GCC: Grappling with its worst economic crisis

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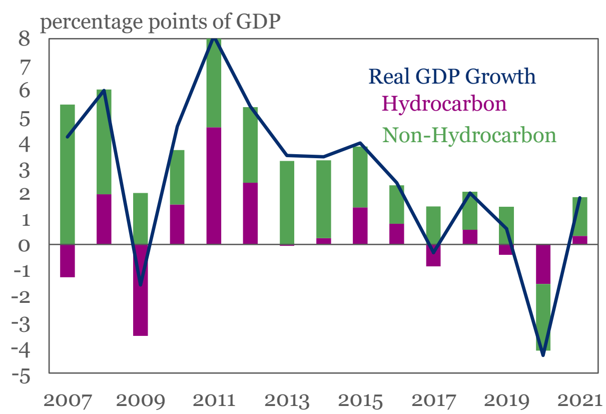
- We deepened the recessions in the six GCC countries, and now expect output to contract by 4.4% in 2020.
- The aggregated current account balance will shift from a surplus of $88 billion in 2019 to a deficit of $33 billion in 2020.
- Financing of the projected fiscal deficit of 10.3% of GDP will remain readily feasible given the GCC's considerable reserves.
- The plunge in oil prices provided a catalyst for reforms, including the resumption of sizable fiscal consolidation.
- Most GCC banks are well positioned to absorb the twin shocks.

Shocked by COVID-19 and the plunge in oil prices, the six GCC states will experience their worst recession in history. Restrictive containment measures and fear of contagion has weakened consumer confidence and demand. The headline PMIs in Saudi Arabia, the UAE, and Qatar declined to less than 45 in April, the lowest reading since the surveys began in 2009. The depth of the contraction for this year and the speed of the expected recovery in 2021 is subject to a high degree of uncertainty. There are some indications that the virus outbreak in the region has successfully been contained, and recent weeks have seen some easing of restrictions.

We expect overall real GDP to contract by 4.4% in 2020. Oil GDP is projected to contract by 5.3% due to the OPEC+ production-cut agreement. The non-oil GDP could contract by 3.8% due to virus-containment measures, the plunge in oil prices, and lower public spending (Exhibit 1). The service sector activity will be hit the hardest due to containment efforts and social distancing. Private and public investments have also been delayed. Growth could resume in 2021 supported by the partial easing in oil production cuts and gradual pick-up in private sector non-oil activity.

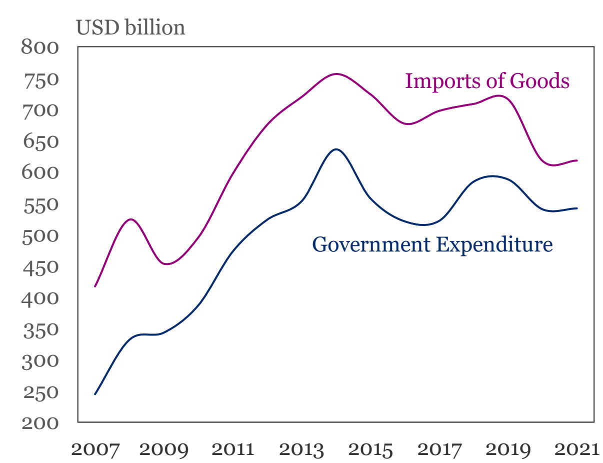
GCC authorities have resumed fiscal adjustments despite the recession. Public investment will likely shoulder the brunt of the cuts, as was the case in 2015 and 2016, and some low-priority projects have already been cancelled. In Oman, salaries of government employees have been reduced, while Bahrain cut operating expenses by 30% and may approve a regulation that allows unpaid leave to public employees. In addition, Saudi Arabia will suspend cost-of-living allowances for public employees, effective June 2020, and will triple its VAT rate to 15%. The UAE kept its VAT rate unchanged at 5%, while Kuwait and Qatar will not introduce VAT before 2021. In Kuwait, we expect the government and parliament to agree on a supplementary budget with lower spending for FY20/21 and pass a new debt law allowing the government to borrow. The significant cut in public spending in the six

Exhibit 1: We expect real GDP to contract by 4.4% in 2020.



