GCC AND EGYPT MACRO OUTLOOK 2023: 'AN OASIS OF OPPORTUNITY'

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Deteriorating macroeconomic conditions are set to increasingly engulf the global economy this year as economic growth labours under tighter financial conditions. In line with our own forecasts, the IMF recently predicted that 2023 will be the weakest year for global growth since 2009, excluding the nadir of the Covid-19 pandemic and the associated economic lockdown in 2020.

The International Monetary Fund's (IMF) latest predictions suggest a global GDP growth rate of 2.7% for this year, 0.9% lower than it had been forecasting in the first half of 2022. We are cognisant that the Fund's base-case scenario remains subject to further exceptional uncertainty in the context of the current global macro and geopolitical landscape, with the balance of risks currently skewed heavily to the downside as recession concerns increase.

Turning to our own region, the GCC and Egypt have made sizable progress in recouping lost output following the Covid-19 pandemic and associated economic lockdowns, and we expect this recovery to continue over the coming months. Indeed, the region's non-oil growth has been clearly reflected in the recent strength of regional Purchasing Managers' Indexes (PMIs), which underscore improving economic performance in the likes of the UAE and Saudi Arabia. Meanwhile, industrial production has continued to expand across much of the region, including the KSA and Egypt, albeit likely at a more modest pace than in recent months compared to the early months of high-stimulus, post-Covid reflation.

The non-hydrocarbon economic diversification story, so important to the economic evolution of the GCC, will be key to cushioning members' economies from the downdraft of probable global recessionary headwinds this year. Key to the most recent diversification strategies has been the pickup seen in regional tourist volumes last year, as the global economy (with the exception of China) emerged from the Covid-19 pandemic and began to relax many of the related restrictions. Indeed, some GCC countries reported a greater number of tourist visitors during 2022 than seen in the pre-pandemic period.

As the Federal Reserve hopefully edges towards a slowing, and then plateauing, of its rate tightening process as the year progresses, we are mindful that the full effects of the rate hikes to date have still to be seen. A key concern of ours is that while tighter Fed monetary policy may have been appropriate in recent quarters for the US economy, the hiking of rates in this region as a consequence of currency pegs may be a headwind for individual GCC economies, particularly at this stage of their business cycle – just as GCC countries are looking to expand growth and diversify further away from oil, higher interest rates are liable to restrict capex, bank lending and, by extension, economic growth.

Facing Up to GDP with Confidence

Just as the aggregate global macro outlook has seen economic growth rates being revised lower in recent months, we do not expect the GCC or Egyptian economies to be immune to buffeting from adverse macroeconomic, monetary and geopolitical factors. As such, we expect economic growth across the GCC and Egypt to consolidate over the course of this year, but to nonetheless outperform much of Europe and the US.

We expect real GDP growth in the GCC to moderate to around 4.2% this year from close to 6.5% in 2022. Meanwhile, we see Egypt's economy expanding by 4.75% in the fiscal 2022/2023 year, a reduction from our earlier estimate of 5.7%.

Putting this in context, GCC and Egyptian growth in the current year should continue to outpace that seen in many Western countries. At the last count, the IMF was forecasting just 1.0% real GDP growth for the US this year, and only 0.50% for the Euro area.

Within the relatively buoyant GCC and Egypt outlooks, it is important to note the positive stimulus to growth from the current robust nature of oil production and associated government revenues across the region. This has provided a buffer for its non-oil economies while at the same time helping to return government balance sheets to fiscal surplus positions.

The latter point may prove to be critical this year as economic conditions weaken against the backdrop of tighter financial conditions. We would go as far as to say that the continued evolution of government balance sheets from deficit to surplus among GCC oil producers was a major regional achievement of 2022. However, and even as the GCC countries continue to cement their fiscal improvements after several years of deep deficits due to pandemic era emergency funding and stimulus, the prospect of higher and possibly stubbornly elevated interest rates will likely ensure that the region will not be without its challenges during 2023.

As mentioned above, we recognise that further incremental interest rate rises this year in the GCC will have a dampening effect on aggregate demand and economic activity across the region. In addition, as we have noted elsewhere in the GIO, when interest rates rise, the potential for negative economic events to occur increases.

Turning to Egypt specifically, its economy will continue to be constrained by uncomfortably-elevated inflation levels, driven largely by higher food and energy import costs for as long as the war in Ukraine and its associated supply chain disruptions persist.

UAE and Saudi Arabia Growth Expectations

After the widespread economic recession of 2020 resulting from Covid-19 pandemic lockdowns, to which the UAE and Saudi Arabian economies were not immune, we saw a steady reflationary rebound in real GDP growth in both the KSA and UAE economies in 2021 and 2022. Given the backdrop of tighter monetary conditions, we now expect to see a moderation in the pace of economic expansion this year; both the KSA and UAE economies are expected to perform robustly, but at a more modest rate of expansion compared to 2022.

