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GCC: A real winner of the global economic headwinds?

EXECUTIVE SUMMARY

After a slowdown in 2023 mainly due to lower energy production and prices, 2024 is expected to be a year of higher economic growth for the Gulf Cooperation Council (GCC) countries as, after several months of pessimism about global oil demand, prices have been on the rise since summer. With tensions on the oil market likely to persist next year, Brent crude oil is expected to average USD 90 per barrel in 2024, after USD 85 per barrel this year.

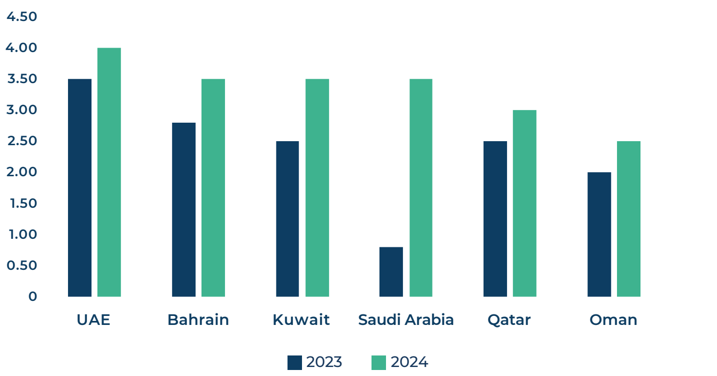
However, the slight increase in oil prices will not benefit all of these countries equally. Bahrain and Oman will remain the two weakest links in terms of public accounts due to their high level of public debt, structural fiscal weaknesses and more limited natural resources compared with other countries in the region. Nevertheless, Saudi Arabia and the UAE, much less vulnerable, will in any case continue to help in case of emergencies when funding is in short supply. In Kuwait, the failure to pass a new debt law since the previous one expired in 2017 will continue to weigh on the government's ability to tap into international capital markets to meet its financing needs. On the other hand, Qatar will benefit from greater room for manoeuvre and adjust the introduction of fiscal reforms at its own pace.

Although they still heavily depend on the oil sector, GCC countries implemented economic diversification plans following the drop in oil prices between 2014 and 2016. While the UAE have been at the forefront of economic diversification, Saudi Arabia has announced substantial investments in recent years. As these two countries, but also Qatar and Oman, are targeting almost the same sectors (construction, tourism, finance), the key risk resides in the creation of intra-competition within the region. Additionally, the main financing sources for these diversification strategies are based on oil revenues. Considering these two factors, economic diversification strategies, while feasible, may not yield the desired results.

The favourable economic environment should not conceal the structural vulnerabilities of some economies

After several months of pessimism about global oil demand, prices started to rise towards the end of June, and then again at the beginning of September following the announcement by Russia and, above all, Saudi Arabia, of the extension of their production cuts until the end of the year. Tensions on the oil market are likely to persist next year, with the OPEC+ coalition looking both determined and capable of keeping prices relatively (but not too) high. Brent crude oil is expected to average USD 90 per barrel in 2024, after USD 85 per barrel this year. Consequently, after a slowdown in growth in 2023, mainly due to lower energy production and prices, we expect all Gulf Cooperation Council (GCC) countries (Qatar, Saudi Arabia, United Arab Emirates, Kuwait, Oman, and Bahrain) to record higher growth rates in 2024 **(Chart 1)**, as oil remains the key pillar for all of them.

Chart 1 - Coface GDP growth forecasts (%)



Source: Coface

The GCC countries, except Bahrain, benefit from relatively low fiscal breakeven oil prices to balance their fiscal position **(Chart 2)**. Their external breakeven oil prices stand between USD 40 and USD 65 **(Chart 3)**, which is also quite low compared with the current level of oil prices (around USD 90 per barrel).