Source: IIF

Exhibit 2: Consolidated GCC imports and public spending are set to decline by 15% and 9%, respectively.



Source: IIF

GCC states could more than offset losses stemming from reduced oil exports, and the new VAT receipts could mitigate lower non-oil revenue related to the effects of COVID-19. Accordingly, our revised calculations show lower fiscal breakeven Brent oil prices for Saudi Arabia ($75/b), Bahrain ($77/b), Oman ($80/b), and Qatar ($54/b) in 2020.

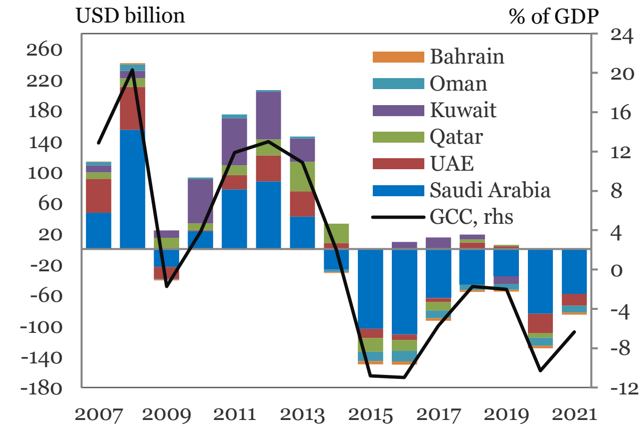
Nonetheless, *we expect the aggregated fiscal deficit to widen from 2.5% in 2019 to 10.3% of GDP in 2020*, equivalent to $144 billion (Exhibit 3), assuming an average Brent oil price of $40 per barrel. We project a decline in hydrocarbon revenue from $326 billion in 2019 to $200 billion in 2020. Saudi Arabia, Kuwait, Qatar, and the UAE, with large public foreign assets, are better placed to accommodate large deficits than Bahrain and Oman. While Bahrain can count on financial aid from its neighbors as a cushion against external pressure, Oman is emerging as an increasingly vulnerable spot in the region in light of its mounting debt (Exhibit 4).

Lower hydrocarbon exports will also weigh on the current account, which we expect to shift from a surplus of $88 billion in 2019 to a deficit of $33 billion in 2020 despite the projected 15% fall in imports. Capital outflows will continue to exceed nonresident capital inflows. As a result, consolidated GCC official reserves will fall by $133 billion in 2020 (Exhibits 5 and 6). Saudi Arabia's reserves, while declining by $52 billion, will remain sizeable at $448 billion by end-2020, equivalent to 29 months of imports of goods and services.

We expect gross public foreign assets of the GCC to remain substantial at around $2.6 trillion, about 70% of which is managed by SWFs with diversified portfolios of public equities, fixed income securities, and shares in global companies (Exhibit 7). While the SWF of Kuwait is bringing back some of its assets held abroad to partly finance the country's fiscal deficit, the SWFs of Saudi Arabia and the UAE continue broadening their global portfolio by buying assets whose valuations have been hit hard by the COVID-19 shock. Official reserves, meanwhile, are invested in liquid assets. The GCC sovereign wealth funds continue to buy assets in the US, Europe, and China, with focus on investing in healthcare, technology, and logistics.

