INSIGHT

QUARTERLY MARKET REVIEW

Q1 2023

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PODCAST

Looking forward, looking back

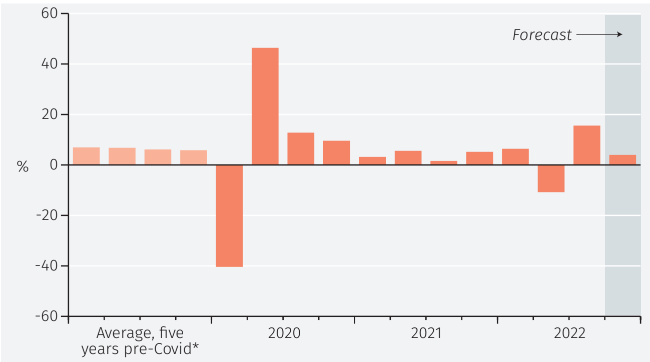
OVERVIEW	EUROZONE	UK	SPECIAL FOCUS
China's role in the global economy	Changing equity market structure	Potential growth downgraded	The Middle East and Africa

OVERVIEW

The past can normally provide some guidance regarding what to expect for the future. However, the highly unpredictable and far-reaching events of 2022 have created greater-than-normal uncertainty about developments in 2023.

Janus, the Roman god of beginnings and transitions, has two faces: one looking to the past, one to the future. January is the month named after him. As prospects for the global economy and financial markets are evaluated at the start of 2023, a look to the past can help us assess what the future may hold. However, with 2022 having been a year of highly unusual events – China's zero-Covid approach, the Russia-Ukraine war and the rapid rise in interest rates – circumspection is in order.

1. China: GDP growth



GDP growth, quarter-on-quarter at an annualised rate

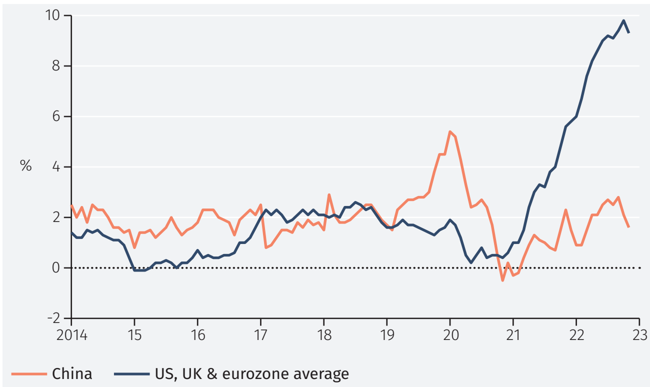
*Average rate of growth in each quarter. Sources: Refinitiv and EFGAM forecasts. Data as at 1 January 2023.

China in the world

In China, the pre-Covid era was a strong and stable one. Economic growth ran at around 6-7% at an annualised rate (see Figure 1) between 2015 and 2019. Certainly, there were concerns about the veracity of that data and various measures sought to provide a more reliable indication. But even so, the gyrations of growth from 2020 to 2022 were particularly astonishing.

Looking forward, the issue is whether China can return to its former performance and once again provide a meaningful contribution to global growth (see Figure 2). A stronger contribution from China would indeed be welcome. Advanced economies are at varying degrees of recession risk, with the chances highest in Europe. China's re-opening of its economy provides some grounds for optimism that it can return to its former role, although the limited efficacy of China's home-produced vaccines and the absence of broad immunity pose the risk of renewed economic dislocation. Worker shortages due to sickness are already widely reported, with disruption to the global supply chain likely throughout 2023. In the short-term the mass travel associated with Chinese New Year, starting on 22 January, poses a significant risk.[1]

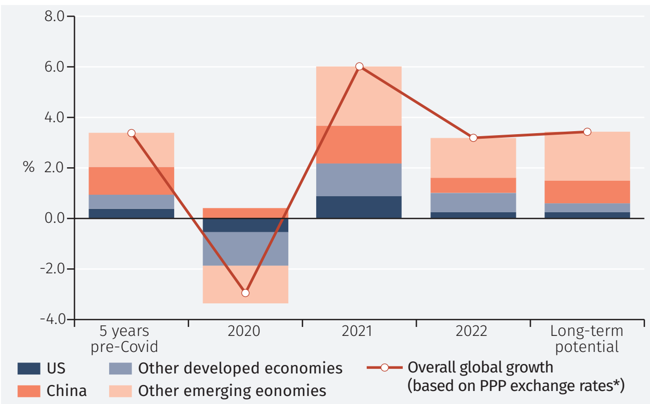
3. Inflation rates: China and advanced economies



Source: Refinitiv. Data as at 1 January 2023.

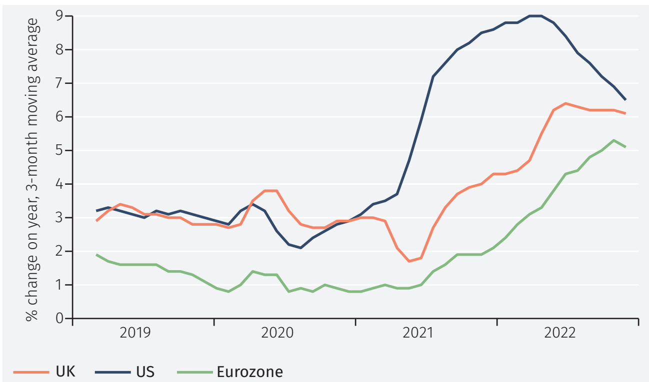
To help support growth, China can ease policy further, especially as inflation has remained subdued (see Figure 3). That is in sharp contrast to the advanced economies where inflation rates are still close to 10%. The good news for advanced economies is that there is some evidence, especially in the US, of wage growth moderating (see Figure 4). The risks of a wage-price spiral may well have been exaggerated.

2. Contributions to world growth



*PPP=Purchasing Power Parity. Sources: IMF via Refinitiv and EFGAM calculations. Data as at 1 January 2023.

4. Wage growth in US, UK and eurozone



Source: Central Bank of Ireland using data from Indeed. Data as at 1 January 2023.

[1] 2023 is the Year of the Rabbit, which promises to be one of longevity, peace, and prosperity in Chinese culture.

China's three constraints

Yet reducing interest rates in China is no guarantee of economic recovery and it faces three major structural challenges.