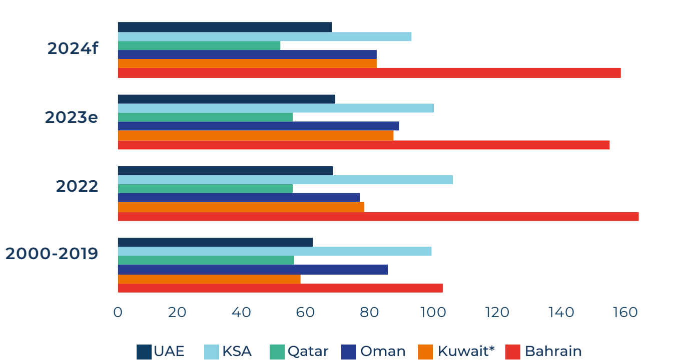
Bahrain and Oman, the weakest links in terms of public accounts

The slight increase in oil prices expected in 2024 will positively impact the fiscal balances of all GCC countries, but Oman, Kuwait and Bahrain, where the share of hydrocarbon revenues in total fiscal receipts is estimated at around 70% in 2023, will benefit to a larger extent. Consequently, we expect Kuwait's fiscal balance to reach a surplus of 3% of GDP next year, after a deficit of -0.3% in 2023. An estimated rise of around 3% in oil production and an increase in refined fuel products will also support its fiscal revenues. The moderate increase in prices should also allow Oman to post a higher fiscal surplus in 2024 (0.9% of GDP, after 0.3% in 2023).

Despite this favourable environment, Bahrain should continue recording the highest public debt-to-GDP ratio in the region with 125% in 2023. Although the hydrocarbon sector accounts for "only" 15% of GDP in Bahrain, its share in fiscal revenues is close to 70%. Given high fiscal breakeven oil price, estimated at around USD 125 per barrel for 2023, the authorities have begun to consider measures to limit a further widening of the budget deficit. In May 2023, they announced the introduction of a corporate tax once an international agreement is reached on the framework, expected at 15% for large multinational companies. The government has also made efforts to limit spending by scaling down its generous subsidy regime program (i.e., higher fuel, electricity, and water fees, etc.). Despite these efforts, Bahrain, which cancelled a USD 750 million bond sale in 2016 after its credit rating was downgraded to junk by the rating agency Standard & Poor's, had to tap into international bond markets in 2021 and 2023 to finance its deficit. Nearly 65% of the central government debt is financed through foreign debt issuances.

On the external front, Bahrain's position is expected to improve slightly in 2024 as oil accounts for 40% of exports. That said, the share of aluminium and steel (20% of total exports) is also rising, in line with larger production capacities and higher prices. Yet, metal prices have receded in 2023 and a significant rebound is unlikely in 2024 as the Chinese economy is expected to decelerate further[1]. Moreover, the maturing oil and gas fields may weigh on Bahrain's hydrocarbon revenues in the longer run, resulting in a narrowing of the current account surplus.

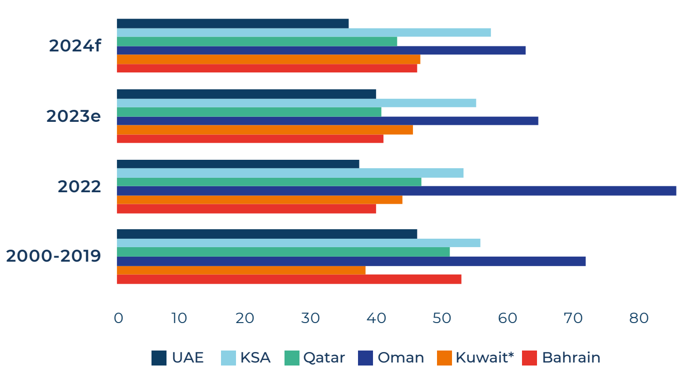
Chart 2: Fiscal breakeven oil prices (USD per barrel)



Source: IMF, Coface

** Kuwait's fiscal breakeven oil price is calculated using the fiscal balance before the 10 percent revenue transfer to the Future Generations Fund and includes investment income as per the IMF.*

Chart 3: External breakeven oil prices (USD per barrel)



Source: IMF

1 - Coface GDP growth forecast in China: 4.5% in 2023, 4% in 2024.

On the other hand, the completion of the long-awaited Sitra refinery expansion project is expected to support Bahrain's exports in 2024.

