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Market Insights & Strategy

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Global Macro Growth Update

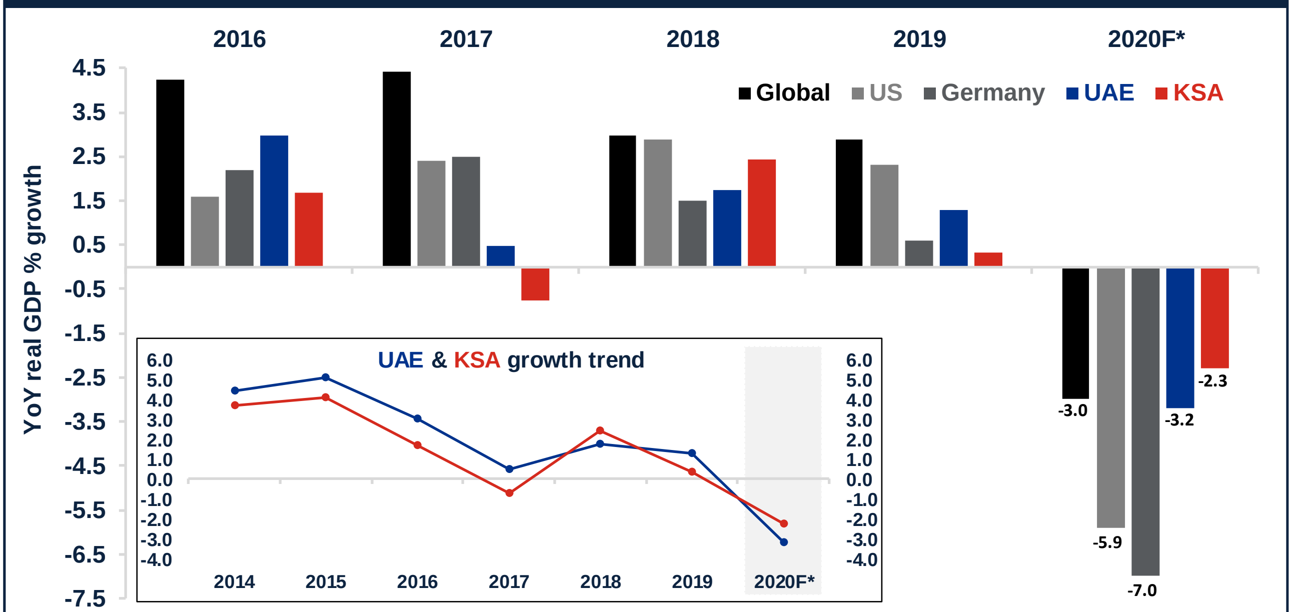
UAE and Saudi Arabia GDP forecasts: Seeing Red

- **UAE and KSA 2020 GDP forecasts cut again as economic restrictions bite**
- **UAE to underperform KSA due to greater non-oil sector weighting**
- **Even as economies now begin to open again, the coronavirus scars will be long-lasting**
- **Light at the end of the tunnel is shining on 2021**

UAE FY2020 GDP cut to -3.2%; KSA FY2020 GDP cut to -2.3%

➢ The downward revisions that we made on April 1 this year to our initial 2020 GDP forecasts for the United Arab Emirates and Kingdom of Saudi Arabia – reducing each to +0.9% and +0.75% respectively – were predicated by our expectation that the Covid-19 outbreak would prove to be transitory and that the sharp, negative non-oil sector economic impact of the pandemic would soon begin to ease.