First, it is no longer an obviously cheap location for manufacturing. The days of the 'China price' when it could undercut manufacturing costs almost anywhere in the world are over. In Asia, many countries now have much lower labour costs. In Vietnam, monthly wages are a quarter of those in China (see Figure 5) and the economy is rapidly becoming a viable alternative (or, perhaps more accurately, a complement) to Chinese production. And, for the US, geographic proximity ('near-shoring') adds to the advantages of the low costs of Latin American labour. This is an important reason why we think other emerging economies (ex-China) are now in a stronger relative position to drive growth.

5. China: no longer as cheap

Source: International Labour Organization. Data as at 1 January 2023.

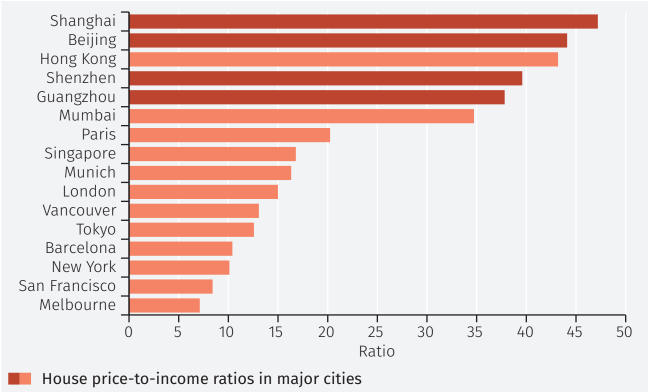
The second challenge relates to the housing market. China's credit boom has fuelled house prices, which are now very high relative to incomes (see Figure 6) – much higher than in well-known expensive locations such as London, Vancouver and San Francisco. The boom and bust cycle in China's property market may well take many years to evolve, although recent government actions will certainly be helpful in this regard.

Third, China's demographics – a shrinking and ageing population – will seriously constrain long-term growth. India will overtake China as the country with the largest population in 2023 and its workforce is much younger.

Reopening and the rest of the world

Even so, China's reopening will provide some impetus to the rest of the world. In the past, China was characterised as an export-driven economy. That has not been an accurate description for some years: net trade – the balance between exports and imports – has provided only a small contribution

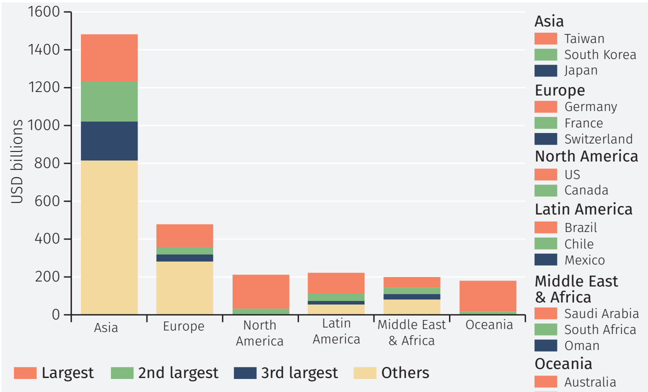
6. House price-to-income ratios in major cities



Source: Numbeo. Data as at 1 January 2023.

to China's growth for many years. What is often neglected is Chinese demand for the goods and services produced by other countries. Understandably, many of those come from China's near neighbours. But European economies (Germany, Switzerland and France) and Latin America also benefit enormously from China's demand (see Figure 7).

7. China: source of imports



Sources: Refinitiv and EFGAM calculations. Data as at 1 January 2023.

A longer look ahead

Although the focus at the start of the year is on the year ahead, longer-term prospects are important in helping to assess the economic outlook. A concern for the major advanced economies is that the shortage of workers will persist and constrain growth opportunities. Productivity trends may take up the slack but, realistically, that is more hope than well-founded expectation. The recent trend has been for weaker productivity. In emerging economies, we think that markets other than China can now play a much more important role in driving world growth. The countries in the MENA region (see *Special Focus* on page 11) are interesting in this respect.

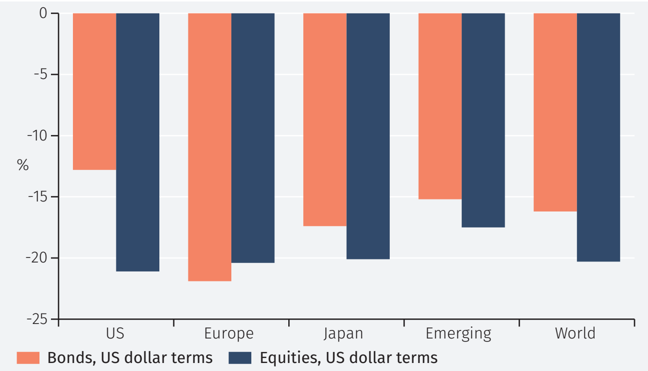
ASSET MARKET PERFORMANCE

Bond and equity market returns were negative across almost all markets in 2022. The underlying cause was higher inflation, leading to higher interest rates and bond yields. The US dollar strengthened against most currencies.

Asset market performance

Global bond and equity market returns were both negative in 2022. Returns from bonds were -16.2% and from equities -20.3% in US dollar terms (see Figure 8).[2] Rising inflation and actual and expected increases in policy interest rates pushed up bond yields around the world, with a consequent fall in bond prices. Such rising interest rates and yields put pressure on equity markets, which were also concerned about slowing economic growth and corporate earnings. In most markets, local currency returns were undermined in US dollar terms by currency weakness.

8. Asset market performance

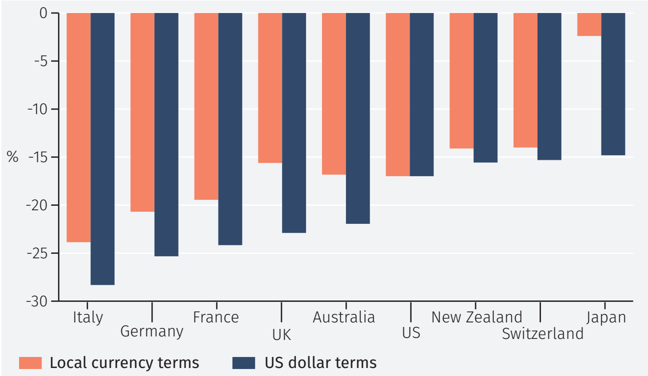


Sources: Barclays Bloomberg (bonds); MSCI (equities). Data for year to 31 December 2022.
Past performance is not necessarily a guide to the future.