Despite recurrent current account surpluses, the large fiscal deficit, and the need to preserve the currency peg, weigh on Bahrain's foreign exchange reserves. The assets in Bahrain's sovereign wealth funds are estimated at USD 18 billion, on top of nearly USD 4 billion at the central bank. While reserves covering three months of imports are conventionally regarded as the minimum adequate level, the addition of these reserves would only cover 1.5 months of imports in 2023 **(Chart 4)**. Therefore, the country will continue to receive financial support from its GCC neighbours, particularly from Kuwait, the UAE and Saudi Arabia, as they will seek to avoid any type of economic shock that may increase social discontent in Bahrain.

Oman's debt dynamics seem more balanced compared with Bahrain but it suffers from structural fiscal weaknesses as well, mainly on the back of limited natural resources. Since the fall in oil prices in 2015 and 2016, Oman had been continuously recording twin deficits (both current and fiscal accounts). In 2022, for the first time since 2013, Oman's budget deficit turned to a surplus. Higher energy prices expected in 2024 and an estimated increase of 3% in natural gas production will add to the fiscal surplus of the country, from 0.3% of GDP in 2023 to 1% in 2024. Coupled with an improvement in the current account balance (forecast to reach 2% of GDP in 2023 and 2.5% in 2024), the authorities will be able to reduce the public debt burden to around 40% of GDP in 2024, compared with nearly 70% in 2020. The government was able to finance the deficit by Eurobond issuances to benefit from low interest rates in 2021. As of 2023, 30% of the central government debt would be financed by foreign investors. Foreign assets of Oman's sovereign wealth funds, which are estimated at around USD 46 billion (approx. 40%of GDP), are another source that can partially cover Oman's future funding needs.

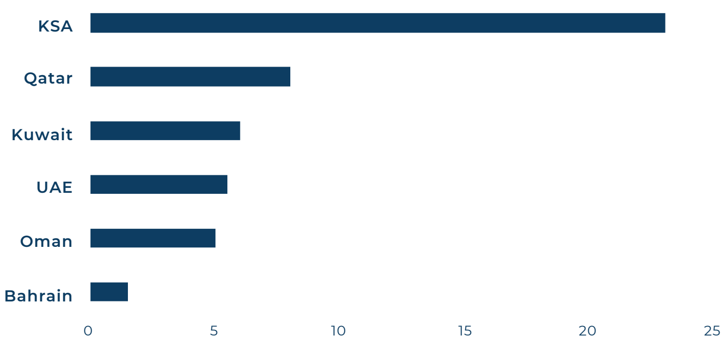
Although Oman's short-term outlook suggests that its current account will remain in surplus, with its central bank having adequate reserves, longer term challenges will persist. With hydrocarbon revenues accounting for nearly 70% of total fiscal receipts and 60% of merchandise exports **(Chart 5)**, the need for Oman to tap into international markets for external debt issuance and the sustainability of the currency peg regime are heavily dependent on energy prices.

Saudi Arabia and the UAE, much less vulnerable, usually come to help

While Bahrain and Oman are considered as the weakest links of the region in terms of fiscal and debt dynamics, other GCC countries such as Saudi Arabia, Kuwait and the United Arab Emirates usually come to help in case of emergencies when funding is in short supply. Although Saudi Arabia's budget balance varies significantly with oil prices, its debt remains low (25% of GDP in 2023). Moreover, the Saudi Central Bank and the Public Investment Fund hold a sizeable amount of foreign exchange reserves (close to USD 800 billion, around 80% of GDP, in end-2022). With this financial strength, Saudi Arabia faces limited difficulties on international capital markets to finance its debt. In the medium-term, the country will remain exposed to oil price volatility, but gradually to a lesser extent as the authorities are trying to stick to fiscal sustainability within the Vision 2030 program. On the UAE's side, the debt load remains manageable (31% of GDP in 2023) on the back of fiscal prudence and relatively strong economic growth. The authorities were able to reduce the debt-to-GDP ratio down from nearly 40% of GDP in 2020 when the country was hit by the COVID-19 shock. In addition to the 5% value-added tax already in place, the 9% corporate tax introduced by the government in 2023 will continue to support revenues.

