Hogan Lovells

Investment Outlook 2017

Deal trends in the GCC

Summary

When oil prices dropped two years ago, it took a while for the severity and durability of the new oil-price environment to sink in. The response came in 2016: governments focused on cutting expenditure, sending a cascade of caution through the entire economy. The impact on deal flow was huge and mostly negative. The upside of an unprecedented boost in sovereign borrowing, as Saudi Arabia and others moved urgently to secure external financing, was compensated by a steep drop in most other areas of activity, with particularly weak years for IPOs and M&A activity.

That cautious approach was cemented by political shocks in two of the GCC's most important partners – first in the UK in June 2016, with its vote to leave the EU; then in the US, with the election of Donald Trump in November threatening to turn the dynamics of economic and geopolitical relations with Gulf allies upside down. Behind all this action, the GCC also enjoyed a far quieter – but perhaps more significant – growth in investment flows from Asian markets, especially China.

As we move into 2017, these trends will continue to encourage caution. Strong growth and confidence is unlikely to return until the oil price stabilises above $60/barrel and nobody expects that to happen soon, even if OPEC sticks with its agreed production cuts. Instead, governments are taking a more serious and long-term approach to fiscal adjustment and structural reform, creating new pockets of opportunity and shifting the potential for deal flow in the future.

The main areas for potential growth that we expect to see in 2017 are:

- Debt capital markets will remain busy, given continued fiscal deficits and demands for corporate refinancing, despite rising borrowing costs
- Private equity in the GCC will pick up as early stage venture-capital style deals with technology start-ups attract international as well as strong local interest, helping to increase M&A activity
- Banks and corporates will look to consolidate and restructure
- A new flow of partial privatisation sales will start to rekindle equity capital markets, especially in Saudi Arabia and Oman
- The PPP project pipeline will expand into education, healthcare and transport infrastructure, as new laws come into force and projects get underway

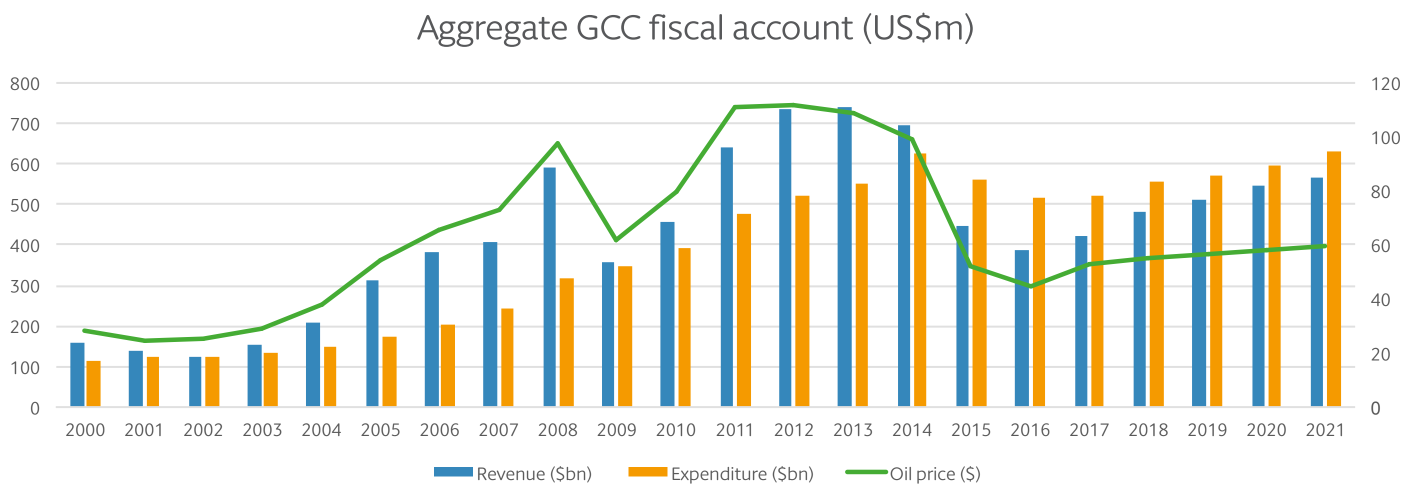
This report explores the market dynamics that will shape the outlook for GCC transactions in 2017 and provides new insights into the longer-term shifts emerging as the world changes.

Resetting Gulf economies – the impact on deal flow

With oil at around $50/barrel, GCC governments are losing approximately $600m a day in receipts, compared with 2014. That shock has unleashed a spiral of austerity – governments are rebalancing public finances, marking down capital expenditure, dropping public sector salaries in some countries and looking at ways to raise additional revenue.

The fiscal squeeze has been exacerbated by tight bank liquidity, while a strong dollar and rising interest rates post-Trump and Brexit just add insult to injury – GCC currencies are appreciating in real terms due to the dollar peg, making it more expensive to export and more difficult to attract capital.

Source: National statistics, Oxford Economics, Elite Economics

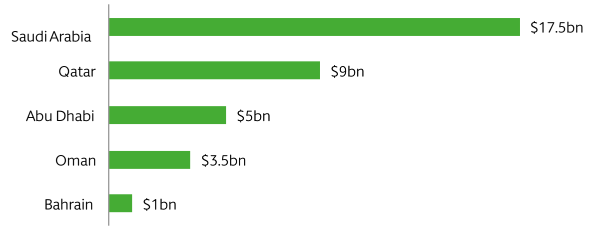


Fiscal squeeze drives a boom in debt capital markets

Governments' need for external financing has led to a record year for sovereign borrowing from the debt capital markets in 2016. Over US$73 billion was raised in bonds and syndicated loans to the end of November, triple the amount in 2015 and considerably more than the previous record of US$50bn in 2009, which was also a year of low oil prices.