Bond markets

There were increases in benchmark 10-year government bond yields across the major markets in 2022. In Japan, the rise was comparatively modest and only came at the end of the year. Yields rose from close to zero at the end of 2021 to 0.41% at the end of 2022 after the Bank of Japan widened the fluctuation band for such yields to +/-0.5%. This meant that, in local currency terms, the total return from Japanese 10-year bonds in the period was just -2.4% (see Figure 9). However, the yen's marked weakness against the US dollar meant this translated into a -14.8% return in US dollar terms. In the US, 10-year yields rose from 1.5% to 3.8%. The rise in yields was even larger in the UK and across the eurozone. Both the UK and Italian bond markets were hit by political developments and concerns about increased government borrowing, although in both economies those concerns eased towards the end of the year.

9. Bond market returns

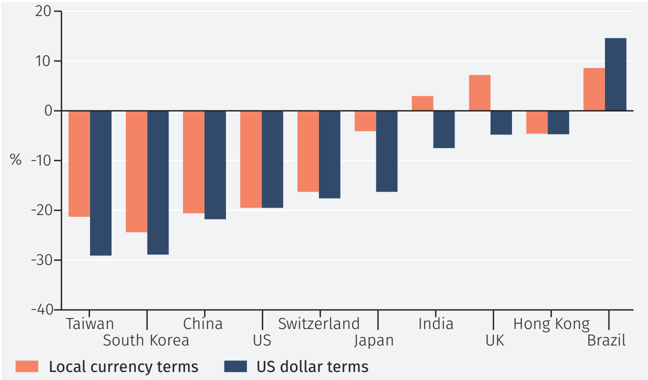


Source: Refinitiv. 10-year benchmark bond total returns. Data for year to 31 December 2022.
Past performance is not necessarily a guide to the future.

Equity markets

Brazil was the one major equity market where positive local currency returns were augmented in US dollar terms by a strengthening of the currency (see Figure 10). Brazil acted early and aggressively to raise interest rates which, by late 2022, was proving successful in moderating actual and expected inflation. Returns in China, South Korea and Taiwan were between -20% and -30%, reflecting concerns about China's zero-Covid policy and a general weakness in the technology sector. Returns from the US equity market were -19.5%. That should be seen in the context of gains of 20% or more in four out of the five previous years. Gains in the UK equity market were positive in local currency terms, benefiting in particular from the strength of the oil sector, but this was undermined in US dollar terms by sterling weakness.

10. Equity market returns



Source: MSCI. Data for year to 31 December 2022.
Past performance is not necessarily a guide to the future.

[2] Global bond returns are measured by the Bloomberg Barclays Global Aggregate Bond Index, which comprises government and investment grade corporate debt from developed and emerging markets issuers in 24 countries. Global equity returns are measured by the MSCI World Index which represents large and mid-cap equities across 23 developed markets.

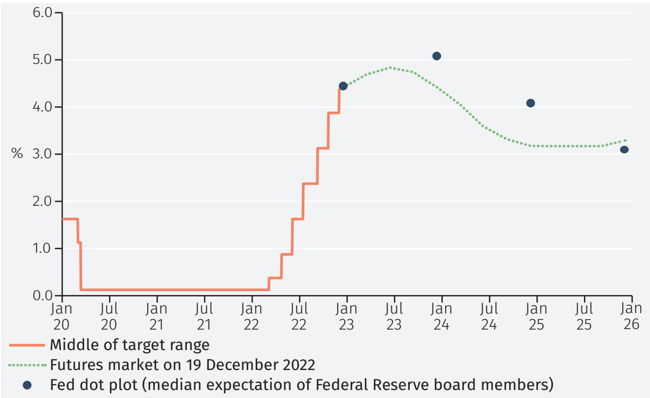
UNITED STATES

There are three key issues for the US economy in 2023. Will the fed funds rate peak, and at what rate? Will the US enter recession? And how sticky will inflation be?

Where will the fed funds rate peak?

The fed funds target rate at the start of 2023 was 4.25-4.5%. The futures market shows the rate peaking at just under 5% in mid-2023, with the rate falling steadily afterwards. Fed board members' median expectation stands in contrast to that: the fed funds rate will be above 5% at the end of 2023 (see Figure 11). We see market expectations as more likely to be correct. It takes some time (probably around 18 months) for the effects of interest rate increases to bring inflation down, providing an argument for the Fed waiting to see the lagged effects of previous tightening.[3]

11. Fed Funds rate: actual and expected paths



Sources: Refinitiv and US Federal Reserve. Data as at 1 January 2023.

US recession? Maybe, but not yet.

For the US, we pay close attention to the slope of the yield curve as a predictor of recession. Every recession since 1960 was preceded by an inversion of the yield curve, when long-term yields fell below short-term rates (see Figure 12). And there was only one yield curve inversion - in the mid-1960s - that was not followed by a recession within two years. With the yield curve currently inverted, there seems a high likelihood of recession. However, the average lag between yield curve inversion and recession is 13 months, pointing to any recession starting later in 2023. A timelier indicator – the trend in the unemployment rate – does not indicate a recession starting soon.[4]

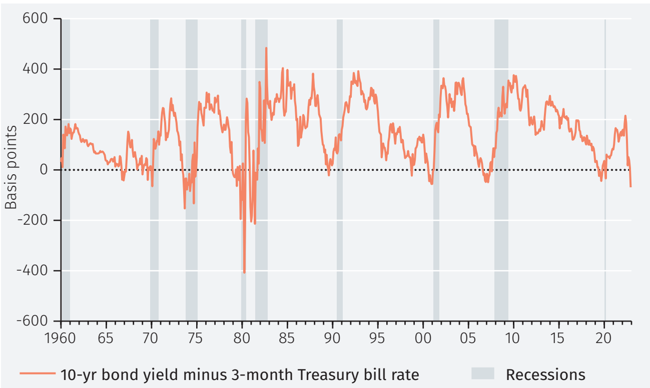
13. US CPI inflation: core goods and services

Note: Core excludes food and energy. Source: Refinitiv. Data as at 1 January 2023.

Inflation problem areas: services and shelter

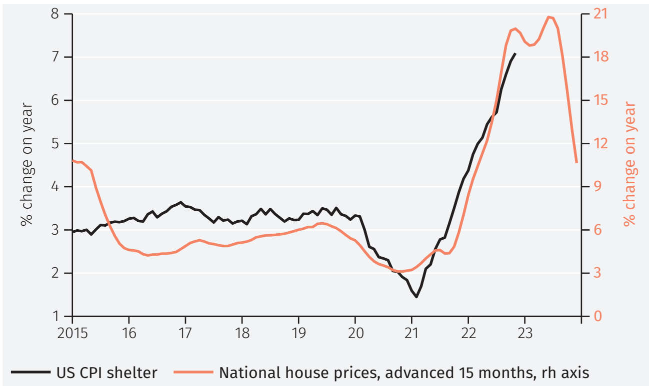
We do see US consumer price inflation falling quite quickly in early 2023 but there are two sticky components that will be closely watched. Services inflation remains elevated (see Figure 13). And the costs of shelter (housing costs) will take time to fall as they bear a lagged relationship with house prices (see Figure 14). On balance, however, inflation will head meaningfully lower as 2023 unfolds.