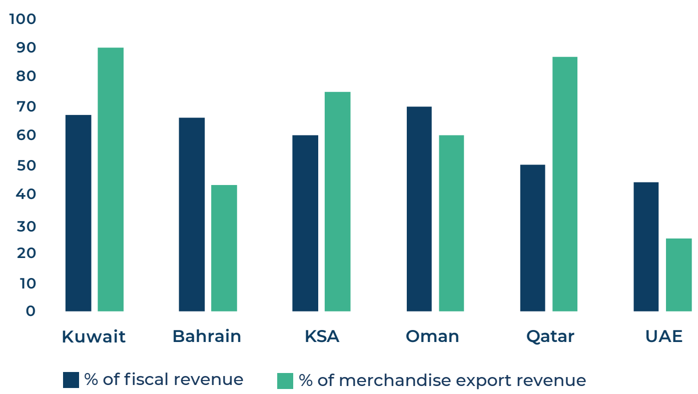
Saudi Arabia, the UAE and Kuwait announced a USD 10 billion aid package to Bahrain in 2018, after providing USD 20 billion to both Oman and Bahrain in 2011, underlying the strategic and economic alliances among those countries. These funds have mostly supported the reduction of fiscal deficits in Oman and Bahrain and mitigated the negative effects of the fiscal consolidation programs. Indeed, Oman and Bahrain witnessed a series of anti-government protests in 2011 that the authorities were able to repress with the support of the other GCC countries. Another aim of this fiscal cooperation is to align all the GCC economies around similar regional initiatives through the introduction of some fiscal reforms (introduction of new taxes, reduction of subsidies and incentives, etc.). This is expected to prevent the business environment of countries that adopt reforms later (i.e. Bahrain, Qatar) from becoming more advantageous than those that adopt them earlier (UAE).

Chart 4: GCC foreign exchange reserves imports coverage (months of imports)



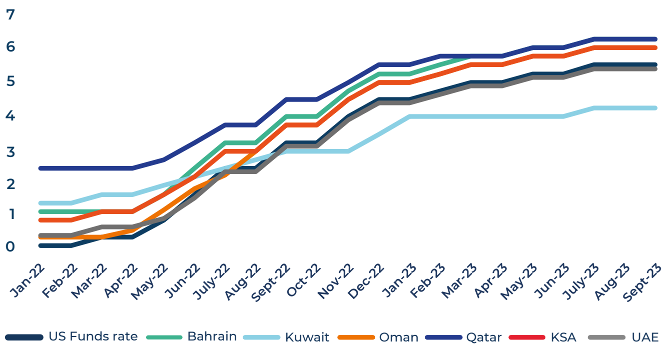
Source: Coface, BMI

Chart 5: Oil as a % of fiscal revenues and merchandise export revenues, 2023



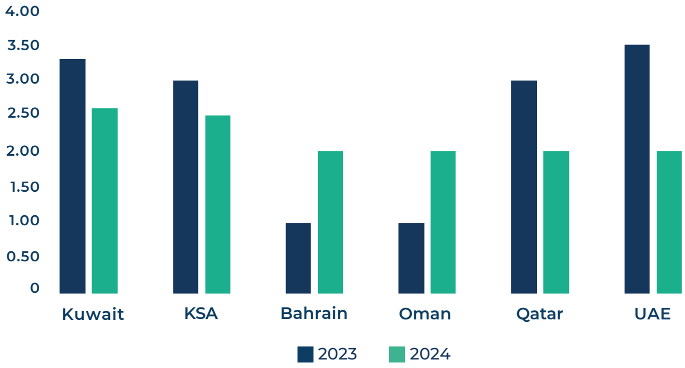
Source: IIF, Coface

Chart 6: Policy rate in GCC countries vs. the US Fed funds rate (%)



Source: Refinitiv Datastream, Coface

Chart 7: Average inflation forecasts (%)



Source: Coface forecast

Despite being less vulnerable than Bahrain and Oman, Kuwait also suffers from a lack of diversification in fiscal resources (VAT, corporate tax etc.) and the importance of the public sector wage bill (estimated at around 40% of total expenditure in 2023), which will hamper the recovery of the fiscal surplus. Moreover, the failure to pass a new debt law since the previous one expired in 2017 will continue to weigh on the government's ability to tap into international capital markets to meet its financing needs. Consequently, when needed, the authorities will continue to use the General Reserve Fund (GRF), the main repository of all of the state's oil revenues and income, which acts as the state treasury account under the management of the Kuwait Investment Authority (KIA) if necessary. The second fund under the supervision of the KIA is the Future Generations Fund (FGF), which is an intergenerational savings platform, and whose assets cannot be withdrawn unless sanctioned by law. While the authorities are planning to approve a public debt law in the first year of its action program for 2023-2027 according to media reports, disagreements between the parliament and the executive will likely persist in 2024. This would delay the approval of the law and other reforms such as the introduction of a value added tax.