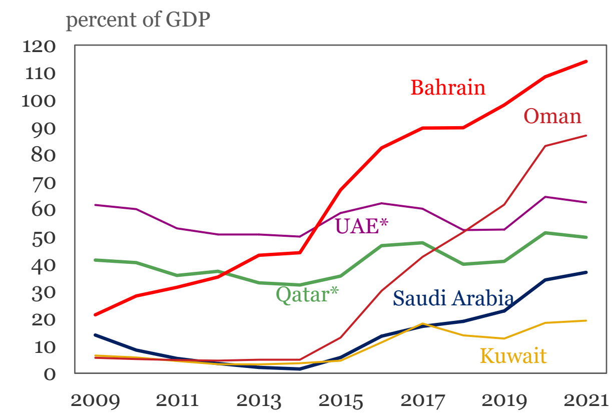
Monetary easing could limit the economic fallout from the COVID-19 shock. Key policy rates have been reduced by 125 bps across most of the region (Exhibit 8). The authorities have also introduced liquidity support measures amounting to 4% of GDP (about $54 billion) to help alleviate stress in the financial system and support the private sector, particularly SMEs which may be less equipped to tackle large temporary shocks. The central banks have set up mechanisms to encourage commercial banks to postpone private sector loan repayments for six months.

Exhibit 3: The consolidated fiscal deficit will widen from 2.5% of GDP in 2019 to 10.3% of GDP in 2020.



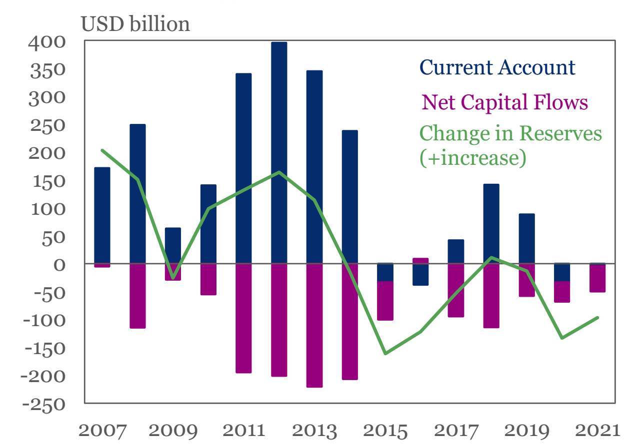
Source: National authorities and IIF

Exhibit 4: Public debt will rise sharply in Bahrain, Oman and Saudi Arabia in 2020.



Source: National authorities and IIF
**Also include government-related-entities in the UAE and Qatar.*

Exhibit 5: GCC current account deficit and net capital outflows will lead to $133 billion decline in official reserves.



Source: IIF

The banking systems remain sound, with strong capitalization, adequate liquidity, and relatively low NPLs (Exhibit 9). Nonetheless, prolonged low oil prices could lead to deterioration in the asset quality of banks in the region, and financial sector stress may increase in few banks in the region. In general, GCC banks have enhanced their risk management and implemented countercyclical capital buffers and loan loss provisions in the past decade to limit systematic financial sector risk.

Exhibit 9: Banking Soundness Indicators, *percent, 2019*

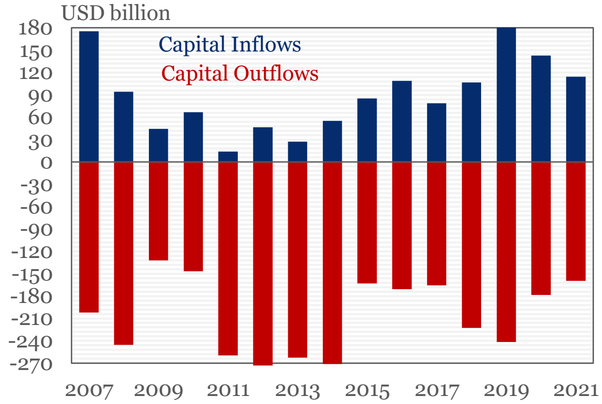
	Capital Adequacy (Tier 1)	NPLs to Total Loans	Loans to Deposits	Return on Assets
Bahrain*	18.7	4.9	68	1.8
Kuwait	17.6	1.8	109	1.3
Oman	18.1	3.2	109	1,5
Qatar	17.5	1.8	126	1.6
Saudi Arabia	18.1	1.9	114	1.8
UAE	16.6	6.2	98	1.6