The KSA and the UAE experienced sharp economic contractions in 2020, with real GDP falling 6% on average, after which growth recovered. We anticipate that the KSA and the UAE expanded by 7.5% and 6.7% respectively in 2022, after which we forecast a more modest growth rate of around 5% for both countries this year, although that growth should be more sustainable as economic diversification continues to evolve.

Robust hydrocarbon sector economic activity in both countries, combined with resurgent oil prices, helped to fuel high single-digit or low double-digit petrochemical sector GDP growth last year. We expect these upstream and downstream sectors to see more balanced performances this year.

We anticipate 4.4% hydrocarbon real GDP growth and 5.2% non-hydrocarbon real GDP growth in the KSA this year. For the UAE, we forecast hydrocarbon and non-hydrocarbon real GDP growth of 5.4% and 4.7% respectively.

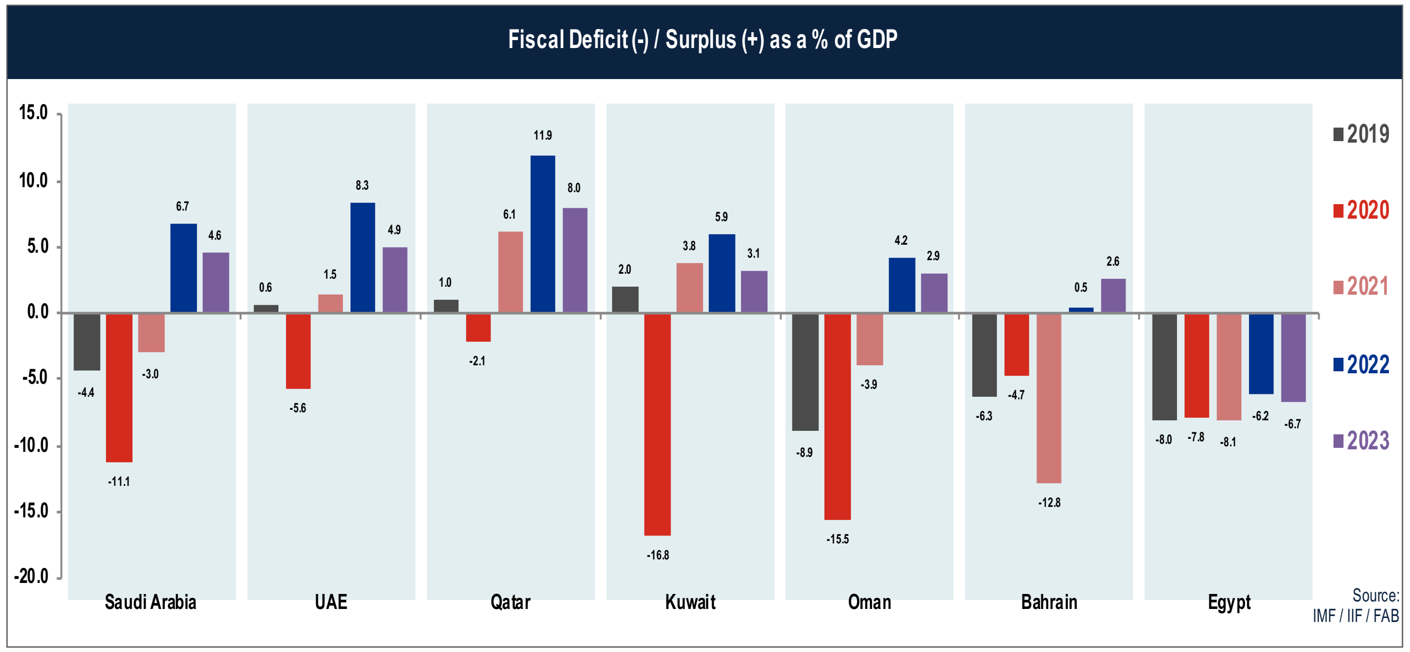
GCC Economic Snapshot – the key numbers*