The landmark deal was Saudi Arabia's debut Eurobond issuance in October, raising US$17.5 billion, the most ever by an emerging market borrower, more than the market had expected

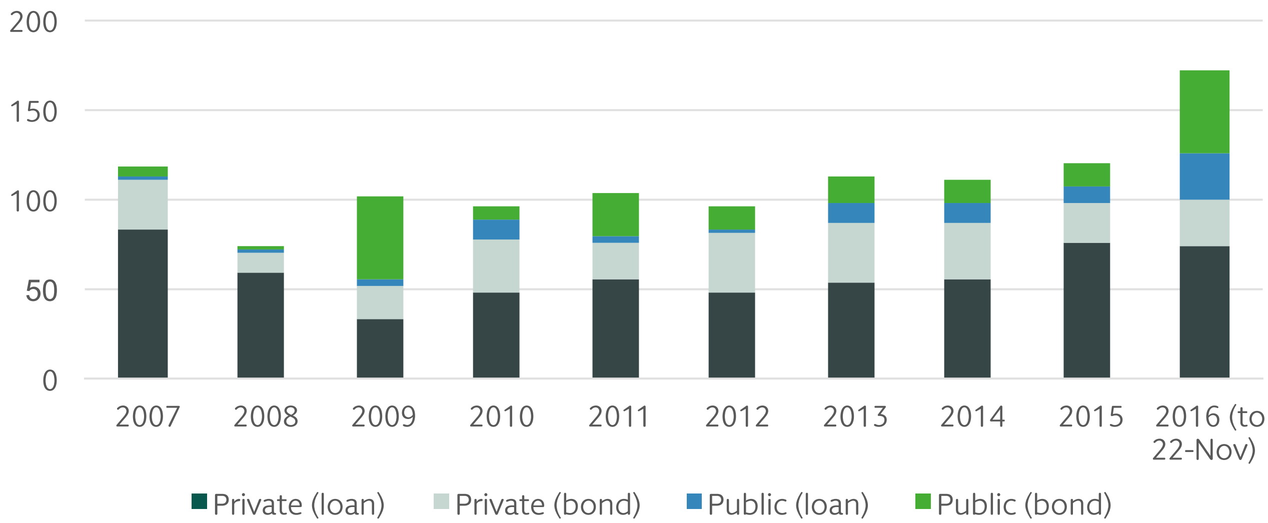
GCC sovereign bond issues 2016 (US$bn)



and at surprisingly tight spreads relative to its credit rating. Prior to that, Qatar had set a record for the region with its US$9 billion issuance in May. Eurobonds were also issued by Abu Dhabi, Oman and even eventually by Bahrain, despite being downgraded below investment-grade by all three major rating agencies. There were also some sizable syndicated loans raised by governments and public sector companies including US$10bn by Saudi Arabia, US$5.5bn by Qatar and US$4bn for Kuwait National Petroleum Company's Clean Fuels Project.

Corporate borrowing from the debt capital markets was also strong, totalling US$100bn in the first 11 months, more than for the full year in 2015 and close to the record set in 2007. Gulf companies are borrowing at high levels for a variety of reasons. Banks borrowed US$22bn in January-November 2016 to finance their own loan books, hit by the slowdown in deposit growth (especially from governments). Companies are also keen to lock in low yields before a combination of higher US interest rates and weaker credit ratings in the region pushes up the cost of borrowing. "Debt has been cheaper, given a low global interest rate environment, creating a perfect situation where the demand side and supply side have been right at the same time," says Steven Drake, Head of Capital Markets and Accounting Advisory Services at PwC across the Middle East.

GCC debt capital markets (US$bn)



Source: Bloomberg, Elite Economics

Note: Only includes debt instruments with a maturity of three years or more. Public borrowing includes 100% government owned companies, but much of the private borrowing is by firms in which the government holds a majority stake.

Viewpoint

Andrew Tarbuck, Partner, Dubai

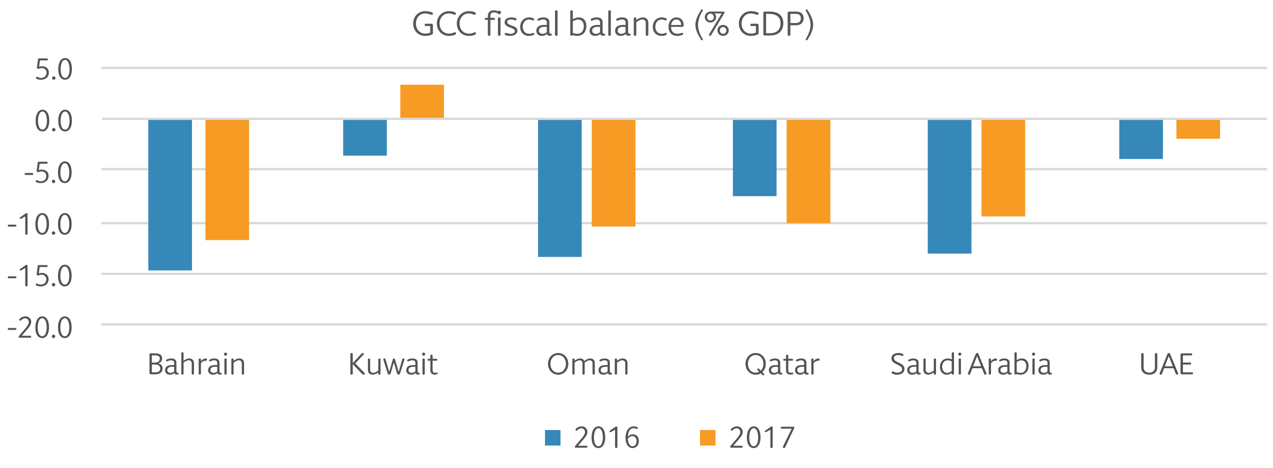
Everyone is saying the Saudi bond issue opened up the debt capital markets for the future. It did provide a benchmark and yield curve and does lead the way to more issues across the region. But when US interest rates rise then bond prices will go lower. The question is if equity markets will then come back, despite the lack of macro demand.