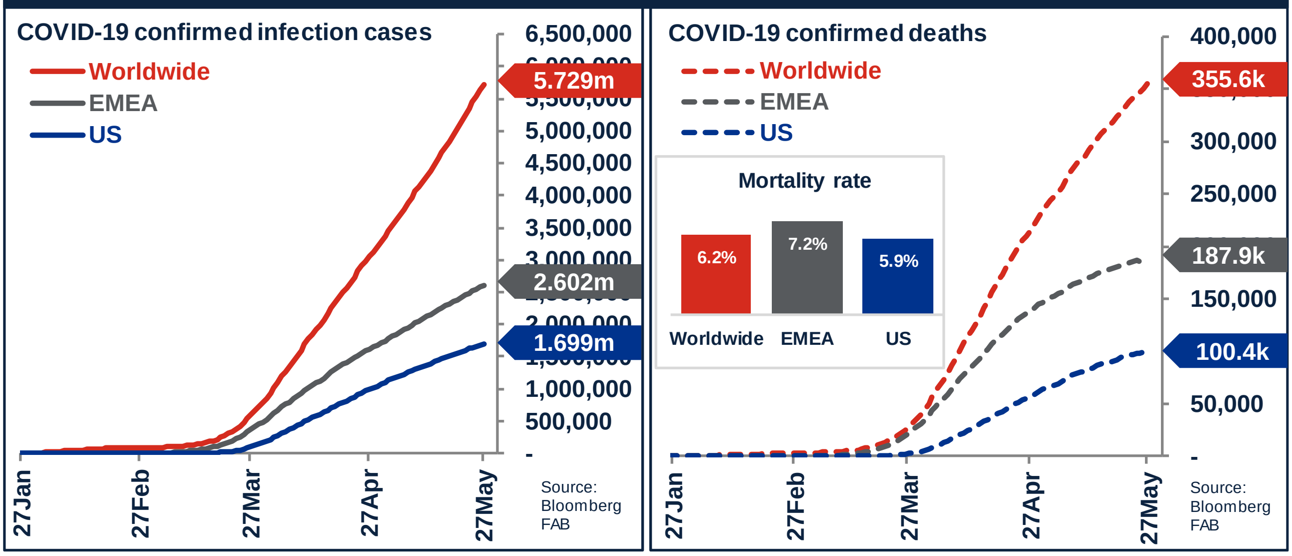
World economic growth: Down but not Out



Note: *2020 forecast for UAE & KSA are FAB forecast and World, US & Germany forecast are from IMF; Source: IMF; FAB; Bloomberg

- While we remain largely constructive in our overarching longer-term macro outlook for the region, we are cognizant that the macroeconomic tsunami created by the pandemic around the globe during 1H this year and the consequent impact of economic restrictions on non-oil sector activity over the past quarter has been far greater than initially assumed. Even as economies now begin to open up again as infection and fatality rates decline, it is increasingly evident that the economic costs of the pathogen will remain with us for many months to come.
- We are braced for some fairly ugly Q2 macro data around the globe and now believe that both the UAE and KSA economies will now contract this year as a result. And given the greater weighting of non-oil sector activity within the UAE economy (we believe 69% versus 31% oil sector) relative to that of KSA (41% oil sector, 59% non-oil sector) we predict that the contraction of the UAE economy this year (-3.2%) will be slightly deeper than that of KSA (-2.3%). Overall though, we clearly need to price in deeper economic contraction than previously assumed.
- Moreover, the severe negative impact being felt by the non-oil sector at the present time is exacerbated by the recent emphasis on this part of the economy as part of the diversification trade. Certainly, across the UAE the near-shuttering of tourism, aviation and hospitality etc. over the past 3 months or so has been acutely painful for all involved.
- Indeed, with many sectors having been paralysed it may be less a question now of how long it will take firms in these sectors to recover, but more a question of how many will survive at all, and at what cost in order to adhere to all the new social distancing and cleansing requirements? Persistent low levels of consumer confidence and heightened reluctance to travel will surely only further complicate, frustrate and delay the recovery story.
- In comparison to our own forecasts, we note that the IMF and IIF anticipate more significant negative growth rates for both countries this year. The IMF forecasts growth of -3.49% and -2.28% for the UAE and KSA respectively this year. The IIF forecasts respective rates of -4.58% and -3.50%.
- Even in the most optimistic scenario where socio-economic restrictions are steadily lifted over the coming months and as medical advances are made toward finding a vaccine for the virus, we believe that the legacy impacts of this coronavirus will leave a scar on the global economy for many months, if not quarters to come. Moreover, we believe that social distancing will remain a factor of the 'new environment' that we find ourselves in and that many people will be hesitant to venture out again, perhaps for several months to come. This in itself will limit the pace of potential economic recovery and dampen GDP growth expectations during 2H 2020.

