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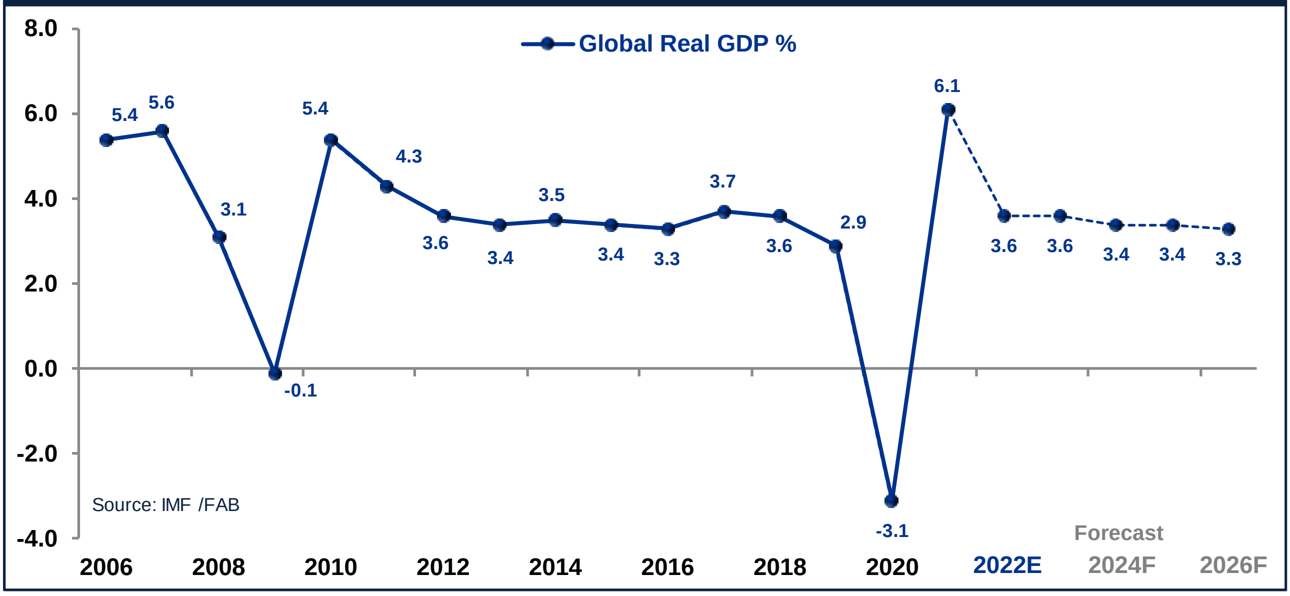
Simon Ballard
Chief Economist

GCC Macro Update (June 2022): A global sweet spot

As the global economy faces up to the challenges of historically high levels of inflation on the one hand and the economic consequences of central banks' monetary tightening response on the other, the GCC region with its solid sovereign credit fundamentals, buoyed by the recent strength in the oil price, continues to offer investors a relative haven. Notwithstanding geopolitical turmoil (across Eastern Europe and Ukraine) and macroeconomic uncertainties elsewhere, we believe that the United Arab Emirates and its immediate neighbours continue to benefit from a relatively favourable economic outlook.

Consolidating global growth picture



Indeed, across the GCC oil producing community, we would suggest that the economic horizon remains reasonably bright, enhanced by the recent shift higher in oil prices and the concurrent recovery in the services sector. Petrochemical revenues remain the arteries of sovereign balance sheet liquidity and health of course, allowing the financing of ongoing economic diversification strategies. But, beyond these short-term drivers of optimism we are also cognisant that the region's underlying credit fundamentals are today being buoyed by regulatory, fiscal and public finance reform.