With government deficits still rising, debt capital markets will continue to grow and develop, driven by sovereign borrowers but forging the path for private borrowers too. "We don't expect oil prices to break the range of US$40-60/barrel in the near future," says Scot Anderson, Global Head of the Energy & Natural Resources Group at Hogan Lovells. "Oil in storage could be deployed by 2017, but the Trump administration is likely to unleash the US oil & gas industry, keeping supply up."

At these prices, all of the GCC sovereigns are expected to post further deficits, many of them substantial. So they will need to continue tapping the debt capital markets, probably at similar levels to those seen in 2016. The next country to come to the market will be Kuwait, which has delayed its debut bond issue, sized at around US$10bn, but plans to launch it before the end of its fiscal year in March. All of the Gulf states are likely to issue more bonds, and both the public and private sector will continue to tap the syndicated loan market.

Costs are likely to be higher for them than in 2016. The response to the election of President Trump has pushed up US Treasury yields, taken billions out of emerging market bonds and stocks and raised the outlook for US interest rate rises, given expectations of higher inflation in the US. The spread on long-dated Saudi paper has suffered less than those of other emerging market sovereigns, but bond prices will go lower. There could also be further ratings downgrades in some countries—Moody's has Bahrain, Qatar, Kuwait and the UAE on negative outlook—which could further increase borrowing costs.

That will not stop governments tapping the market. "This is not discretionary price discovery," says Simon Williams, Chief Economist for CEEMEA at HSBC. "The need for cash is accelerating the development of domestic capital markets. They will become more important providers of capital as the Gulf's own domestic sources fall." Sovereigns might also look more to Islamic financing. They only used Islamic sources for US$6bn of their borrowing in the first 11 months of 2016, the least in nominal terms since 2010 and only 8% of their total borrowing, compared with a 38% share over the previous five years.



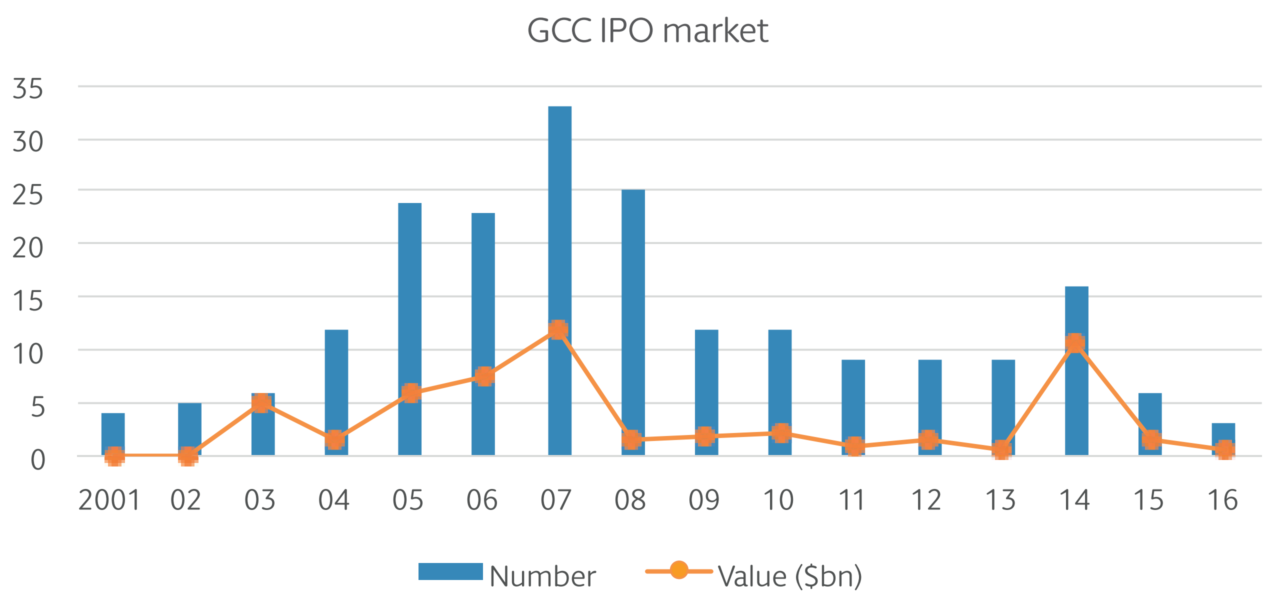
Source: IMF Regional Economic Outlook, October 2016

IPOs get a boost from privatisation sales

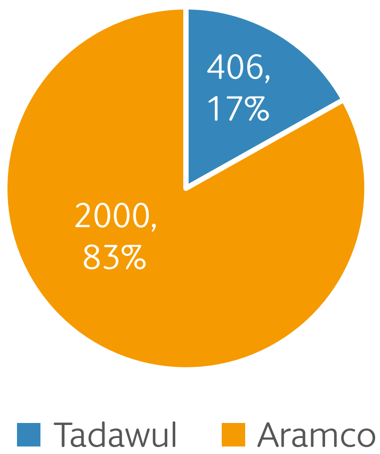
After a bumper year in 2014, led by the US$6bn initial public offering (IPO) of Saudi Arabia's National Commercial Bank, the regional IPO market has largely dried up as weak equity markets led firms to delay plans. There were only three IPOs in 2016, down from six in 2015, raising just US$800m, all of them in Saudi Arabia. This was the lowest number of IPOs since the 1990s and the lowest amount of capital raised since 2002.