12. US yield curve slope and recessions



Source: Refinitiv. Data as at 1 January 2023.

14. CPI shelter and house prices



Source: Refinitiv. Data as at 1 January 2023.

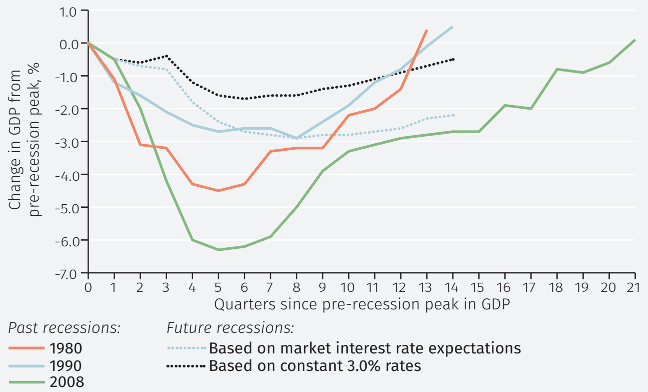
[3] See EFG *Infocus* 'Monetary policy lags', December 2022.
[4] The Sahm indicator suggests that an unemployment rate of 3.9% would signal the start of recession. In November 2022 it was 3.7%. Source: Refinitiv as at 1 January 2023.

The UK is widely expected to be in recession in 2023. Cyclical weakness should, however, not be confused with underlying structural problems. Several factors constrain longer-term growth.

Bringing inflation down

The Bank of England sees a UK recession starting in the final quarter of 2022 and lasting up to two years. Based on the policy interest rate staying at 3%,[5] the recession's trajectory will be similar to that of 1990 – that is, relatively shallow; with the higher interest rates embedded in market expectations it would be more severe (see Figure 15).

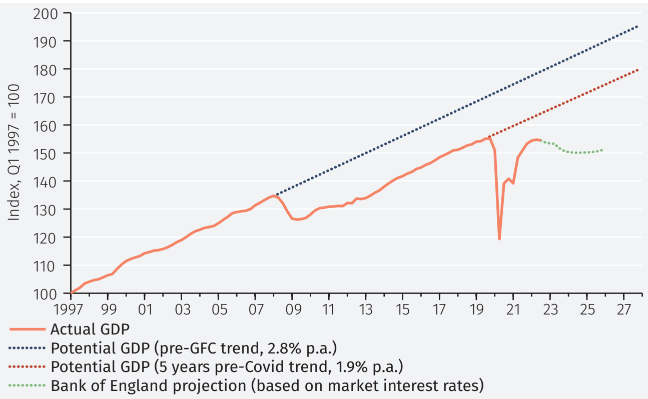
15. UK recessions: past and future



Source: Bank of England *Monetary Policy Report* November 2022.

While this is undoubtedly a concern, the bigger long-term issue is an apparent decline in potential growth. Trend growth up until the 2008 global financial crisis was 2.8% p.a. (see Figure 16). After the crisis, that potential growth path was missed by a wide margin. The UK economy has been on a slower growth trend since then (almost 1% p.a. less). But the Bank of England's current projections are that the new, lower potential path will also be missed.

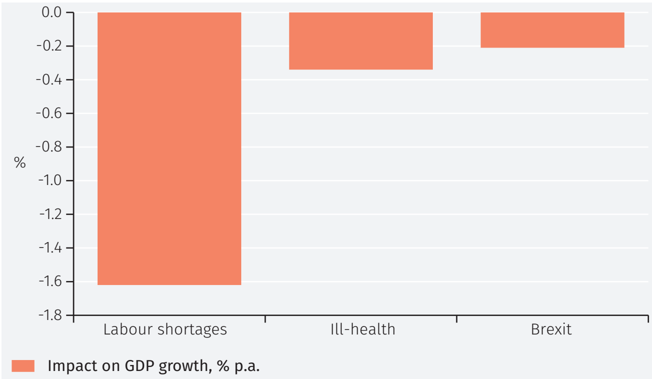
16. UK GDP: falling below potential



Sources: Refinitiv and EFGAM calculations. Data as at 1 January 2023.

A similar pattern has been seen in other economies - in Japan after 1990, for example. Projecting Japan's growth at the 4% p.a. rate of the 1980s proved to be a serious flaw. There were two root causes of slower growth in Japan then, closely replicated in the UK now: slower productivity growth (the OBR now assesses this as 1.7% p.a.[6]) and a shortage of workers. One recent assessment (see Figure 17) suggests worker shortages will reduce potential growth by 1.6% p.a. Together, those estimates paint a picture of very low potential GDP growth, most likely less than 1% p.a.

17. Drags on potential growth

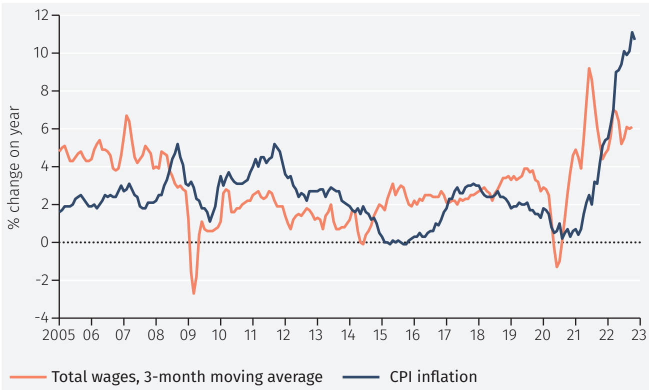


Sources: House of Lords: *Where have all the workers gone?*, OBR and EFGAM estimates.
Data as at 1 January 2023.

Wages have lagged prices

Worker shortages find one manifestation in demands for higher wages. Wages have fallen well behind price increases – by a cumulative 15% since 2009 (see Figure 18) – with a consequent fall in real disposable incomes. Those pressures will ease if, as we expect, UK inflation falls sharply during 2023. But relief is unlikely soon.

18. UK: wages and prices



Source: Refinitiv. Data as at 1 January 2023.

