)*
*(Note: The Spike in 2015 was due to a CBI policy that restricted the sale of USD, but was abandoned alter after the massive rise in parallel rates)*

The improvement in liquidity in the broader economy will eventually filter down to the equity market but is not there yet as the anaemic market turnover demonstrates. Nevertheless, the market is showing signs of resuming its correlation with the country's oil revenues (chart below). However, liquidity in the form of both increased local and foreign inflows needs to be translated into higher market turnover for the market's recovery to be sustainable. Given the time lag, the recovery will likely be in fits and starts with plenty of zig-zags along the way, which underscores the opportunity to acquire attractive assets that have yet to discount a sustainable economic recovery. The prospects of the economic recovery following the ISIS conflict are discussed in the author's recent research piece as a non-resident fellow at the Institute of Regional and International Studies (IRIS) at the American University of Iraq in Sulaimani (AUIS): "Iraq's Economy after ISIS: An Investor's Perspective".

**Oil Revenues (green) vs the RSISUSD Index (red)**




*(Source: Iraq Stock Exchange (ISX), Iraq's Ministry of Oil, AFC)*
*(Oil revenues as of Dec. with AFC est.'s for Jan.)*

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