Source: PwC

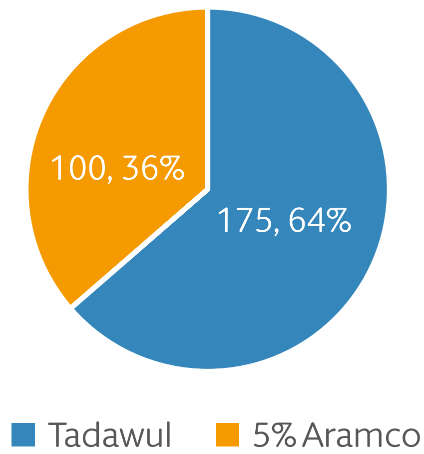
Looking into 2017 and beyond, however, the fiscal squeeze is likely to drive a pickup in IPOs, with privatisations a source of new listings. Privatisation was not a priority during the oil boom and the few that took place were driven by a desire to share wealth with nationals, not to raise capital. The new economic climate has resulted in a reassessment of the role of government companies. Part-privatisation is seen as a tool to raise capital to help fill the immediate budget deficit, enhance efficiency and, hopefully, boost the profitability of government-controlled companies.



Tadawul market capitalisation (US$bn)



Tadawul free float (US$bn)



Source: Tadawul, FT, Elite Economics

The most dramatic plan, of course, is Saudi Arabia's ambition to list oil giant Aramco which, even given current oil prices, would be the world's most valuable company by a considerable margin. There have been few firm details about how the Aramco IPO will proceed. Initially it was assumed that only some downstream subsidiaries would be privatised, but senior officials have repeatedly clarified that the parent company itself will be listed, albeit no more than 5%. The listing could happen as soon as 2018 and more details of it are likely to emerge during 2017, including the company's first financial accounts. It would probably have, at least, a dual listing, as the Saudi stock exchange, Tadawul, is not sufficiently liquid. Aramco is thought to be worth around US$2tn (although estimates vary widely), and so only 5% of it would represent over a third of the Tadawul's free float, as well as the vast majority of its market capitalisation.

Serious efforts towards privatisation are also underway in other sectors in Saudi Arabia, including electricity, water, airports, and food processing. Some of these have been under consideration for a few years, but the National Transformation Plan has added to the pressure to move forward and expanded the range of government companies under consideration.

While most of the planned sales will take longer to prepare, some may start coming on to the market in 2017. The Saudi Electricity Company is unbundling its generation business into four companies, one of which is expected to be privatised soon. The National Water Company has been undergoing restructuring for several years, with a view to an IPO in 2020. The General Authority of Civil Aviation plans to privatise King Khaled International Airport in Riyadh and has also indicated an interest in privatising several smaller airports. Saudia, the national airline, is also planning to float three

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Simon Williams, Chief Economist, CEEMEA at HSBC

Viewpoint

Imtiaz Shah, Partner, Dubai

GCC countries are taking a more serious and long-term approach to reform than before. The mood music is different. They are willing to do what is needed to move away from oil and rebase the economy. They want to reset the economy so that, when the market turns again, it will be different. Government spending is not going to drive the next boom.

of its non-core units, as it did with its catering and ground services units in recent years. Saudi Grains Organisation, which operates silos and flour mills, picked HSBC in May 2016 to advise it on privatisation options and it could go ahead in early 2017. HSBC is also advising Tadawul on its own IPO, which is unlikely to happen before 2018.

Other Gulf countries are also looking seriously at privatisation, with discussions to float companies or reduce government stakes in already listed entities. Oman, which faces urgent fiscal pressure, is considering privatising crown jewels such as Oman Air, Oman Post and some downstream subsidiaries of Petroleum Development Oman, as well as reducing its 51% stake in Omantel. Bahrain is also in need of funding from privatisation sales and there have been long-standing discussions to sell parts of Gulf Air and Bahrain Airport Company, among others. In February 2016, Sheikh Mohammed bin Rashid Al Maktoum said he was considering privatising “most government services” in Dubai, and in Abu Dhabi there has been talk of privatising aspects of healthcare. However, there does not appear to be much urgency about these plans in the UAE and it is unclear if any substantive deals will emerge in 2017.

Will family firms go to market?

There could be a pick-up too in IPOs by family firms, which comprise about three-quarters of the private sector in the GCC. Traditionally, most have been reluctant to raise capital on public markets, preferring bank financing. However, tighter bank balance sheets and easier listing rules may now encourage them to do so. This comes at an opportune moment, as many family firms, founded in the early decades of the regional oil boom, are now moving into the hands of the third generation. This transition typically spreads ownership across many people, some of whom may have less interest in the business and reasons to exit from all or part of their holdings, something which can be facilitated by an IPO.

The 2015 UAE Companies Law made IPOs easier for family firms, reducing the minimum free float for listed firms from 55% to 30% and so enabling founders to retain control. It also introduced some important technical changes to IPOs in relation to underwriting and book-building, which are due to be clarified by regulations from the Emirates Securities and Commodities Authority (SCA). These changes and the growing sophistication of local capital markets may encourage firms to IPO locally rather than choosing a foreign exchange.

