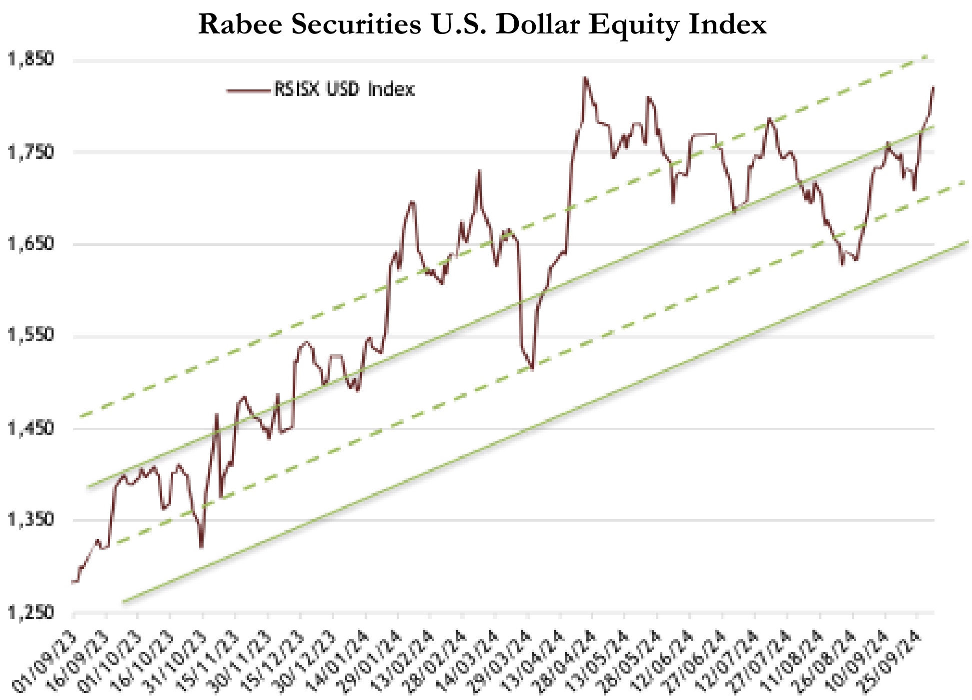
"Market Rallies as Conflict Escalates"

Ahmed Tabaqchali, October 3rd, 2024

The equity market, as measured by the Rabee Securities U. S. Dollar Equity Index (RSISX USD Index), was up 8.5% in September, and is up 17.2% year to date. The market shrugged off the widening of the ongoing Middle East conflict that is engulfing Lebanon, and in a replay of the earlier escalation in [April](), it rallied, on significantly expanded trading volumes, throughout the month and continued to rally as the conflict intensified. Then in April, a series of Israeli and Iranian attacks and counterattacks ignited fears that these could lead to a war that would destabilise the region –fears that are resurfacing as the current widening has led to the first salvo of a likely series of Israeli and Iranian attacks and counterattacks. This time, the timing of the upcoming U.S. presidential elections, and the closeness of the race are major elements in the calculations of the combatants in assessing the scale and breadth of the series of attacks and counterattacks, as well as the prospects of a regional war.

For Iraq, these developments would threaten the relative stability that it has enjoyed over the last few years, irrespective of its distance from the conflict or of the non-existent possibility that it would be drawn into it as a combatant. However, since the start of the conflict in early October 2023 the market is up 57.1% by early October, with the rally resuming momentum as the conflict escalated as it did in this month and earlier in April. While this is partly the market discounting the potential that an escalating conflict would not draw in Iraq, however it is primally a function of the market discounting the powerful dynamics that were driving the transformation of the economy, and that were already in place prior to the onset of the conflict.

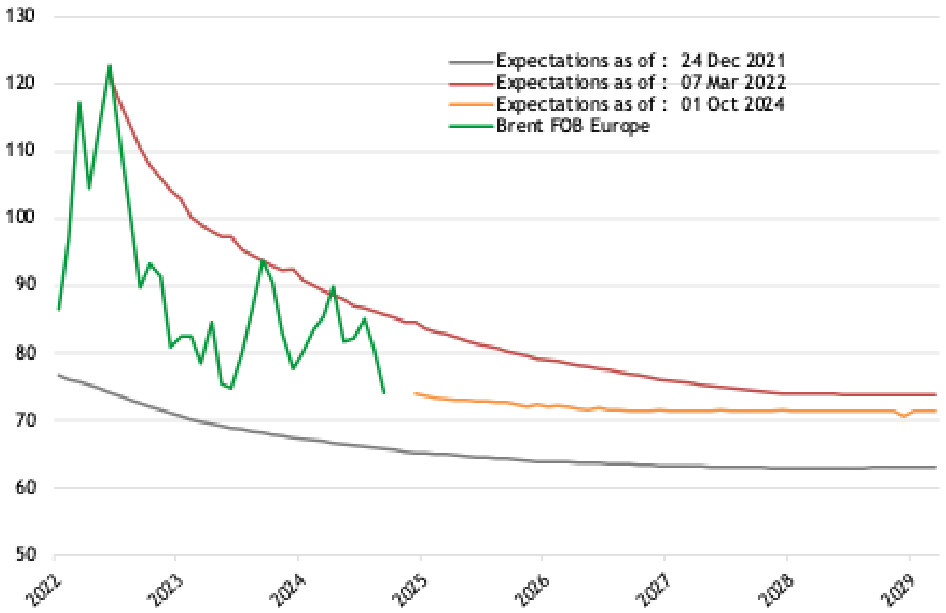
Specifically, these dynamics are the expansionary 2023 and 2024 budgets that are providing a major boost to the non-oil economy, and the developments that promise to accelerate the adoption of banking and bring about a transformation of the sector and its role in the economy. These in turn provided the wherewithal for strong profit growth for the leading companies in the country as discussed last month in "Companies' Earnings Growth Continues, while Market Takes a Breather". The market's technical picture, as asserted here over the last few months, continues to be positive, with the four-month pull-back taking place within its multi-month uptrend (chart below).



(*Source: Iraq Stock Exchange, Rabee Securities, AFC Research, daily data as of October 2nd*)

Moreover, globally, oil markets continue to discount a contained conflict, as much as they have done following its onset, with near-term expectations primarily reflecting concerns over the current oil supply-demand imbalance, which have over the last few weeks driven prices and expectations lower. Overall oil market expectations, as measured by Brent crude futures contracts as of October 1st (yellow line, chart below), are still near the middle of a range bound on the upper end by supply fears following the invasion of Ukraine (red line, chart below), and in the lower end, by those at the end of 2021 (grey line, chart below) – with price spikes following the first salvo in the series of attacks and counterattacks unlikely to change the trajectory of these price expectations. Interestingly, medium- to long-term expectations were mostly reflecting prospects for a resumption of global growth following the U.S. Federal Reserve's aggressive rate cuts and China's significant stimulus package –all of which are supportive for Iraq's equity market given the country's extreme leverage to oil prices.

Market Expectations for Future Oil Prices
As measured by Brent Futures Contacts (USD per barrel)



(*Source: Wall Street Journal, U.S. Energy Information Administration, AFC Research, data as of October 1st*)

The equity market, as measured by the Rabee Securities U. S. Dollar Equity Index (RSISX USD Index), which by the close of the month is 13.5% below its 2014 peak, has the potential to regain that peak and to rally further, reflecting the developments discussed here over the last few months. However, significant risks remain given Iraq's recent history of conflict, extreme leverage to volatile oil prices, as well as the risks that the widening of the current Middle East conflict will not be contained and evolve to destabilise the region.

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