Indicators	UAE				Saudi				Kuwait			
	2020	2021	2022E	2023F	2020	2021	2022F	2023F	2020	2021	2022F	2023F
Nominal GDP (US$ Billion)	358.9	407.2	491.5	486.0	702.8	810.1	1040.2	899.7	106.0	134.3	170.4	162.0
Real GDP (% change y-o-y)	-6.1	3.2	6.7	5.0	-4.1	3.0	7.5	4.8	-8.5	2.1	7.0	3.5
Per Capita GDP (US$ Thousand)	36.3	41.6	49.7	48.7	20.1	18.7	23.4	21.9	21.7	29.0	35.9	33.3
Per Capita Real GDP % change y-o-y	-7.3	3.4	5.2	3.4	-5.7	2.3	5.3	2.3	-6.4	2.8	1.1	0.5
Nominal GDP from oil sector (% share)	29.1	28.1	30.2	29.4	37.5	35.7	37.9	37.1	45.9	44.9	47.2	46.4
Gov. Revenue from oil sector (% share)	41%	46%	50%	48%	55%	60%	67%	61%	57%	66%	77%	69%
Inflation (% change y-o-y)	-1.9	2.1	2.8	3.5	3.4	3.1	2.7	3.0	2.1	3.4	4.1	3.7
Budget Balance as % GDP	-7.3	-0.1	8.3	4.9	-12.1	-2.9	6.7	4.6	-22.7	-5.3	5.9	3.1
Net Foreign Assets in US$ billion	132.0	140.7	169.9	187.4	467.0	458.8	512.1	556.9	69.1	59	61.7	63.3
Govt. Debt as % of GDP	36.2	31.3	20.6	17.6	32.5	38.1	29.6	26.2	4.5	4.6	0.2	6.4
Total External Debt as % of GDP	101.1	87.3	73.8	76.1	29.8	28.6	29.5	31.3	49.7	42.6	34.8	38.1
Foreign Direct Inv. (FDI) in US$ billion	19.9	21.8	24.0	25.2	5.4	19.3	12.8	13.4	-0.56	-0.59	-0.71	-0.85
Fx Reserves in US$ billion	103.2	127.9	147.9	157.9	453.2	454.9	508.4	523.3	48.1	44.9	48.9	50.9

Indicators	Qatar				Oman				Bahrain			
	2020	2021	2022F	2023F	2020	2021	2022F	2023F	2020	2021	2022F	2023F
Nominal GDP (US$ Billion)	144.4	175.9	212.1	197.5	74.0	84.5	90.6	93.0	34.7	38.9	41.5	43.2
Real GDP (% change y-o-y)	-3.7	1.8	4.5	3.0	-3.1	2.7	3.8	3.5	-5.1	2.8	3.5	3.0
Per Capita GDP (US$ Thousand)	50.1	60.2	71.8	66.2	16.7	18.8	20.0	20.1	23.6	26.0	27.2	27.8
Per Capita Real GDP % change y-o-y	-5.4	0.3	3.1	2.6	3.1	1.7	2.7	1.4	-4.3	1.3	1.5	1.0
Nominal GDP from oil sector (% share)	38.6	38.3	39.7	39.1	42.4	42.7	43.1	43.4	19.5	19.2	18.8	18.5
Gov. Revenue from oil sector (% share)	42%	51%	60%	55%	67%	76%	77%	76%	59%	69%	66%	66%
Inflation (% change y-o-y)	-2.6	2.3	2.8	2.5	-0.9	1.6	2.5	2.5	-2.3	2.0	2.5	2.5
Budget Balance as % GDP	-2.1	6.1	11.9	8.0	-16.7	-3.9	4.2	2.9	-15.5	-4.6	0.5	2.6
Net Foreign Assets in US$ billion	-68.6	-85.2	-63.5	-51.4	9.2	12.0	13.8	14.6	-1.6	0.4	2.1	3.3
Govt. Debt as % of GDP	71.8	59.4	39.1	33.3	78.4	65.9	58.6	55.3	116.6	107.6	101.3	99.0
Total External Debt as % of GDP	138.7	116.3	95.8	102.0	104.7	92.0	74.9	77.5	207.6	242.6	246.8	220.1
Foreign Direct Inv. (FDI) in US$ billion	-2.4	-1.1	0.3	0.5	2.9	3.3	3.5	3.7	1.5	1.0	1.8	2.0
Fx Reserves in US$ billion	37.5	38.9	48.6	52.5	15.0	19.7	25.7	28.7	3.4	1.9	3.9	6.6

*Note: * As estimated by Institute of International Finance (IIF) in its June 2022 update; Source: IIF/IMF/WB/FAB*

As GCC economic activity consolidates, so too will government balance sheets. After the significant improvements in official fiscal balances seen last year, we anticipate continued progress this year. From the -12.1% and -7.3% deficits that we calculated for the KSA and UAE respectively in 2020, we believe that the respective government balances should be closer to +4.9% and +4.6% of GDP this year.



Source: IIF/FAB

Receding Tide of Inflation

For the GCC region overall we anticipate that a relatively benign inflation outlook compared to many other parts of the world should provide welcome stability in its macro landscape. Having said that, we are aware that the region has not been, and will not be, going forward, immune to global price pressures. However, elevated inflation, subsequent rising interest rates, and consequent tighter financial conditions are typically felt most severely by oil-importing countries.