Don't re-open up too far, too quickly

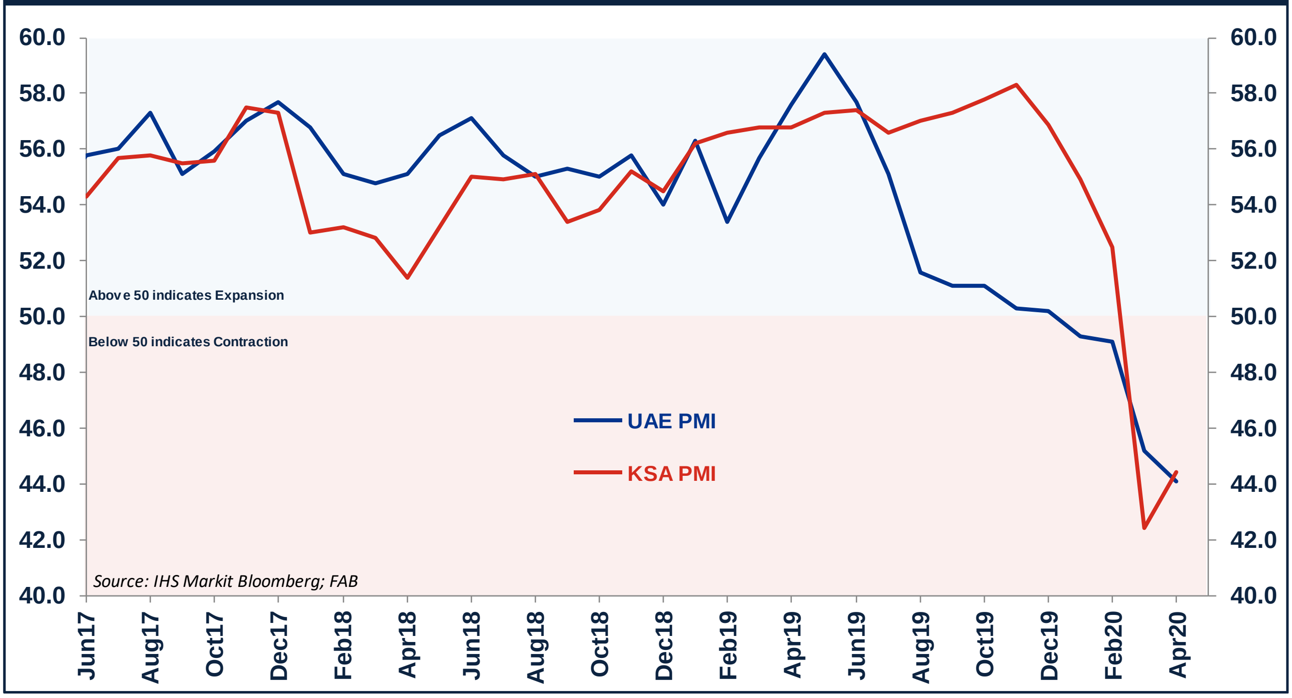


- Beyond this though we remain optimistic that as Covid-19 is contained and infection rates fall, and in the context of loose monetary policy and extensive fiscal accommodation, we will see global economic recovery begin to emerge during 2021. This being the case we now expect UAE and KSA GDP to rebound next year to around +2.5% and +2.2% respectively.