*Source: National authorities. * For Bahrain only conventional banks.*

We do not expect a change in the exchange rate regimes in the short term. Indeed, the plunge in oil prices has led to no significant pressure on the peg to the dollar, reflecting investor confidence underpinned by large GCC public foreign currency assets. The 12-month forward exchange rates also show no imminent pressure on the peg to the dollar. While investors have recently priced in a 4% loss in the Omani rial over the next 12-months, they expect the Saudi riyal, the UAE dirham, and Qatari riyal to fall by less than 0.5%. Furthermore, the GCC central banks have again confirmed their commitments to strongly defend the pegs. Continued fiscal adjustment will be instrumental in supporting the pegs.

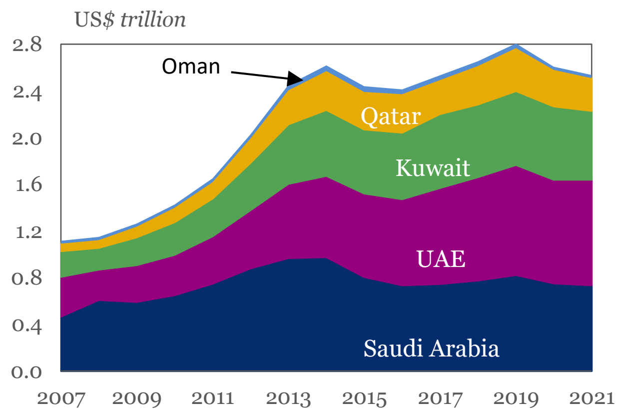
Brent oil prices are expected to remain in a range of $40-50 a barrel over the medium term, well below the fiscal breakeven oil prices for the six GCC states. Under such prolonged oil prices, the deficits could remain large despite continued fiscal adjustment. While financing of deficits will remain readily feasible given the region's substantial public foreign assets, pressures on liquidity and the exchange rate may increase.

Exhibit 6: Capital outflows continue to exceed inflows.



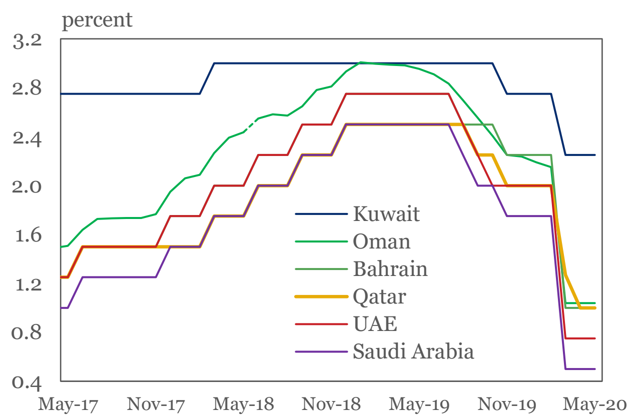
Source: IIF

Exhibit 7: The SWFs of GCC countries will remain substantial, with assets equivalent to 146% of GDP in 2020.



Source: IIF

Exhibit 8: Key policy rates have declined by 100 to 125 basis points in March and April 2020.



Source: IIF projections.

Key Economic Indicators

Exhibit 10: Saudi Arabia

	2017	2018	2019	2020	2021
Nominal GDP, $ billion	689	787	793	648	687
Real GDP, % change	-0.7	2.4	0.3	-4.0	1.6
Hydrocarbon GDP	-3.1	3.1	-3.6	-5.8	1.0
Non-hydrocarbon GDP	1.2	2.2	3.3	-2.7	1.9
CPI Inflation Rate, Avg., %	-0.8	2.5	-2.1	1.5	2.0
Fiscal Balance, % GDP	-9.2	-5.9	-4.5	-13.0	-8.5
Current Account, % GDP	1.5	9.0	6.3	-1.2	-0.4
Public Foreign Assets, $ bn*	747	777	822	751	740
Public Debt, % GDP	17.2	19.0	22.8	34.1	36.9
Oil Production, mbd	9.96	10.33	9.81	9.22	9.31
Brent oil price, avg	54.8	71.5	64.2	40.0	45.0

Source: National authorities, IIF forecast for 2020.