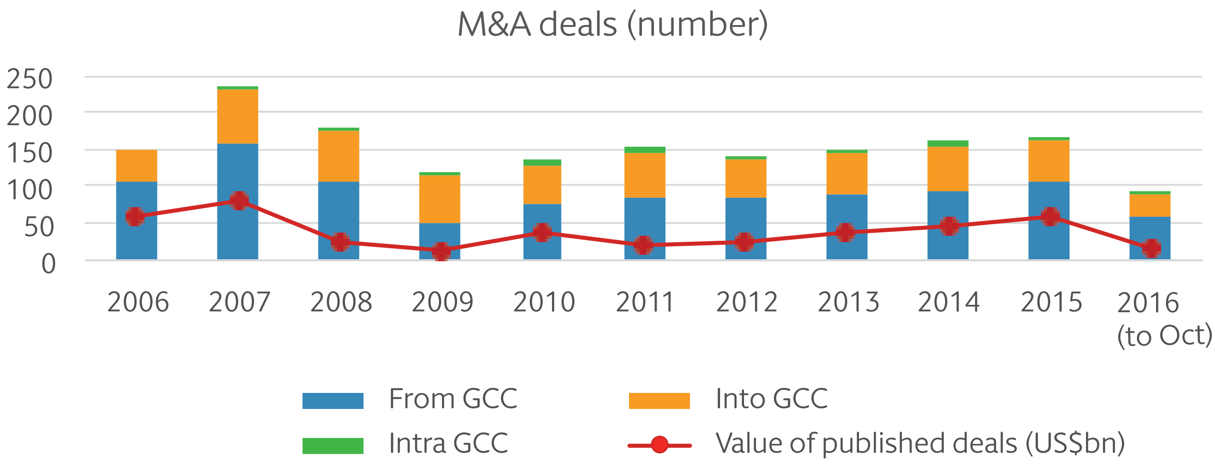
Saudi Arabia, too, is actively preparing for a raft of new IPOs, though these are not likely to come on stream before 2018. Saudi banks, including Al Rajhi and NCB, have launched a series of IPO investment funds. The Capital Market Authority issued a ruling in August 2016 permitting foreign investors to subscribe to IPOs for the first time and has done impressive work to set a basis for good governance and transparency. It is also launching a new market for smaller companies, with minimum requirements of just US$2.7m in capital and 20% free float, according to draft rules issued for consultation in November. A similar market exists in Qatar, although it has yet to attract any listings.

Whether the IPO market does pick up will depend primarily on confidence, however. “There is some pent-up demand and a number of issuers who are keen to come to market,” says PwC’s Drake. “But they won’t do that if investor demand is weak and valuations remain depressed because of macro factors.”

M&A activity will pick up a little in 2017

2016 was a weak year for M&A activity. Data from the first ten months of the year suggest that the number of transactions—to, from and within the GCC—was the lowest for more than a decade, and the total value of known transactions (this is often unknown when deals are between private companies) was only slightly higher than in 2009, in nominal terms. This stands in stark contrast to 2015 which was the busiest year since the boom period of 2006-8.

An exception to the general weak trend was the US$2.4bn purchase of a majority stake in Kuwaiti food company Americana by Adeptio, an investment vehicle owned by Dubai businessman Mohammed Alabbar, which was one of the region’s largest ever private sector M&A transactions. Saudi Arabia’s Public Investment Fund subsequently agreed to buy a 50% stake in Adeptio itself. These developments could herald more intra-GCC deals in 2017. “M&A is very much a confidence-based market, so uncertainty in the macroeconomic environment and weak equity markets are not supporting it at the moment and weak valuations tend to create a wider gap between seller and buyer expectations,” says PwC’s Drake. “But we are beginning to see more M&A activity come back, as people begin to recognise what the new oil-price environment looks like.”



Sources: Bloomberg, Elite Economics

The deal data for 2016 excludes the merger of National Bank of Abu Dhabi and First Gulf Bank, which was first floated in June, but is due to complete in March 2017. This will be the region's largest ever merger of listed companies, which are collectively worth about US$27bn. The merger made sense because the UAE is overbanked relative to the size of its population and economy and because leaner times for the sector favour larger and more efficient banks. Across the GCC, the low oil price has affected deposits, meaning that many banks have weaker funding and liquidity. This encourages consolidation, particularly as banks with a bigger capital base are able to write bigger cheques to fund major projects.

There is plenty of talk of other possible bank mergers in the region, but these have traditionally been difficult because many banks are associated with merchant families who are unwilling to dilute their influence. The Abu Dhabi deal was relatively straightforward, given that the government and royal family own a majority stake in both banks. The realities of adjusting to an era of low oil prices could cause other potential combinations to emerge – even cross-border ones. Resistance would remain high, although the emergence of half a dozen pan-GCC banking giants would make commercial sense.

While big bank mergers hit the news, there are signs of a more general trend towards consolidation taking place in the GCC. In Abu Dhabi, for example, the government announced it would merge three leading research institutions, Khalifa University, Masdar Institute and the Petroleum Institute, having earlier in 2016 announced the merger of two sovereign wealth funds, Mubadala and the International Petroleum Investment Company. The key driver in such defensive mergers is the need to become more cost-efficient and do things more profitably, with many organisations – in both the public and private sector – looking at lay-offs and restructurings. Defensive strategies could well accelerate as companies start to work out the impact of the introduction of value-added tax on their pricing strategies in 2017, in preparation for its expected introduction in many GCC countries in 2018. Cross-border M&A is likely to pick up pace too, with deals under discussion in the fast-growing e-commerce sector, for example.

Private equity had a watershed year – expect more activity

Although private equity deal flow within the GCC was relatively weak during 2016, it was a watershed year as demand and supply started converging, boding well for more activity in 2017. "High valuations in the Gulf mean that some private equity firms have stayed away," says Markus Federle, Senior Managing Director and General Counsel at Samena Capital. "But valuation expectations are coming down, so there are good prospects for more and more attractive deal flow in 2017."