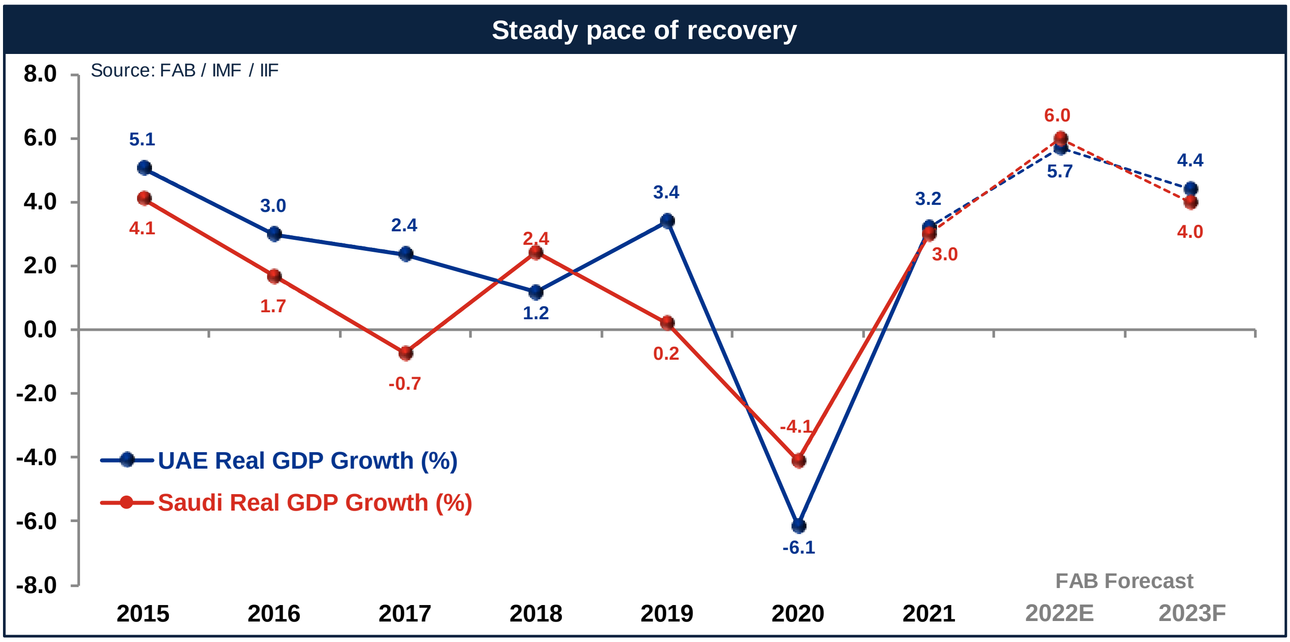
The immediate return for GCC producers from the strong oil price should be robust economic growth and the return of large current account surpluses. According to a recent report by the Institute of International Finance, for the MENA region as a whole, the aggregated current account surplus will surge from $120bn in 2021 to around $400bn this year (2022), with the GCC accounting for 90% of the total.

All of this implies that non-resident capital inflows may be limited as sovereigns show reduced need to issue debt/borrow, although we recognize that the need for corporates to refinance maturing debt and loans will remain significant. At the same time we would expect resident capital outflows to gain momentum. IIF predicts such outflows to total just shy of a record $400bn this year.

United Arab Emirates

Notwithstanding the volatility as well as geopolitical and macroeconomic uncertainties experienced by the country over the past couple of years, we maintain our adherence to a robust macro outlook for the United Arab Emirates economy in 2022 and 2023. Indeed, we believe that the UAE's economic prospects should remain positive for the medium-term, with the macro outlook buoyed by robust oil prices (above $100/bbl) as well as by the recovery in the service sector that has been seen recently. Moreover, the economic outlook should also be underpinned by ongoing public finance reforms, which in turn will reinforce fiscal metrics.

In aggregate, the economic diversification initiative should also see solid support over the coming quarters and this will further strengthen the business environment, albeit with leveraged government-related entities (GRE's) remaining susceptible to the effects of monetary tightening. And of course, the funding of such diversification efforts will remain dependent on Abu Dhabi's petrochemical (oil) revenues for the foreseeable future, as well as the success of the already more diversified economy in Dubai, especially in terms of tourism, real estate and services activity.