Exhibit 11: United Arab Emirates

	2017	2018	2019	2020	2021
Nominal GDP, $ billion	378	418	409	349	370
Real GDP, % change	0.5	1.7	1.7	-4.8	2.7
Hydrocarbon GDP	-2.8	2.8	3.9	-4.9	2.8
Non-hydrocarbon GDP	1.9	1.3	0.7	-4.7	2.6
CPI Inflation Rate, Avg., %	2.0	3.1	-1.9	-1.6	1.3
Fiscal Balance, % GDP	-1.4	2.0	0.9	-7.3	-4.2
Current Account, % GDP	7.3	9.7	7.6	0.9	2.6
Public Foreign Assets, $bn*	821	883	943	871	904
Public Debt, % GDP**	60.2	52.4	52.4	64.6	62.3
Oil production, mbd	2.93	3.00	3.17	2.96	3.01

Source: National authorities, IIF forecast for 2020.

Exhibit 12: Qatar

	2017	2018	2019	2020	2021
Nominal GDP, $ billion	167	191	183	150	155
Real GDP, % change	1.6	1.5	-0.3	-4.3	0.2
Hydrocarbon GDP	-0.7	-1.1	-1.0	-2.9	0.7
Non-hydrocarbon GDP	3.8	3.2	1.1	-5.5	-0.2
CPI Inflation Rate, Avg., %	0.4	0.3	-0.7	-1.6	0.8
Fiscal Balance, % GDP	-6.6	2.2	0.9	-3.8	0.0
Current Account, % GDP	3.8	8.7	2.3	-4.7	-4.0
Public Foreign Assets, $ bln *	292	329	368	311	274
Public Debt, % GDP**	47.7	39.9	40.9	51.4	49.7
Oil & gas production, mbdoe	3.67	3.63	3.59	3.49	3.51

Source: National authorities, IIF forecast for 2020.

Exhibit 13: Kuwait

	2017	2018	2019	2020	2021
Nominal GDP, $ billion	121	141	131	107	115
Real GDP, % change	-4.7	1.2	0.4	-5.1	2.6
Hydrocarbon GDP	-9.0	0.2	-2.2	-7.0	2.3
Non-hydrocarbon GDP	2.6	2.3	2.9	-3.3	3.0
CPI Inflation Rate, Avg., %	1.6	0.6	1.1	1.6	1.7
Fiscal Balance, % GDP	7.8	10.6	4.8	-9.8	-5.3
Current Account, % GDP	7.8	14.4	7.1	-8.5	4.5
Public Foreign Assets, $ bln	636	626	639	577	592
Public Debt, % GDP	18.2	13.9	12.7	18.5	19.2
Oil production, mbd	2.70	2.75	2.68	2.47	2.53

Source: National authorities, IIF forecast for 2020.

Exhibit 14: Oman

	2017	2018	2019	2020	2021
Nominal GDP, $ billion	71	79	74	65	70
Real GDP, % change	0.3	1.8	0.6	-5.3	2.4
Hydrocarbon GDP	-3.0	2.8	0.2	-4.4	3.3
Non-hydrocarbon GDP	2.8	1.1	0.8	-6.0	1.8
CPI Inflation Rate, Avg., %	1.6	0.9	0.1	0.5	1.0
Fiscal Balance, % GDP	-13.9	-8.7	-9.4	-16.1	-12.5
Current Account, % GDP	-15.2	-5.5	-7.3	-15.1	-12.1
Public Foreign Assets, $ bln*	33.5	34.2	32.4	25.8	21.1
Public Debt, % GDP	46.4	53.4	63.5	85.3	88.9
Oil & gas production, mbdoe	1.53	1.60	1.60	1.53	1.58

Source: National authorities, IIF forecast for 2020.