There are other drivers, too. Institutional investors are becoming more interested in locked-up investments because of the lack of good returns on more liquid investments, which are also quite volatile. In addition, new legislation is starting to remove obstacles to investment. In the UAE, the new insolvency law came into force and is now in effect and provides clear guidelines and structures for commercial bankruptcy. The passing of this law bodes well for the introduction of the long-delayed UAE foreign investment law, which would allow 100% ownership in key sectors.

Viewpoint

Charles Fuller, Partner, Dubai

One of the challenges for private equity in the Middle East is the lack of a secondary market. That means when the IPO market is stagnant, holdings are just not sold.

We're doing a secondary deal in Saudi Arabia now and we hope that if a few deals are signed we could open the door to greater co-operation and co-investment. Regional private equity houses could sell on to international ones, seeing secondary sales as a way of helping their companies expand.

Local private equity firms, like Abraaj, and entrepreneurs, such as Mohammed Alabbar and Fadi Ghandour, have started investing in tech start-ups, attracting support from government entities such as Saudi Arabia's Public Investment Fund – and piquing interest from outside investors. "A new trend is that a number of PE firms will now also consider earlier-stage and venture capital type investments," says Federle. "Smartphone penetration is high and there is a lot of tech entrepreneurship in the region which - when compared to India or Asia - is meeting limited availability of VC funding."

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Markus Federle, Samena Capital

In 2017, there is likely to be a surge in venture capital in areas such as e-commerce, life sciences and healthcare as the international venture capital firms take a new look at the region. In addition, local venture capital funds – currently tiny at US$10-30m – are coming to the end of their life cycles and expect their next round to push funds to US$100-200m.

PPP expands into new sectors in 2017

The squeeze on government finances has prompted a growing interest in using public private partnerships (PPPs) to implement major projects. In the past, the PPP model was largely restricted to the power and water sector. However, new laws have been drafted to facilitate its wider application. Kuwait updated its PPP law in 2014 to address its shortcomings and require project companies to be floated. Dubai passed its law in 2015, and Oman and Qatar are currently drafting their own, with assistance from EY and PwC, respectively, and these should be enacted during 2017. Saudi Arabia lacks a dedicated PPP law, but has been tendering PPP projects under the framework of its general Procurement Law and is looking to improve the framework through initiatives such as amending its personnel laws to allow staff to be seconded to PPP projects.

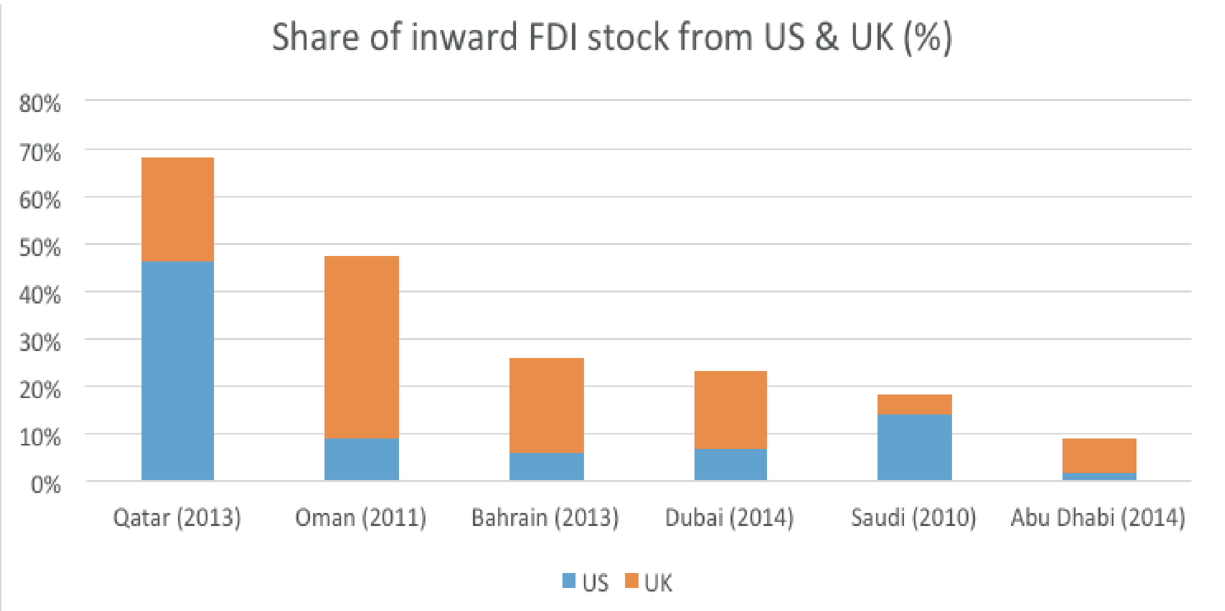
In Kuwait, the most advanced PPP project under the new law is one to build, finance, operate and transfer nine schools, which was opened to bids in November 2015. Oman is planning to develop four new hospitals on a PPP-basis and Qatar is also considering PPP for education and healthcare. In Saudi Arabia, Medina's US$1.bn Prince Mohammed bin Abdulaziz airport was expanded in 2012-15 under a PPP which gives the developer a 25-year concession to operate it, before transferring ownership to the State. Other Saudi airports are set to be developed using this PPP model and feasibility studies are underway in other sectors, including hospital construction. Transport is another suitable sector, and Dubai Roads and Transport Authority was one of the main drivers behind the emirate's PPP law.