UAE: 2020 GDP forecast reduced to -3.2%

- As outlined above, we now expect that the UAE economy will contract during FY2020 as a whole and have reduced our GDP growth forecast for this country to -3.2% from +0.9% previously. This reduction is based on the effects stemming from the recent shutdown of much of the non-oil sector economy, especially within the hospitality sector with hotels, restaurants, beach clubs, gyms etc. being shuttered.
- Furthermore, on the assumption that oil production is currently being ramped up, driving some positive momentum within oil sector GDP, the implication is that downside pressures coming from the non-oil sector will only be made more acute.
- One should also consider the different population compositions of the UAE and KSA. With a greater dependence on expat workers in the UAE, we are cognisant that job losses and possible consequent expat exodus from the region could be more costly in terms of GDP for the UAE than for KSA.
- This said we do continue to see the economic challenges being partly mitigated by accommodative government and central bank policy, and it is this that underscores our consistent longer-term (2021) optimistic outlook for the economy.
- Moreover, lower oil prices and economic contraction will also weigh on the government's balance sheet. As noted previously, it is now highly unlikely that the government will be in a position to achieve the officially forecast and approved zero-deficit federal budget for 2020. More probable, in our view, is that the UAE will find itself dipping back into budget deficit territory this year, possibly to the extent of around 7%. Balanced budget hopes will have be put on hold for now.
- However, we also believe that increased oil production in the context of low, but stable oil prices, together with the ongoing commitment from the UAE government and central bank toward infrastructure spending and fiscal stimulus will help to cushion growth metrics over the coming quarters. All of this should be viewed in the context of our forecast 'shallow-U' shaped recovery, commencing during H2 and into 2021.

Non-oil sector taking a hit

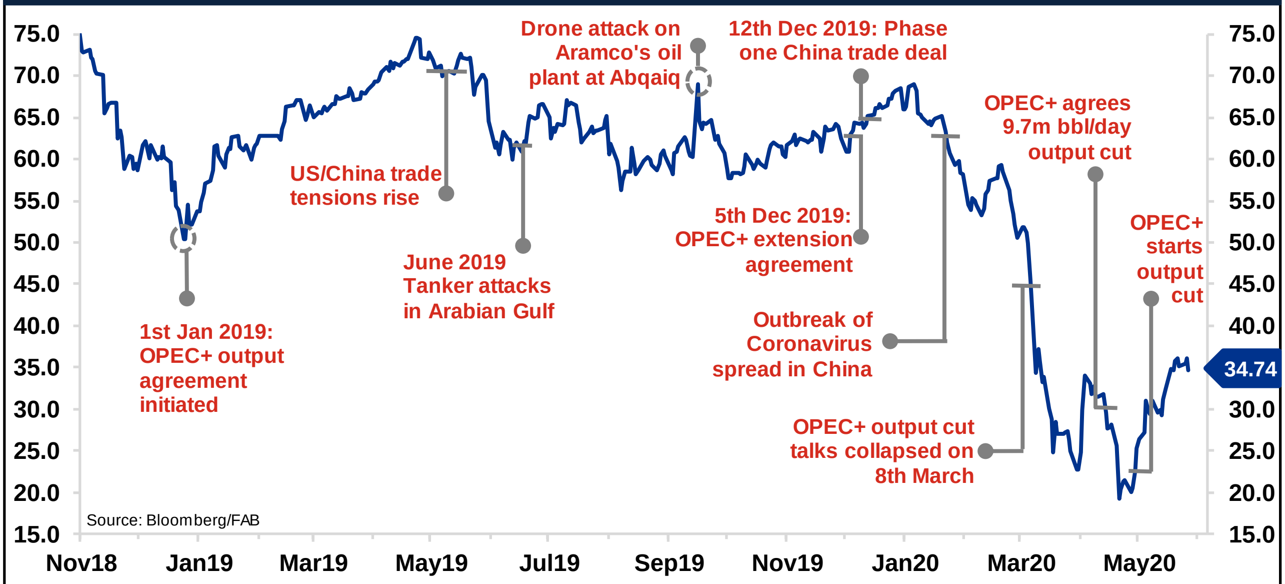


- On the flip side of course, we are cognizant that if we are wrong and if the current outbreak proves to be prolonged and sustained – if there were to be a second wave of the pandemic – then it could create a much longer-lasting disruption to the global supply chain, trade and manufacturing through the end of this year. So, let's be realistic; even our 2H2020 recovery/stabilization prognosis will not be enough to offset the probable depression-like conditions in Q2 or for the global economy to avoid a recession for this year as a whole.