Exhibit 15: Bahrain

	2017	2018	2019	2020	2021
Nominal GDP, $ billion	35.4	37.7	37.8	35.2	36.6
Real GDP, % change	3.8	1.7	1.5	-3.9	0.7
Hydrocarbon GDP	-0.7	-1.3	1.0	-1.3	0.7
Non-hydrocarbon GDP	4.9	2.3	1.6	-4.4	0.7
CPI Inflation Rate, Avg., %	1.4	2.1	1.0	2.5	2.5
Fiscal Balance, % GDP**	-10.0	-6.3	-6.6	-9.2	-7.5
Current Account, % GDP	-4.1	-6.5	-1.9	-7.6	-4.1
Official reserves, $ bln	2.3	1.9	3.5	2.9	2.8
Public Debt, % GDP	89.7	89.8	97.9	111.9	114.1
Oil & gas production, mbdoe	0.43	0.42	0.43	0.43	0.43

Source: National authorities, IIF forecast for 2020.

**Official reserves plus SWFs.*

***Including extrabudgetary operations or debt of government-related-entities.*

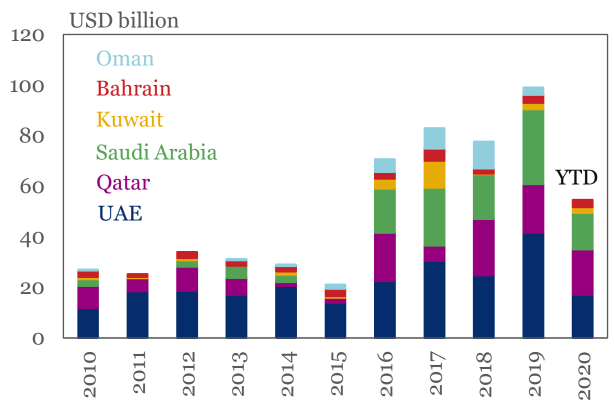
Exhibit 16: AGGREGATED GCC - MAIN ECONOMIC AND FINANCIAL INDICATORS