[5] This is already an outdated scenario as policy rates were raised to 3.5% on 15 December, after the forecast was made.
[6] Office for Budget Responsibility (OBR) *Briefing paper No.8 Forecasting potential output – the supply side of the economy.*

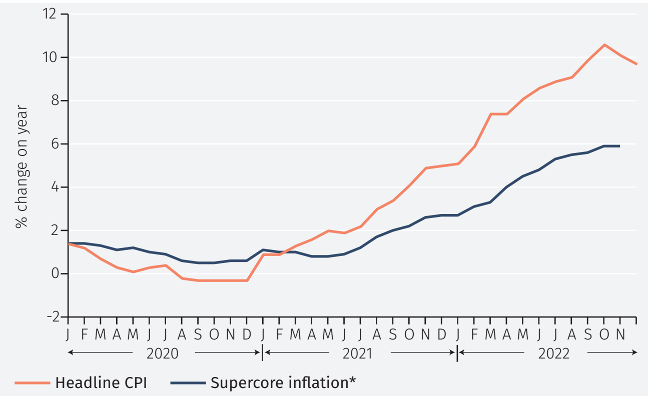
EUROZONE

The eurozone expanded on 1 January 2023, with Croatia becoming the 20th member state. For a small, open economy that makes sense. But the current circumstances of the bloc remain challenging.

Welcome, Croatia

Croatia's eurozone membership from 1 January 2023 was the first expansion since Lithuania joined in 2015.[7] For such small, open economies which are well integrated with the rest of the EU, like Croatia, eurozone membership makes sense. However, there is no doubt that the expansion comes at a difficult time for the bloc.

19. Eurozone inflation



*Excluding energy and selected foods. Source: Refinitiv. Data as at 1 January 2023.

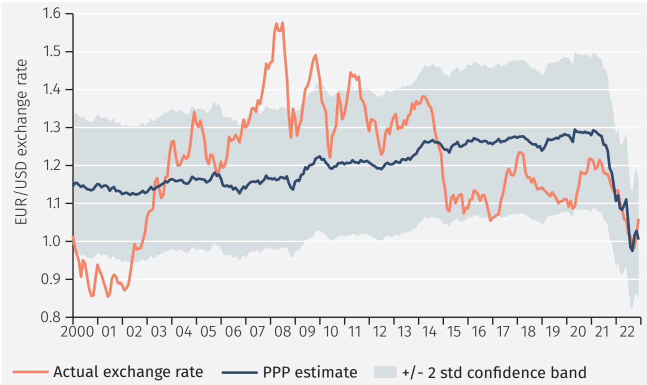
Summer peak in rates?

The headline inflation rate dipped below 10% in December 2022, although that rate and most other underlying measures (see Figure 19) are still well above the ECB's 2% target. That means further increases in the ECB's policy rate are almost certain. Klaas Knot, head of the Dutch central bank and one of the governing council's more hawkish rate-setters, sees a series of half percentage point increases in the first half of the year, taking rates to a peak in mid-2023.[8] Partly as a result of this, but also because of the ongoing energy supply issues, there are concerns about a likely recession. Survey data, however, do not suggest that this will be particularly sharp (see Figure 20). The ECB's central forecast is for modest GDP growth (just under 1%) during the year, with a 1% drop in an adverse scenario.

The euro currency and equity markets

The relative path of ECB and US policy interest rates may well support a strengthening of the euro against the US dollar in 2023 (broadly, ECB tightening is behind Fed tightening). Furthermore, the currency is also reasonably valued (see Figure 21).

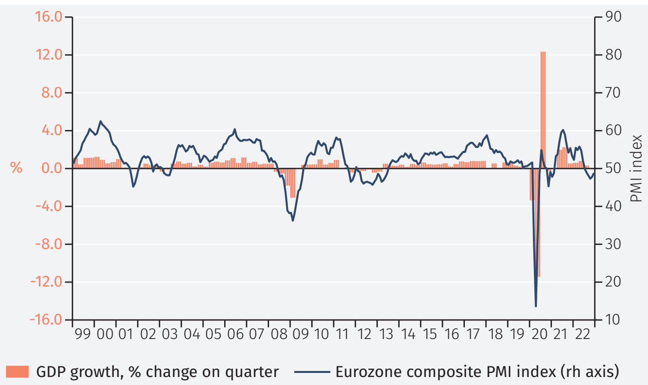
21. Euro against the US dollar: reasonably valued



Sources: Refinitiv and EFGAM calculations. Data as at 1 January 2023.

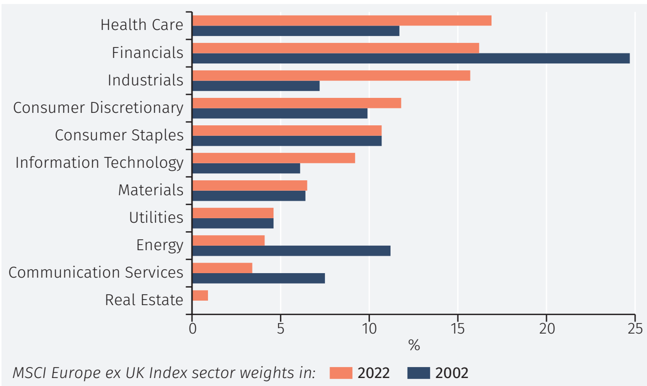
European equities have been out of favour in recent years but we think they provide some interesting valuation and sectoral opportunities. This is especially the case as the structure of the equity market has changed markedly in recent years. The financials and energy sectors have a much lower weight than 20 years ago (see Figure 22) with consumer, healthcare and IT sectors having a greater representation. For 2023, European equities may well provide an underappreciated opportunity.

20. Eurozone GDP and PMI



Source: Refinitiv. Data as at 1 January 2023.

22. Equity market: changing composition



Source: Factset. Data as at 1 January 2023.

[7] Bulgaria aims to join in 2024.
[8] 'Leading ECB policymaker hints at sharp climb to peak rates', *Financial Times* 26 December 2022: shorturl.at/jpHK6

The Swiss National Bank (SNB) has raised its policy interest rate to 1% and a further increase is likely. The main reason is that inflation is set to rise above its 0-2% target in 2025.