In the context of the current global macro uncertainties, we maintain an optimistic – but importantly, realistic – outlook for UAE economic growth this year and in 2023 and beyond. In particular, the macro outlook is buoyed by the recent rebound in the oil price, after the downturn in commodity prices during the pandemic and consequent global recession

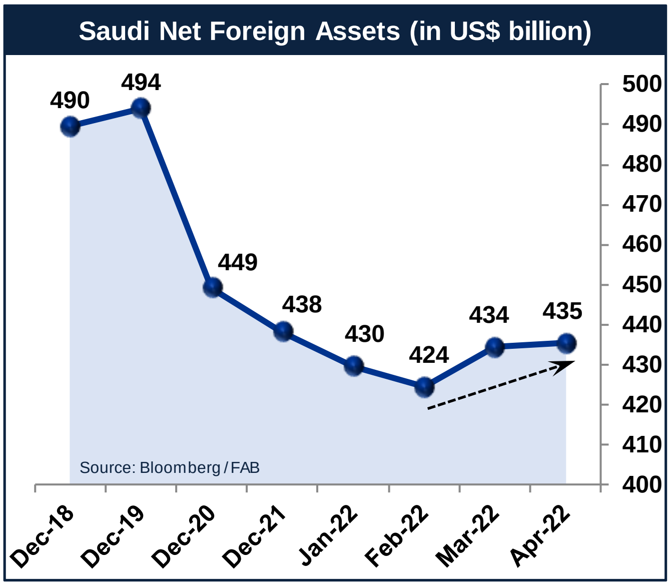
For 2022, we now expect real gross domestic product (GDP) growth to reach 5.7%, up from 3.2% in 2021 and much improved from the -6.1% recession of 2020. This latest upside to the economy, underpinned by rising oil production, a reopening of tourism and a marked recovery in real estate, should then lead to a modest consolidation in growth expectations for 2023, where we forecast real GDP growth of +4.4%.

Moreover, healthier oil revenues will be a clear boon for the sovereign balance sheet and will help to reverse the government deficit of the pandemic era. From deficits of 7.3% and 0.1% in 2020 and 2021 respectively, we expect the UAE government balance sheet to return to surplus this year. In line with our view, IIF latest data forecasts a UAE government overall balance surplus of 8.3% this year and 4.9% surplus in 2023. Furthermore, ongoing fiscal reform should help to reinforce public finances in the coming years as well as reduce the economy's fiscal vulnerability to oil price gyrations. The introduction of corporation tax will boost federal tax coffers in this respect, as will the further monetization of some key public-sector assets.

Inflation and the spectre of central bank tightening remains the major source of global market volatility at present and this will also be a key area of focus for the UAE economy over the coming months. That said, price pressures remain far more muted in the UAE than they are in the U.S. and Europe, but they are rising toward multi-year highs nonetheless. Notwithstanding near-term upside momentum to inflation pressures, with oil in triple-digit territory, we anticipate that UAE inflation, while higher than the fallow period of 2019/2020 and early 2021, will rise but should remain moderate at around 2.75% on average over the coming 12-18 months. The strength of the USD (peg) should act as an anchor on UAE/dirham inflation going forward.

Saudi Arabia

Similar to that of the UAE, we anticipate a robust outlook for the Saudi Arabian economy over the coming years, supported by the current strength in global energy prices as well as steadily rising oil production volumes. Combined, this should help to drive a consistent base in real GDP growth over the next few years. From the recession of 2020 when the KSA economy contracted 4.1%, and the sharp rebound to +3.0% real GDP growth in 2021, we anticipate economic expansion of 6.0% this year, followed by a consolidation to 4.0% growth in 2023.