Annualised inflation tended to be above 5% across much of the GCC during the second half of last year, reaching levels not seen in over a decade. Nonetheless, putting this in context, it was still approximately only half the level of inflation experienced across many Western (US and European) countries.

Furthermore, inflation pressures are already easing off across much of the GCC, including in Qatar where, in the run up to the FIFA World Cup in late 2022, suppliers took advantage of the event to push prices higher. We

expect regional inflation pressures to recede further, although not dramatically, over the course of this year. Overall, we now expect price pressures across the GCC to recede from the 5-6% level averaged in 2022 to or just below 3% this year. This moderation in inflation should also be supported by the region's USD-pegged currencies, which will continue to limit imported inflation.

As alluded to earlier, Egypt will remain exposed to a much higher inflation complex this year than elsewhere in the wider region, given that the Russia/Ukraine conflict is keeping food (and energy) prices high, and importantly as a result of the recent devaluation of the Egyptian pound. Therefore high inflation will continue to weigh on the country's economic outlook in 2023, exacerbated by tighter financial conditions and high domestic interest rates.

Fiscal expenditure policy in Egypt should keep the government deficit high this year, while at the same time the combination of high debt levels, volatile energy prices and uncertainty around food security issues will all create downside risks. At least regarding the latter, though, we are comforted by the fact that Egypt currently has about six months of wheat reserves, and is actively looking to source new supplies.

Further Detail on Egypt's Macro Situation

A major macro-political event for Egypt last year was October's staff-level agreement reached with the IMF. The loan package, at USD 3 billion over 46 months, was at the lower end of what some analysts had been hoping for, although it was nonetheless a step in the right direction. The deal was of course hardly a panacea for Egypt's current macroeconomic malaise, and in the meantime further tight central bank monetary policy will likely be required in the coming months.

In September last year the Central Bank of Egypt (CBE) left interest rates unchanged at its scheduled policy meeting, although it did increase the Reserve Ratio to 18% (from 14%), an indirect, but nonetheless decisive, tightening move. We applauded this move at the time, seeing it as a good example of the various tools that the CBE has at its disposal when setting monetary policy.

To get the October IMF agreement over the line, the CBE was required to move to a more flexible exchange rate mechanism, and at the same time to increase policy rates by 200 basis points. At the time of writing, since the currency depreciation in March last year the EGP had weakened more than 50%, although we were hopeful that the need for further meaningful devaluations would be limited. That said, we do expect the central bank to prioritise economic growth over defending the pound during the course of the current year.

Given the chasm of the country's trade deficit, and the extent to which the country's international reserves have declined since the first quarter of 2020, investors should indeed be ready for some further modest downward currency adjustments this year, as well as more monetary tightening to help bring about a resumption of Foreign Direct Investment (FDI) inflows. With Egyptian inflation having touched its highest level since 2017 in recent months, resulting in negative real yields of around 300 basis points, and coupled with declining market liquidity, the need for additional rebalancing is clear.

GCC Macro Summary and Outlook

Despite the buffeting from macroeconomic headwinds and geopolitical challenges resulting in recent steady global growth downgrades, with the IMF cautioning that 2023 could be the weakest year for global growth since 2009, aside from 2020, the economic outlook for the GCC remains robust. The region continues to be supported by strong oil revenues for its oil exporters, which helps create a buffer for regional non-oil sector activity.

Notwithstanding an unexpected weakening in energy prices, the current year should see a further improvement in the GCC's overall fiscal situation, facilitated by the continued moderation of inflation pressures.

GCC interest rates, as a function of the USD-pegged currency regimes, will be biased higher in line with any further monetary tightening by the Federal Reserve over the coming months. We expect the terminal fed funds rate to be reached by May or June this year, and for monetary tightening to then be paused.

While higher GCC official interest rates would tend to be a constraint on the access to capital, the outlook for the broader regional government funding environment should be ameliorated by our expectation that the gradient of the Fed's rate curve should flatten in the months ahead. Moreover, as we saw in the 2005/2008 period of economic strength, we know that high interest rates and solid non-oil real GDP growth can co-exist.

In aggregate, the macro outlook for the GCC region in these opening weeks of 2023 is certainly far more optimistic than it is across many Western geographies, especially with the latter now facing the looming spectre of recession – that is if they are not already in recession. In contrast, we forecast modest but sustainable levels of real GDP growth for the GCC member states, with export earnings reinforcing strong current account positions, and continued structural strength derived from the return of sovereign balance sheets to fiscal surplus status.