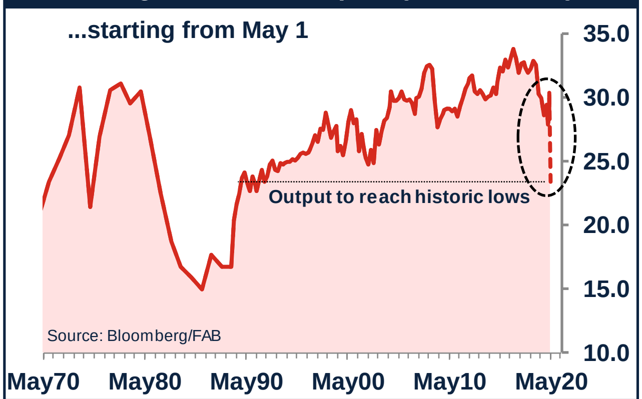
Saudi Arabia: 2020 GDP forecast reduced to -2.3%

- We have revised our previous forecast for economic growth in Saudi Arabia to -2.3% for this year as the global macroeconomic costs of Covid-19 persist longer than we had initially hoped and anticipated. Overall, this reduction is designed to reflect the near-term global contractionary economic impact of the COVID-19 pandemic, alongside the balance of lower oil prices and Riyadh's commitment to increasing oil production volumes. With a larger weighting for the oil sector within the Saudi economy relative to that of the UAE, we expect KSA economic growth to modestly outperform its neighbour this year; economic growth in KSA will be less negatively impacted by socio-economic restrictions and the flooring of the non-oil sector.
- Moreover, beyond the short-term economic hiatus though, stabilization in the economic outlook should then help GDP in the Kingdom to post a modest recovery in 2021 and 2022. We anticipate Saudi GDP picking up to +2.2% next year and then to a conservative +2.5% in 2022.
- With KSA having stated that it will carefully manage oil production volumes in order to offset the recent weakness in prices and to maximize petrochemical revenues, this should offer some reprieve to the GDP outlook. Again, we see KSA as benefitting from its smaller non-oil sector contribution to GDP, compared to the UAE.
- However, similar to the UAE, we believe that recent market turbulence will weaken Saudi's near-term current account position, which we expect to have slipped deeper into deficit during Q2. At the same time, non-resident capital flows will likely also have been under pressure. Latest figures suggest to us that KSA could post a budget deficit of around 10% of GDP in 2020, down from the government's earlier projections of a deficit of -6.4% of GDP (and versus -4.6% in 2019).

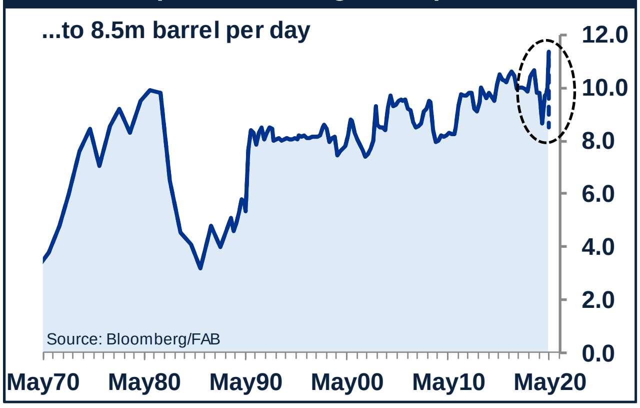
Brent Crude - Historical price movement (US$/barrel)



OPEC agreed to cut output by ~7m bbl/day...



Saudi expected to bring down production...



Across the broader GCC/MENA region

- More broadly, we would suggest that a similar pattern of challenges to growth and fiscal budgets are being seen across the wider GCC and MENA region. The GCC (oil producing) economies should, however, neatly outperform the broader MENA region as the latter experiences more recessionary conditions in the coming months.
- As noted previously, the problem for a number of MENA countries is that they have limited fiscal headroom with which to provide stimulus in order to combat the deteriorating macro environment. They may therefore be unable to offer any meaningful stimulus packages in order to support their key sectors against the persistent threat of contracting global trade, disrupted supply chains and displaced consumers.

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