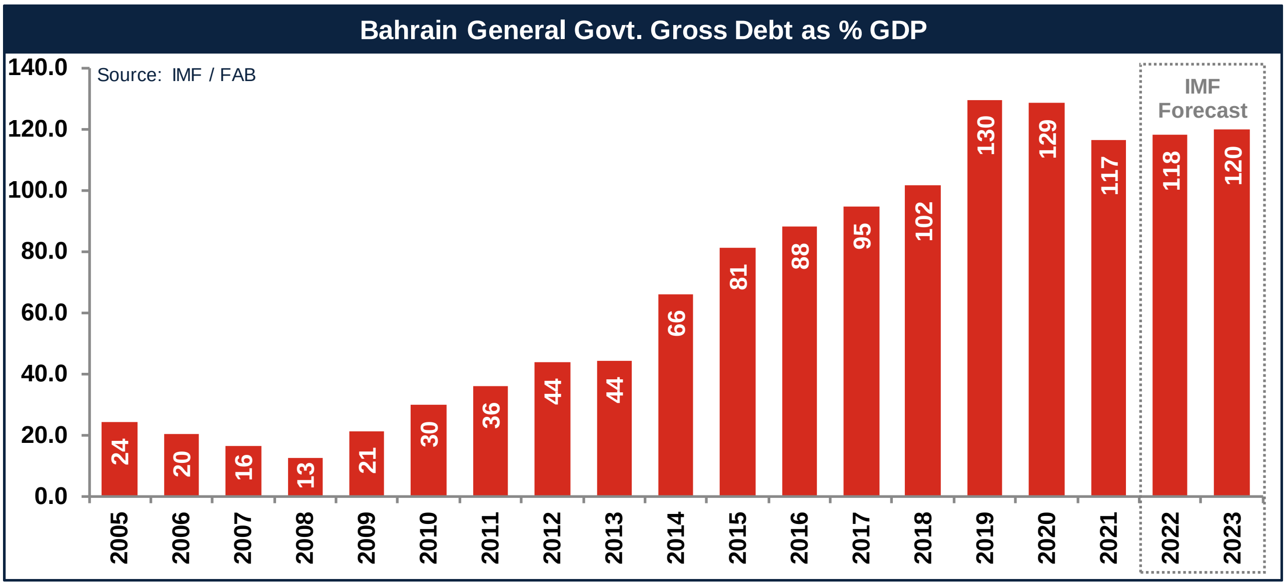


Just as we are seeing in the United Arab Emirates, we also forecast a further sharp improvement in the KSA government balance this year and next year. From a deep (-12.1%) government deficit in 2020 and a smaller deficit of -2.9% in 2021, the more buoyant current picture surrounding oil production and prices should result in a return to large fiscal and current-account surpluses from this year. We forecast a government surplus of some 6.7% this year (2022) and a surplus of 4.6% in 2023 as the oil price environment consolidates and the trajectory of economic growth stabilizes. Such an optimistic macro outlook has recently resulted in rating outlook upgrades (to positive) from both S&P and Fitch Ratings in March and April this year respectively.

The theme for KSA's economic outlook will also remain firmly fixed on diversification in the coming years, albeit on the understanding that such efforts will remain funded by – and therefore reliant on – petrochemical revenues over the next several years at least. Fiscal and regulatory reform will be at the heart of diversification though, including through new, friendlier corporate laws and regulation and a greater focus on privatizations.

Bahrain

A much smaller and more diversified economy than its immediate geographical neighbour, the majority of Bahrain's economic activity (and GDP) stems from the non-oil sector. As such, we note that GDP growth this year and in 2023 will be dependent on infrastructure, gas, logistics and tourism. This being said the weaker sovereign credit rating profile of Bahrain, compared to those of KSA and the UAE, reflects the country's much higher public debt/GDP ratio, which at over 100% of GDP, is the highest of the GCC region. The ratio is perhaps accentuated by the government's strategy of directing its (limited) oil revenues in favour of financing employment for Bahraini nationals, rather than using the funds to reduce government debt levels.



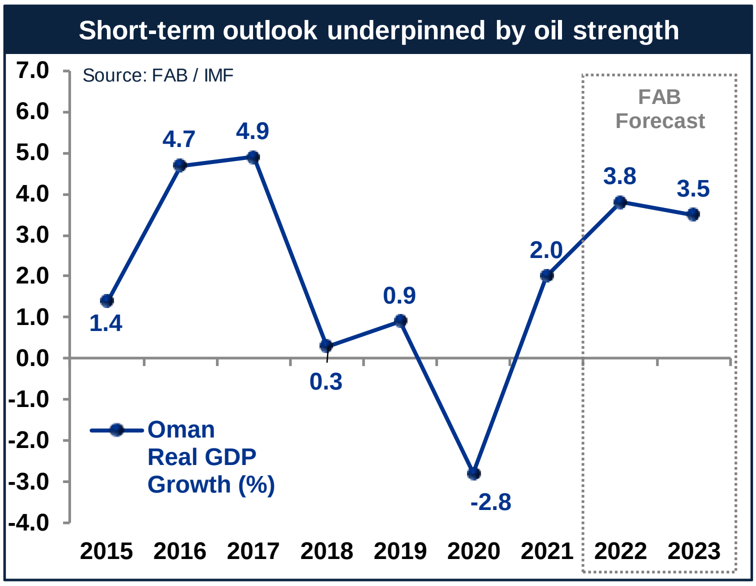
In line with improving global growth metrics, we forecast that Bahrain GDP should register further recovery this year and next after the pandemic-driven recession of 2020. The current strength seen in the oil price should help the government to secure current account and fiscal surpluses while also avoiding the need for austerity measures in order to balance the budget. We forecast real GDP growth of 3.5% this year and 3.0% in 2023.