	2014	2015	2016	2017	2018	2019	2020	2021
OUTPUT AND PRICES								
Nominal GDP, USD billion)	1,642	1,388	1,361	1,460	1,654	1,628	1,354	1,433
Crude oil production, mbd	17.3	17.9	18.4	17.4	17.9	17.4	16.4	16.6
Natural gas production, mbdoe	6.5	6.7	6.9	7.0	7.1	7.1	6.9	7.0
Real GDP % change	3.4	3.9	2.4	-0.3	2.0	0.6	-4.4	1.8
Hydrocarbon	0.5	3.3	2.8	-3.4	2.1	-1.3	-5.3	1.6
Non-hydrocarbon	5.7	4.2	2.1	2.0	2.0	2.2	-3.8	1.9
Domestic demand % change	7.8	2.0	-2.0	1.2	0.2	2.4	-5.5	2.4
Private consumption % change	4.9	2.1	1.0	2.1	2.9	0.9	-3.7	5.4
Public consumption % change	7.1	-1.7	-10.3	6.6	1.8	0.0	-3.9	2.9
Gross fixed capital % change	8.2	4.1	0.1	-1.5	-0.7	3.5	-7.2	0.0
Exports of goods and services % change	0.1	1.2	4.0	-1.0	3.6	-1.6	-5.4	-0.8
Imports of goods and services % change	6.5	-1.4	-8.7	2.2	0.7	2.1	-7.3	0.1
CPI % change average	2.4	2.2	2.0	0.4	2.1	-1.5	0.4	1.6
MENA EXTERNAL SECTOR, USD billion, unless otherwise indicated								
Trade Balance	494.9	207.5	161.2	236.3	363.3	293.0	147.0	171.5
Merchandise exports	993.7	687.9	622.7	706.5	831.7	770.9	550.3	582.7
Merchandise imports	-498.8	-480.5	-461.5	-470.2	-468.4	-477.9	-403.3	-411.2
Balance of Services, Income & Transfers	-257.2	-240.7	-199.1	-194.7	-222.2	-204.6	-180.4	-175.6
Current Account Balance	237.7	-33.2	-37.8	41.6	141.2	88.4	-33.4	-4.1
% GDP	14.5	-2.4	-2.8	2.9	8.5	5.4	-2.5	-0.3
Net capital flows	-206.5	-67.0	8.5	-94.6	-114.2	-58.0	-34.9	-44.7
Nonresident capital flows	55.2	85.0	108.8	78.9	106.8	182.1	142.8	123.7
o/w Foreign direct investment	23.6	16.2	20.8	17.4	20.6	20.5	16.0	23.9
Portfolio investment	10.8	9.6	60.0	61.3	45.6	82.4	56.7	53.8
Other investment	20.7	59.2	28.1	0.2	40.6	79.2	70.2	46.0
Resident capital flows	-261.7	-152.0	-100.3	-173.5	-221.0	-240.2	-177.7	-168.4
o/w Foreign direct investment	-19.3	-37.2	-34.6	-34.8	-46.6	-32.3	-27.9	-27.9
Portfolio investment	-129.9	-66.6	-37.2	-27.9	-43.8	-57.2	-50.0	-43.0
Other investment	-112.5	-48.2	-28.5	-110.8	-130.6	-150.7	-99.8	-97.6
Official Reserves excluding gold	1,248	1,087	965	912	923	910	777	680
change in official reserves	-15	-161	-122	-53	11	-13	-133	-97
Other public foreign assets	1,717	1,649	1,712	1,879	1,975	2,105	1,982	1,958
Total External Debt	495	557	665	757	838	926	971	1,034
% GDP	30.1	40.1	48.9	51.9	50.7	56.9	71.7	72.2
FISCAL SECTOR AND GOV'T DEBT								
Total revenue % GDP	40.7	29.4	27.3	30.0	33.6	34.1	29.6	31.4
Total expenditure % GDP	38.7	40.2	38.3	35.7	35.3	36.1	39.9	37.8
Of which: Hydrocarbon revenue, % GDP	31.1	19.0	15.2	17.1	21.0	20.0	14.8	15.1
Overall balance % GDP	2.0	-10.8	-11.0	-5.7	-1.7	-2.0	-10.3	-6.4
Government debt % GDP	18.5	24.5	32.3	34.9	32.6	35.0	46.9	47.9
BROAD MONEY AND CREDIT								
M2 % change	9.7	3.6	1.0	4.1	2.5	4.7	1.3	3.6
Private sector credit, % change	11.8	10.2	4.1	1.1	4.7	6.3	-1.0	5.4

Source: Authorities through 2019; IIF forecasts for 2020.

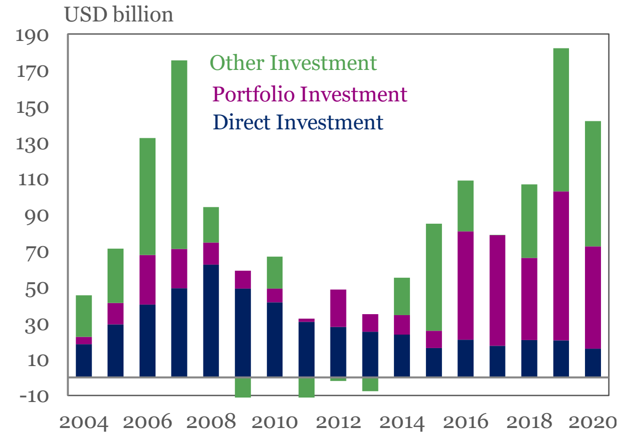
Fixed Income

Exhibit 17: We expect bond issuance in 2020 to remain high on the back of large fiscal financing need.