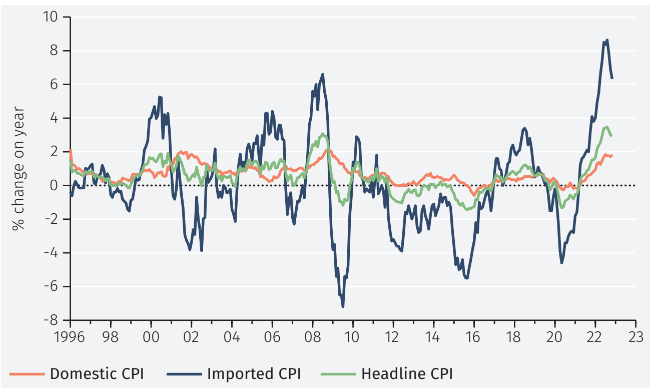
Inflation pressures

The SNB's monetary policy meeting in December was slightly more hawkish than expected, not because of the increase in interest rates to 1.00% (which market participants had correctly anticipated) but from the upward revision to the SNB's inflation forecasts. Although inflation in late 2022 was lower than the SNB had projected in September, its forecast for end-2023 was raised to 2.0%. Furthermore, after bottoming at 1.8% in 2024, the SNB now sees inflation rising in 2025, to above the 0-2% target range.

The SNB's message is that monetary policy and financing conditions need to be tightened further. The SNB will likely increase interest rates again in March. Beyond March, there is a risk that interest rates will be raised further if inflation does not fall faster than the SNB currently anticipates. Even so, it seems unlikely that Swiss policy rates will go much above 1.5%.

Interestingly, the SNB stressed that the upward revision to the inflation forecast for late 2023 and early 2024 was due to "stronger inflationary pressures from abroad" and to the spreading of price increases to a wider range of goods and services (see Figure 23).

23. Swiss inflation

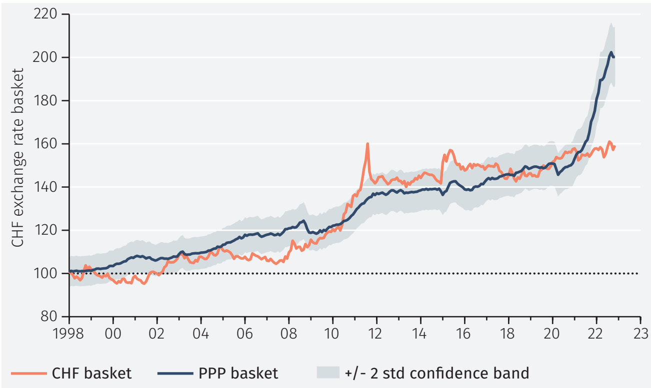


Sources: Refinitiv and EFGAM calculations. Data as at 1 January 2023.

The SNB expects that GDP growth in 2023 will average less than 1%, half the rate expected for 2022. Although growth is moderating, the outlook for the Swiss economy remains underpinned by a strong labour market, a competitive export sector and solid public finances (notably, a debt-to-GDP ratio of only around 40%).

The concern about imported inflationary pressures highlights the role of the exchange rate and foreign currency holdings in Swiss monetary conditions. The SNB will be happy if the franc stays strong, or stronger, as it alleviates the upward pressure on inflation, thereby reducing the need to increase interest rates. Based on purchasing power parity, the Swiss franc seems to have room to rise significantly before it would be seen as a headwind to Swiss exports (see Figure 24). This reflects the much lower increase in the prices of tradeable goods registered in Switzerland compared to its main trading partners.

24. Swiss franc exchange rate basket and PPP*

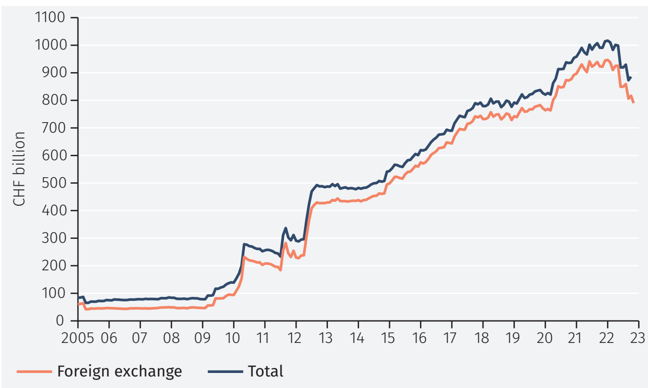


*PPP=Purchasing Power Parity. Sources: Refinitiv and EFGAM calculations. Data as at 1 January 2023.

Running down reserves

The SNB reduced its foreign currency reserves in 2022 (see Figure 25) as it supported the currency, thereby limiting the spill over from quickly rising import prices. That meant crystallising a loss of almost CHF150 bn, the result of which will be that the SNB will not distribute any dividend to the Federal Administration and the Cantons. Despite this, it seems likely that the normalisation of the SNB balance sheet will continue in 2023.

25. SNB reserves



Sources: Refinitiv and EFGAM calculations. Data as at 1 January 2023.

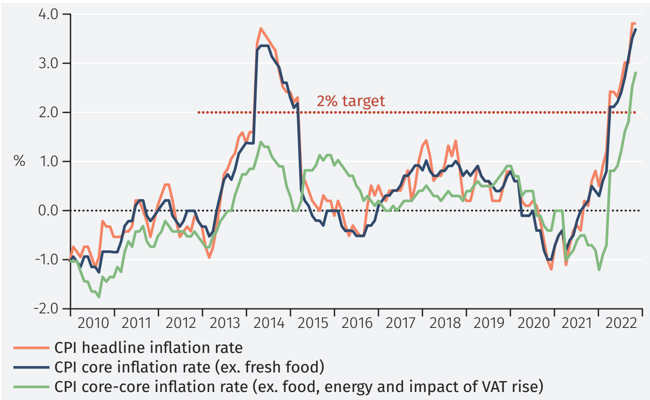
ASIA

Japan's inflation rate has reached a 41-year high, but this is unlikely to persist; and corporate earnings should be strong. Changes in foreign currency reserves pose an interesting challenge.

Japanese inflation: a temporary blip?

Japan's 'core' inflation rate reached a 41-year high in November 2022, at 3.7% year-on-year. The upward pressure on prices reflected mainly higher imported costs as a result of the weaker yen and higher global commodity and energy prices. Both of these factors look set to reverse quite quickly in 2023. There seems little risk of inflation becoming ingrained in Japan. One reason is that absolute price stability has been a feature for the last quarter century. The underlying inflation rate (the core-core rate shown in Figure 26) averaged precisely zero in the 25 years to January 2020.

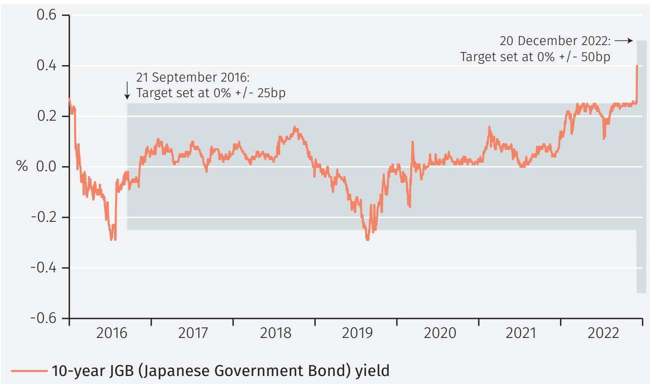
26. Japan: inflation above target



Source: Refinitiv. Data as at 1 January 2023.