The rollout of PPP projects has not been entirely smooth, and there are likely to be further delays in 2017 as government entities that are new to PPP struggle to set the terms and incentives in ways that meet state objectives and are also commercially attractive. Nevertheless, a strong pipeline of PPP is expected. Ultimately the pace of both privatisations and PPP tenders will depend on the evolving fiscal outlook, driven by oil price projections, as governments assess how important private financing is to their strategic plans across various sectors.

The implications of Trump and Brexit for GCC deal flow

It is likely that 2016 will be remembered for two related 'black swan' events, the Brexit referendum and the election of Donald Trump as President of the United States. These both went against the strong weight of polling and market expectations. They also shared some common causes, including a populist revolt against the political elite by voters who have experienced economic stagnation since the 2008 financial crisis and have lost faith in globalisation. The long-term implications of the two votes will take time to emerge, but the first effects are already being felt. A series of elections in European countries will add uncertainty to the outlook for 2017.

The US and the UK are the largest bilateral investment partners for most Gulf countries, and so developments in these countries are particularly significant for the region and may have a bearing on bilateral deals. American firms are the largest direct investors in Qatar and Saudi Arabia, while British firms are top in Oman, Bahrain and the UAE. Meanwhile, Gulf sovereign wealth funds, as well as individuals and companies, are heavy investors in both countries. The UK has long been a favoured investment destination, given historical links: Kuwait, Qatar and the UAE are all major investors in UK real estate and blue chip equities. Traditionally Gulf exposure to the US has principally been through portfolio investment in Treasuries and equity markets. However, more recently there have been several major deals, such as a US$3.5bn investment in Uber by the Saudi Public Investment Fund and a series of sizable property acquisitions by the Qatar Investment Authority, which established a New York office in 2015 and announced its intention to invest US$35bn in the US over five years.



Source: National statistical agencies, most recent data. N.B. the UK FDI in Qatar comes primarily from Shell, which we have categorised as British, although the Ministry of Development Planning & Statistics categorises it as Dutch.

Viewpoint

Peter Watts, Partner, UK

Brexit is just one of many things going on for investors. The exchange rate impact was the first and most tangible effect of Brexit, bringing the pound to a more realistic level. Then came the general sense of uncertainty, but we don't see evidence of GCC companies not doing something because of Brexit. Finally, there is a whole series of issues that will evolve over the next few months and even years. These will determine if the UK becomes more free market or more protectionist, more innovative or more conservative. This shift in the direction of travel could end up having the most significant effect on investment.

The most immediate implication for the Gulf has been the impact on the currency markets. The British pound fell to a more than 30-year low—on concerns about a growing trade deficit and weaker investment flows—while the US dollar, by contrast, rose to a 13-year high in the immediate aftermath of Trump's election, on expectations of fiscal stimulus and faster Fed tightening. These currency moves boost the firepower of Gulf investors, drawing on dollar-linked assets and oil revenue, and may also make UK assets look particularly affordable, depending on long-term expectations for sterling, although existing UK holdings have taken a heavy hit from the recent devaluation. There have been some indications from UK real estate firms of increased interest from Gulf investors since the fall in the pound. On a macroeconomic basis, however, the real appreciation of local currencies pegged to the dollar is creating headwinds for some Gulf exporters and those trying to attract outside capital and tourists.

Aside from anti-globalisation and anti-establishment tendencies, many of the new populist movements have prominent Islamophobic attitudes, driven by concerns about terrorism, migration and multiculturalism. This could be a factor which influences Gulf investment allocation decisions, for example favouring countries that are more welcoming to Muslims, such as Canada. Although Mr Trump utilised fears about Islamic terrorism in his campaign, he has softened his statements since the election. He also has personal business interests in the region, including the development of three golf courses in Dubai in association with Damac, and property investments with Landmark.

There is an expectation that Trump will take a transactional approach, focusing on maximising key interests such as job creation and reducing immigration, while questioning long-term strategic goals. “It is like the opening gambit of a negotiation,” says Mike House, Partner in Washington D.C. “They don’t have a clear plan. They will take a look, see if changes are needed and then make them and see where it goes.”

For the GCC, some areas of engagement, such as large-scale defence contracts, will remain strong. Others, such as strategies for fighting ISIS in Iraq and Syria, could be the cause of growing tensions – but they could also be simpler to handle under President Trump than under President Obama. Gala Riani, Director for MENA Analysis at Control Risks, explains that a big question, which was already being raised under President Obama, will now be asked more clearly and more urgently: “Why should the US dedicate resources to stability and security in the Middle East if they are no longer dependent on the region’s oil and are relatively insulated from trends around the oil price?”

In 2017, the incoming Trump administration is likely to make investors more cautious. That is already clear for Iran, where new non-nuclear sanctions are being considered even if the national security team decides to keep the nuclear deal intact. There might also be new taxes on imports, designed to encourage manufacturing in the US – this would alter the dynamics of supply chains in many industries and needs to be watched carefully.

Viewpoint

Warren Thomson, Partner, Dubai

Last year, everyone in Dubai was saying that if you are not in Iran, you’re already too late. Even before the elections, US companies were worried about reputational risk even if they had licences - and those who could invest, didn’t because of difficulties on the ground and banks’ unwillingness to handle transactions. With Trump looking at new sanctions on Iran, the threat of snapback is too great.

An immediate threat to Gulf investment in the US comes from the Justice Against Sponsors of Terrorism Act (JASTA), which became law in September after Congress overrode the presidential veto. It permits victims of terrorism on US soil to sue foreign governments, with a primary focus on Saudi Arabia for 9/11 victims. US federal courts now potentially have the power to seize sovereign assets in the US to pay awards made in cases under JASTA and the first three cases have already been launched. Before the election, there had been plans to water down the law as part of a larger end-of-year omnibus bill – but Trump has decided to shift this opportunity into next year in order to focus on changes in his priority areas such as tax, trade and immigration.