Oman

Among its GCC peers, Oman still shows the second highest proportion of GDP (>43%) dependent on the hydrocarbon sector in 2022, according to IIF data. Kuwait is just slightly ahead at 50.1% of real GDP accounted for by hydrocarbon activity. It was perhaps as a result of Oman's oil sector weighting, that the economy was still below pre-pandemic levels at the end of 2021, constrained by the recession-driven downturn in the oil price in 2020 and the time taken to gradually recover during the course of 2021.

As such, we believe that the current strength in the oil price is now helping to underpin the outlook for Oman's GDP growth this year and in 2023. It should also bolster the country's external and fiscal balances – with a fiscal surplus expected this year – which S&P cites as a key justification for increasing the sovereign rating to BB- with stable outlook back in April.

Indeed, latest data shows Oman had a budget surplus of OMR468m (c. 3.4% of GDP) in the first four months of 2022, driven largely by the strength in oil and gas prices that in turn buoyed government revenues. At the same time, we also note that at +4.2% YoY, government expenditure growth remained modest, down sharply from the 10.2% YoY rate seen in January and February.



A healthier surplus outlook should help the government to reduce its public debt position. Indeed, OMR9.2bn of loans were repaid in April, including early repayment of a $2.2bn March 2023 loan. Overall, Oman central government public debt is now seen declining to 50.7% of GDP by the end of this year, down from an estimated 68.6% at the end of 2021 (IIF data).

Moreover, we would suggest that Oman's oil revenue growth should pick up pace in the latter half of this year as changes in the oil price tend to be reflected in the fiscal balance sheet with a (3-4 month) lag.

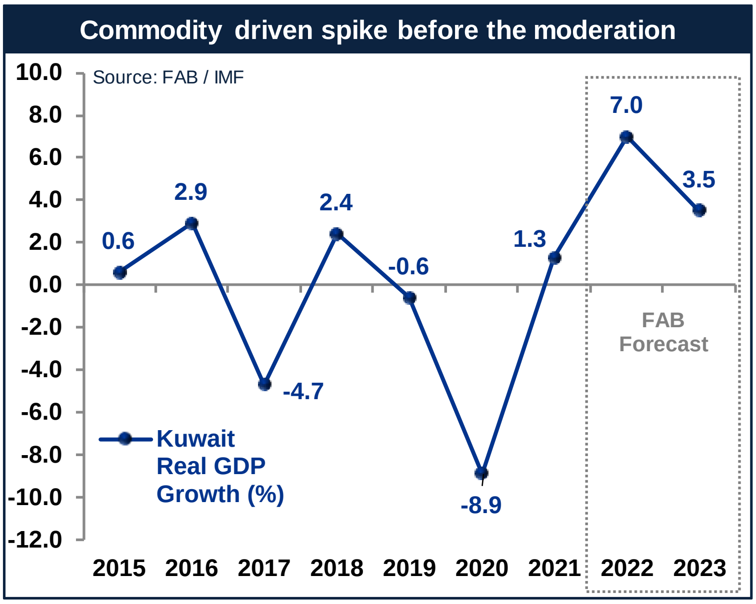
Net, net, improved oil and gas production volumes will be positive for economic growth this year and (to a lesser degree) in 2023. This combined with the global relaxation of Covid-19 restrictions and a recommencement of global travel as well as the benefits of structural reforms and diversification should fuel inward investment to the Omani economy.

Against this though, we are cognisant that global inflation pressures are also being felt in Oman (CPI to reach 4.5% this year) which will likely impact the consumer and dent private spending. On top of this, we also recognize that any subsequent interest rate increases (as the central bank tracks the FOMC and the USD) could damage sentiment toward (capital) investment. We anticipate Oman to register real GDP growth of 3.8% this year and 3.5% growth in 2023.