There are concerns, of course: fiscal policy is being eased and the labour market is tight. But we doubt this will change the fundamental position. The band that the Bank of Japan has set for 10-year bond yields (see Figure 27) has been widened and some see this as a precursor to a much more significant rise in yields. But with inflation well-anchored, we doubt that will be the case.

27. JGB 10-year yield: widening the band



Sources: *Financial Times* and Refinitiv. Data as at 1 January 2023.

[9] One example is in oil trading with Saudi Arabia https://www.globaltimes.cn/page/202212/1281416.shtml

GDP and corporate earnings

In recent years, corporate earnings in Japan have grown much faster than the overall economy (see Figure 28). The main reason is that Japanese corporate profit margins, which for many decades were stable at a low level, have expanded sharply. That structural trend will, we think, continue and be helped in 2023 by the shorter-term benefit of the yen's previous weakness.

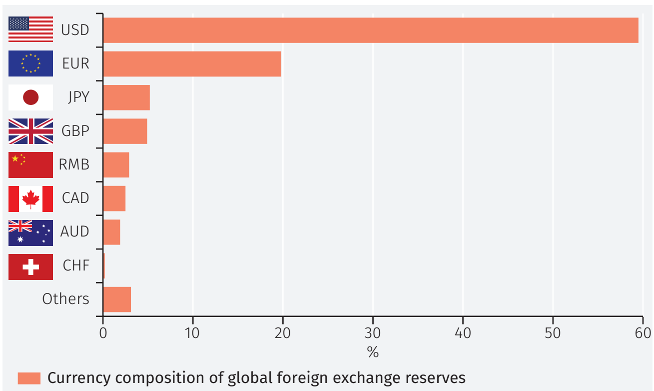
28. Japan: corporate earnings outgrow GDP

Sources: Refinitiv and EFGAM calculations. Data as at 1 January 2023.

Composition of foreign exchange reserves

The sharp yen weakening last year rekindles one perennial concern about currencies: whether foreign exchange reserves (see Figure 29) can continue to be dominated by the US dollar. Yen volatility and the low level of yen yields undermine the case for a shift into yen. China would like to see greater international use of the renminbi,[9] but there is a good deal of resistance, especially as China's capital markets do not remain fully open. A stronger case can, perhaps, be made for reserves being held in other Asia-Pacific economies. South Korea, Australia and New Zealand are candidates in this respect.

29. Currency composition of global foreign exchange reserves

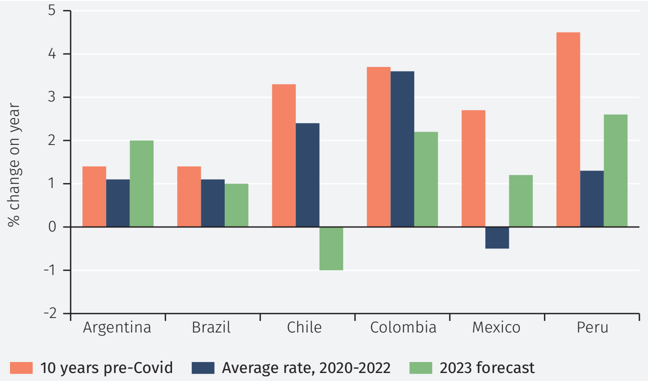


Source: IMF COFER database via Refinitiv. Data as at 1 January 2023.

Latin America faces a return to below-trend GDP growth in 2023. A clear difference between countries with strong fundamentals and others that continue to face increased political risks will be notable.

Key themes
Most economies in Latin America will see weaker growth in 2023 than they did in the pre-Covid period (see Figure 30). Commodity prices will prove less of a tailwind next year, but higher demand from China could help growth. Political risks in Brazil and Colombia have largely cleared and the focus in 2023 will turn to pending reforms. However, political risks have risen in Peru once again. Uncertainty over the new constitution and higher social spending will become a headwind for Chile.

30. Latin America GDP growth



Sources: IMF and Refinitiv. Data as at 1 January 2023.

In ***Mexico*** inflation seems to have peaked at close to 8%, following monetary tightening from the central bank. The outlook for fiscal policy is less certain. As Lopez Obrador enters the last year of his presidency, the use of fuel subsidies and other potential increases in social spending could become an issue.

The first year of the Petro administration in ***Colombia*** saw the President forging alliances with other left-wing parties and successfully passing a tax reform. Proposed changes to the energy sector are less likely to gather support. Economic growth is expected to decelerate in 2023 as a result of higher taxes, lower oil prices and tighter financial conditions.

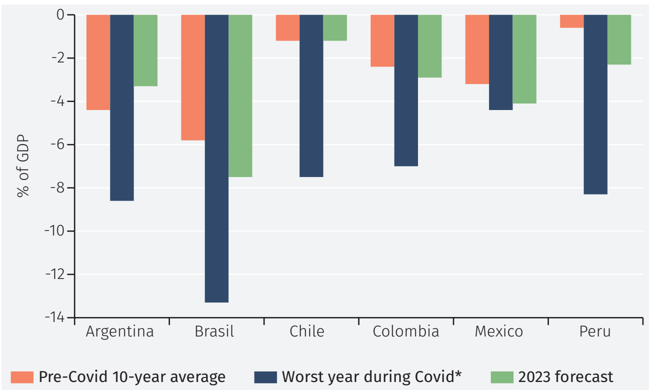
Brazil will endure a deterioration of macroeconomic conditions in 2023 as a result of the deceleration in household consumption from tighter financial conditions and the increase in borrowing costs. Inflation seems to have peaked. Lula's new government is expected to be more moderate than those of his previous terms of office. We expect the main discussion will be centred around the tax reform bill which is already being considered in Congress. This is likely to be supported by Lula as a key to modernisation of the economy and a support for foreign investment. Additionally, the country's commodity exports, particularly oil, iron ore and soybeans, could benefit from a reopening of China, which represents almost 30% of Brazil's total exports.

The outlook for ***Peru*** has worsened in the last few months. Former President Pedro Castillo was impeached in early December after his attempt to dissolve Congress. His short Presidency, from July 2021 to December 2022, was characterised by regular cabinet reshuffles and the lack of governability given the fragmented Congress. Growth in Peru is expected to decelerate to levels close to 3% in 2023. Monetary policy has been one of the few stability anchors in Peru. The sharp increase in interest rates from 0.25% in August 2021 to 7.5% in December 2022 has contributed to a stabilisation of inflation, but this remains elevated at 8.6% year-on-year.

