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Saudi’s New Emerging Market Status Gives A Big Boost To MENA On Global Trading Floors

Saudi Arabia’s inclusion in MSCI Inc.’s Emerging Markets Index (MSCI EM) this week is another huge win for the Kingdom’s capital markets and a significant milestone for the whole of MENA. The “halo effect” of MSCI’s move, following similar upgrades by index providers FTSE Russell and S&P Dow Jones earlier this year, will be felt on trading floors across the region as MENA becomes an investment destination that global investors can no longer ignore.

In many ways, Saudi’s new emerging markets status should be viewed as another important step in the evolution of its equity market. Further economic expansion and increasing levels of foreign investment will support its ambitions of a deeper and more dynamic stock market.

Saudi Arabia’s elevation to emerging markets status resulted from a number of capital market modifications and improvements made to its equity market infrastructure. On top of this, the pace of domestic reform that continues to unfold inside the Kingdom continues to impress. Like other small emerging markets there have been a host of significant social and economic changes implemented.

While Saudi Arabia’s economic fundamentals remain strong, there have also been numerous developments since the beginning of 2019 that lead us to believe that the Kingdom is in the middle of a recovery. For example, the success of both Saudi Aramco and the government’s recent international bond issues highlight the ability of Saudi Arabia to attract capital, and with that rising levels of foreign investors. Government projects inside Saudi Arabia have been reinstated and consumption numbers such as electronic point-of-sales data, as well as total credit card transactions, are also on the rise. All of these factors have helped alleviate investors’ concerns and support overall market performance.

The expected increase in foreign flows resulting from Saudi Arabia’s inclusion in MSCI EM is likely to be significant. More than $8.6 billion has already found a home in the market this year from international institutional investors, including passive flows through ETFs of over $2.5 billion. In total, we expect $6.5 billion in flows to initially come into the market on MSCI’s first inclusion date on May 28, and $40 billion overall (because of Saudi’s 2.7% inclusion weighting in the MSCI EM Index). If Aramco’s IPO goes ahead in 2021, as some media reports suggest, then the Kingdom’s representation in the MSCI EM could almost double. Foreign ownership levels in the Saudi stock market are now at a record high of 3.2%, excluding strategic stakes, which is encouraging, but still low compared with emerging market peers.

The halo effect of Saudi’s MSCI EM inclusion could reverberate across stock exchanges in MENA, making the region’s growing allocation sizable enough for international investors to sit up and take notice. In short, MENA becomes much harder for global investors to bypass.

To date, MENA has accounted for approximately 1.8% of MSCI EM, through the UAE, Qatar and Egypt. With Saudi Arabia's inclusion, that share of the index will increase significantly to around 4.5% after the second phase of inclusion in August. There is also a strong possibility that Kuwait will be upgraded to emerging market status by MSCI next month. Expectations of such a move have already spurred recent gains made by Kuwaiti stocks. If an upgrade is forthcoming, more than $2 billion in passive inflows (and up to $10 billion in total) could find its way into the Kuwait market.

Significant liquidity events like upgrades by index providers such as MSCI, FTSE Russell and S&P Dow Jones make the argument for owning MENA stocks a much more attractive one. With representation in gauges like MSCI EM now rivalling the likes of Brazil, South Africa and India, MENA has truly arrived on the global investment stage. The halo effect for investors will likely be felt far and wide.

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