Kuwait

With some 50.1% of Kuwait's economic growth originating from the hydrocarbon sector – the highest rate in the GCC – the economy stands to benefit neatly from the current strength in the oil price. Moreover, Kuwait's oil and gas sector accounts for about 90% of fiscal revenue according to the Economist Intelligence Unit (EIU).

Looking ahead though, the government does remain firmly focused on diversification through its 'New Kuwait Vision 2035' initiative. The EIU notes that 'Kuwait's five-year development plan for 2020/21-2025/26 includes a focus on the establishment of the Northern Economic Zone, which will encompass, among other things, the mega Silk City project and the US$6.5bn Mubarak Al Kabeer Port, both of which are deemed crucial to the future growth and development of Kuwait'.



On the flip side to this though we also note the constraints on progress with regard to (economic and fiscal) reforms as well as possible labour market and housing sector blockages due to friction between the executive and the legislature.

Near-term though, the current robust nature of commodity (oil & gas) prices should create a fertile macro environment for economic output and growth, all of which will see the added benefit of the gradual unwinding of OPEC-mandated oil-production quotas.

Overall, as we rebound from the 2020 nadir of the pandemic and global recession, and as domestic demand picks up as Covid-19 restrictions are eased, we anticipate a spike in Kuwait's real GDP growth this year to as high as 7.0% this year, before retreating to around 3.5% next year (2023).

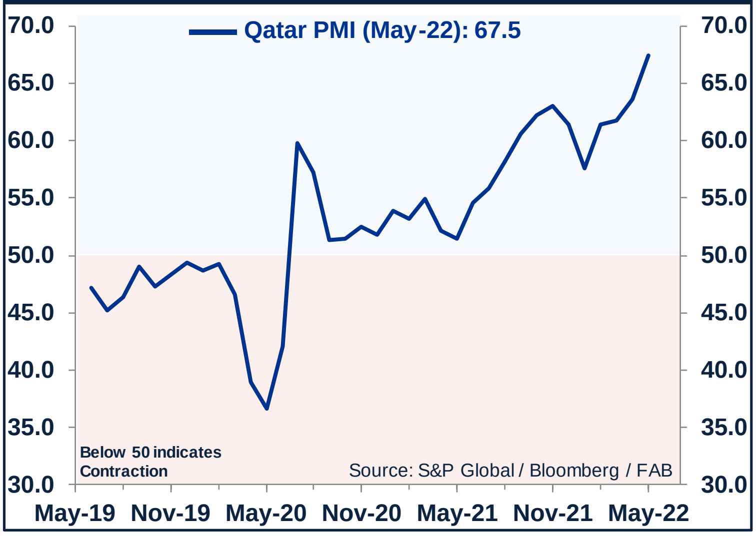
Continued…

Qatar

With Qatar's private sector PMI running solidly in expansionary territory (67.5 in May) the outlook for GDP this year and next looks reasonably robust. We anticipate real GDP growth in Qatar this year of 4.5%, with 3.0% growth to follow in 2023.

The current elevated level of oil and gas prices will buoy the economic outlook over the coming months, while improved levels of private consumption as well as ongoing gas sector investment should also help to bolster the macro environment. The latter half of this year should also see economic activity bolstered by higher tourism revenues coming from the FIFA World Cup.

Robust performance ahead of the FIFA World Cup



We recognize that the Qatari economy boasts one of the highest levels of GDP per head in the world, but it still relies heavily on the export of hydrocarbons. According to IIF, mining (including oil and gas) accounts for just shy of 40% of Qatar's GDP. As such, economic diversification will also remain a key theme for the country going forward. Indeed, as part of the Qatar National Vision 2030 initiative, this will need to be accelerated in the coming months with a focus on economic competitiveness and the need to ensure future fiscal sustainability.

Meanwhile, the economic outlook will also be enhanced by improving regional geopolitics, which we believe should continue to support provincial investment and confidence. In the context of the conflict in Ukraine, Qatar could benefit by leveraging its role as a global liquefied natural gas (LNG) exporter and diverting a more significant percentage of its exports toward Europe to try to, at least partially, offset the latter's supply deficit from Russia. This would surely be gratefully received by Europe and could help to further enhance the country's diplomatic reputation with the region.

Simon Ballard

Chief Economist

Market Insight & Strategy
FAB Global Markets
Tel: +971-2-6110012
Mobile: +971-50-9332806
Email: Simon.Ballard@bankfab.com

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