Argentina will have Presidential elections in 2023. The political scene will remain uncertain given the lack of clear successors in the Peronist party to Alberto Fernandez and Cristina Kirchner. Additionally, the inability of the government to access foreign funding, persistent inflation above 90% and the fading effect of strong commodity prices will hit growth.

The outlook for ***Chile*** is also highly unpredictable. Economic fundamentals remain strong, with a low debt-to-GDP ratio of 36%, strong governance indicators and ongoing fiscal consolidation. However, in 2023 the challenging external environment, persistent inflation and uncertainty around the outcome of the constitutional reform process will contribute to a weakening of economic activity and pressure on the fiscal position (see Figure 31).

31. Latin America fiscal balance

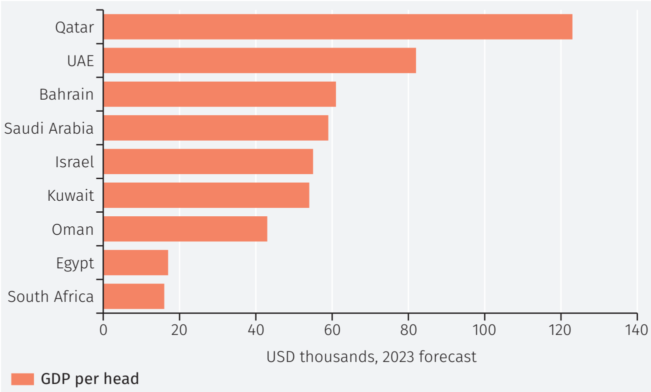


*2020 for all countries apart from Chile (2021). Sources: IMF and Refinitiv. Data as at 1 January 2023.

The MENA (Middle East and North Africa) region tends to attract relatively little attention from international investors. It is a region, however, of wide diversity and a rich range of opportunities, where important structural changes are taking place.

The MENA region is a vast and diverse region which tends to attract relatively little attention from international investors.[10] One aspect of its diversity is the wide range of prosperity. Qatar, host of the 2022 football World Cup, has a GDP per head (see Figure 32) higher than all but three other countries in the world.[11] Even relatively prosperous African economies (such as Egypt and Morocco, which are part of the MENA region) have living standards little more than a tenth of that.

32. Middle East and Africa: GDP per head at PPP*

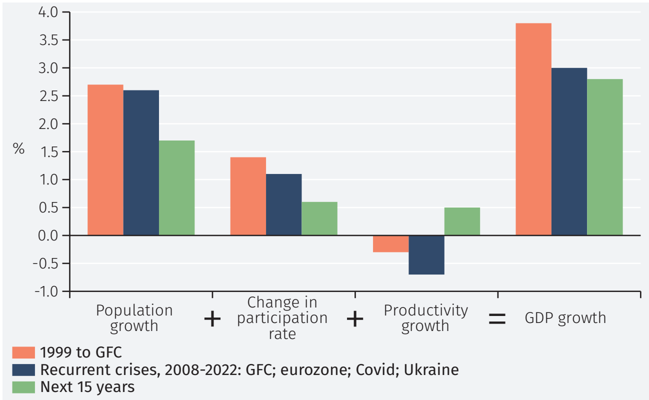


*PPP=Purchasing Power Parity. Source: IMF via Refinitiv. Data as at 1 January 2023.

Drivers of growth: Saudi Arabia

The region stands in contrast to the rest of the world in that demographics are still relatively favourable: populations are growing and are relatively young. Of course, that in itself is no guarantee of success. Looking at one specific economy, Saudi Arabia, the largest of the GCC economies, illustrates the issues involved. Over the next fifteen years, Saudi Arabia's population is expected to continue to grow by around 1.7% p.a. (see Figure 33), lower than in the past but still much faster than the major advanced economies. The participation rate – the proportion of the population in employment – is also expected to rise. This is primarily due to the increased participation rate of women in the workforce and a further increase in the ex-pat population (a trend counter to that in much of the world). The key driver of whether these two trends can be transformed into higher growth lies in productivity (output per worker). Historically, that has been weak in Saudi Arabia. Vast oil-related wealth is generally not conducive to productivity enhancing work practices. However, a substantial transformation of the

33. Saudi Arabia: drivers of growth

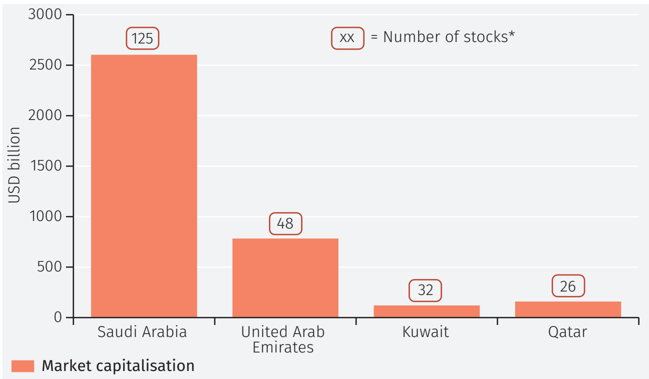


Sources: Oxford Economics via Refinitiv and EFGAM estimates and calculations. Data as at 1 January 2023.

economy is planned, notably with the Kingdom's 2030 vision. This is a framework to reduce Saudi Arabia's dependence on oil, diversify its economy, and develop the infrastructure, health, recreation and tourism sectors.

In terms of whether such a plan is affordable, Saudi Arabia – and indeed all the GCC countries apart from Bahrain – have both substantial current account and government budget surpluses. The accumulation of these over time means the major economies have substantial foreign assets. Saudi Arabia has by far the largest equity market in the region (see Figure 34) and recent IPOs have increased the breadth and depth of the markets there and in the UAE. In short, the transformation of the region seems to be readily affordable.

34. MENA equity markets



*with a market capitalisation of over USD 300m and an average daily volume traded in excess of USD 0.5m
Sources: Regional Stock Exchanges and EFGAM calculations. Data as at 1 January 2023.

[10] The MENA region comprises the six GCC (Gulf Co-Operation Council) members - Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates as well as Algeria, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Morocco, Tunisia and Yemen. This is the World Bank's definition. Other definitions vary: some include Turkey, for example.

[11] Luxembourg, Ireland and Singapore. Source: IMF *World Economic Outlook* database. 1 January 2023.

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