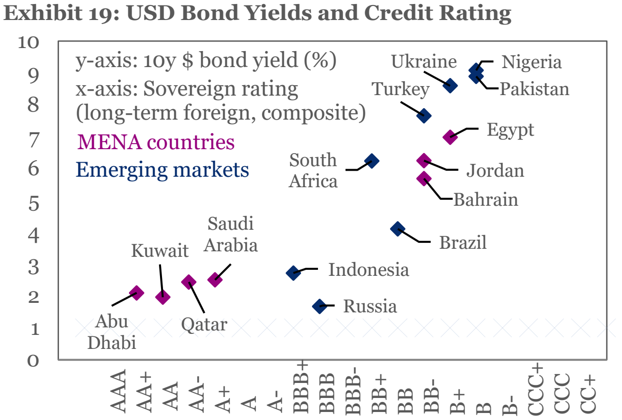
Source: Bloomberg and IIF

Exhibit 18: Non-resident capital flows to GCC will remain high despite the global backdrop.



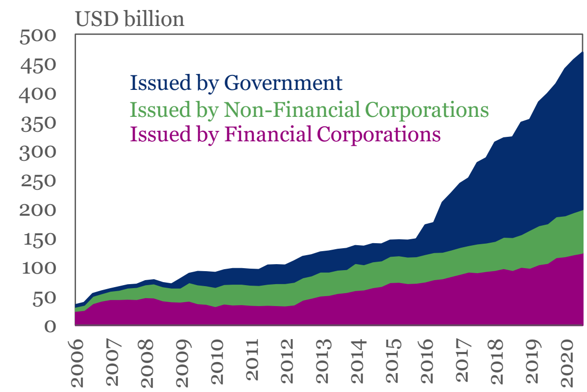
Source: IIF

Exhibit 19: USD Bond Yields and Credit Rating



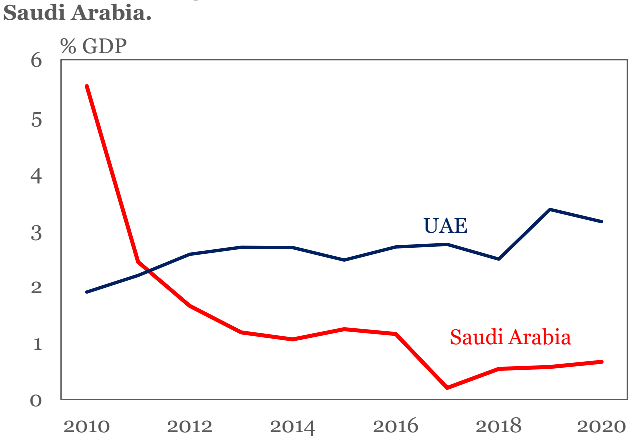
Source: Bloomberg and IIF

Exhibit 20: GCC Outstandind Debt Securities



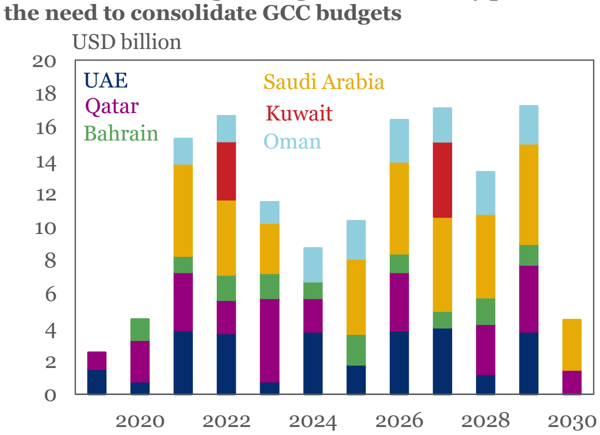
Source: BIS and IIF

Exhibit 21: Foreign direct investment remains subdued in Saudi Arabia.



Source: Bloomberg, national authorities, and IIF

Exhibit 22: Sovereign foreign bond maturity profile raises the need to consolidate GCC budgets



Source: Bloomberg, national authorities, and IIF