Adel al-Jubeir, the Saudi foreign minister, has warned that any threat could cause Saudi Arabia to sell off its investments in the US, principally its US$90bn in US Treasuries (which were anyway reduced by about a third over 2016 to fund the budget deficit). Although unlikely, this would create a significant opportunity for major deals to reinvest those funds elsewhere, particularly given the recent shift towards a more active investment strategy by the Public Investment Fund.

Another dominant theme in the populist revolts is a rejection of trade liberalisation—whether represented by the EU single market or NAFTA—which is perceived to have damaged the jobs market and living standards. The latest regional trade deals, the Trans Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) are now both effectively dead. If the revolt goes beyond rejecting these deals and leads to new protectionist measures then global growth is likely to slow and the countries with the most open economies will be disproportionately affected, which will be a factor to consider for Gulf companies and funds contemplating foreign investments in 2017.

Vietnam's rapidly growing economy has attracted attention, for example, but it is the country outside Latin America that may be most exposed to potential US protectionism, given that exports to the US comprise 16% of its GDP. Until now, it had been receiving growing interest from the Gulf, such as the involvement of Emaar in a US$1.3bn development project in Ho Chi Minh City. Conversely, countries that trade largely with other regions or whose economies are driven more by domestic demand than exports might attract more interest from investors if a wave of protectionism does indeed emerge. Equally, if investors judge that the swing to protectionism will only be a brief phenomenon, to be reversed after subsequent elections or abandoned as countries seek greater competitiveness, then a dip in markets in affected countries, such as Vietnam, might present buying opportunities.

Asian engagement is on the rise

The Gulf has a long history of financing flows with Asia, in both directions. The relationship is rooted in trade, with Asia purchasing the bulk of GCC exports and providing a growing share of its imports. Asian companies are also increasingly active in the GCC, particularly South Korean and Chinese firms in the construction sector. The inter-regional relationship is mirrored and enhanced by developments in the banking sector. Asian banks have been developing a presence in the Gulf, particularly in Dubai and Qatar, while Gulf banks have also gone East. Asian direct investment in the GCC is rising too, with South

Korean, Japanese and Singaporean companies among the top ten sources of investment for most Gulf countries.

There has been another burst of Asian activity in 2016, albeit driven more by China this time. Asian investors have subscribed to about 30% of GCC bonds this year, roughly double the region's usual participation rate, according to analysis from Standard Chartered. Asian banks have also begun to play a direct role in the issuance process, with Bank of China serving as one of the arrangers for the debut Saudi bond issuance in October. Industrial & Commercial Bank of China was a co-manager of the $2.25bn issuance by Kuwait petrochemical firm Equate in November 2016, and three Japanese banks-Mizuho Securities, SMBC Nikko and MUFG—were among the joint lead managers. Chinese banks appear to be looking to diversify their assets abroad as opportunities for profitable lending in their home market diminish given high levels of leverage and a slowing economy. Gulf firms have also continued listing bonds in Asian markets, including a US$300m five-year Formosa bond, issued in Taiwan by the Saudi-based Apicorp in October 2016.

Meanwhile, Gulf sovereign wealth funds have long discussed diversification into Asia, but there have been signs of a fresh push in recent years. Qatar Investment Authority has launched a new strategic focus on Asia with two sizeable investments: Asia Square Tower One in Singapore for US$2.5bn in June 2016 and a US$1.2bn stake in Hong Kong Electric in 2015. The UAE has also been looking east, with Mubadala launching a US$10bn joint investment fund in December 2015 with China Development Bank Capital and China's State Administration of Foreign Exchange.

In October 2016, Saudi Arabia's Public Investment Fund announced plans to form a US$100bn technology fund together with Japan's Softbank, whose track record includes being the key early investor in Alibaba, China's e-commerce giant. Mubadala and Qatar Investment Authority are reported to be considering joining the tech fund. Gulf sovereign wealth funds have also been granted some of the largest allocations for investment in mainland Chinese shares, as the government controls foreign participation in its domestic equity market. Even though most Gulf sovereign wealth funds are unlikely to receive new capital injections while their governments are running deficits, it is likely that they will continue to look for opportunities in Asia in 2017, funded by income and redemptions elsewhere, as growing uncertainties in the West further spur efforts at regional diversification.

Qatar Investment Authority has launched a new strategic focus on Asia with two sizeable investments: Asia Square Tower One in Singapore and a stake in Hong Kong Electric.

A year of cautious progress and a reason for hope

Like last year, 2017 will be a year of cautious deal-making, but investors are starting to feel more comfortable in the new low oil price environment. They are finding opportunities opening up as governments embrace external financing and encourage a broader private sector role. That should ensure a pickup in market activity in 2017 – a development that is unlikely to be constrained by the ramifications of new directions in the US and UK.

Looking further ahead, successful reforms will lay a firmer foundation for stable growth and significantly more developed markets, but the risks remain great. The appreciation of the dollar and rise in interest rates will hold back non-oil growth, making it more difficult to create the jobs and infrastructure that the growing population will need. A higher-than-expected rise in oil prices might also be just enough to take the pressure off governments to continue with painful reform. “There is a risk of something coming loose if adjustment doesn’t keep pace or growth is too slow,” says Williams of HSBC. “But given the wealth the region commands, we see little prospect of a fiscal or foreign exchange crisis.”

What is clear is that the next growth phase in the GCC will not come from government spending as in the past. For the long-term development of capital markets, private equity, PPP and foreign direct investment, that is the biggest reason for hope.

Please note: The views expressed in this report are those of the authors, and not of the firm as a whole.

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