Qatar has greater room for manoeuvre and will adjust the introduction of fiscal reforms at its own pace. Qatar's economy is relatively more diversified than that of Kuwait and Saudi Arabia, but its debt-to-GDP ratio remains relatively high (45% of GDP in 2023) despite its fiscal surpluses. The diversification of fiscal revenues is low (50% of total fiscal revenues come from hydrocarbon sales) but the substantial financial buffers (total assets of the sovereign wealth funds are estimated at USD 475 billion - around 200% of GDP - and foreign exchange reserves cover eight months of imports) allow the country to delay fiscal reforms such as the introduction of a 5% VAT. Given a higher degree of autonomy in terms of finances and politics compared with other GCC countries, Qatar was able to resist to the Saudi-led economic and diplomatic blockade between 2017 and 2021.

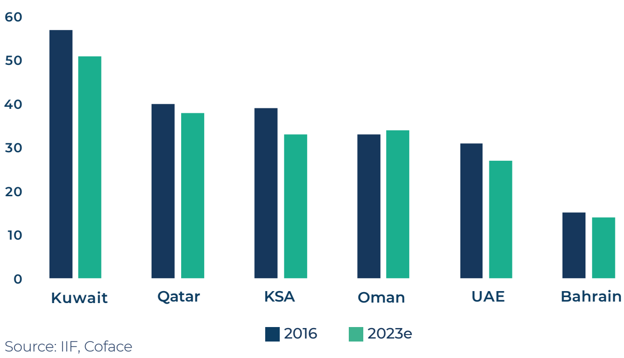
Different financial situations but (virtually) the same monetary policies

These different structures within the GCC economies indicate that, while these countries have formed an economic and financial alliance, their financial situations are unequal. However, regarding monetary issues, they have very similar structures: their currencies are pegged to the US dollar, except for Kuwait that has a currency peg against an undisclosed currency basket. This allowed the Kuwaiti central bank to implement the least aggressive monetary tightening in the region **(Chart 6)**. It has raised its policy rate by a cumulative 275 basis points since March 2022 despite a hike of 550 basis points by the US Federal Reserve. In the meantime, the others central banks had no choice but to tighten further. In line with the Fed's future policy moves, we expect GCC central banks to hold their policy rates until the Fed decides to begin its rate cut cycle.
It is worth noting that, mainly on the back of these tight monetary policies and low energy prices (thanks to large subsidies), inflationary pressures have remained relatively limited in the region compared with the rest of the world **(Chart 7)**.

Fierce competition in the sectors targeted by diversification efforts

Although they still heavily depend on the oil sector, GCC countries implemented economic diversification plans following the drop in oil prices between 2014 and 2016 (from USD 102 to USD 45 per barrel on average). These aim at increasing the share of private sector investments in non-oil sectors including finance, construction, and services. The UAE has been at the forefront of economic diversification. Its successful positioning as a global business hub has significantly reduced its reliance on oil over the years **(Chart 8)**. The share of the oil and gas sector in GDP is estimated to have fallen from 30% in 2016 to around 25% in 2023, while the share of the services sector has risen from 48% to 55%. A similar decline of the oil sector's weight in GDP has also occurred in Saudi Arabia, where it now stands at 33%. Kuwait and Qatar remain amongst the less diversified countries in the region, with oil and gas still representing around 50% and 40% of GDP, respectively.

Chart 8: Oil share in GDP (2016 vs 2023, %)



Source: IIF, Coface

Both Abu Dhabi and Saudi Arabia have announced their diversification strategies under the name of Vision 2030 mostly putting the fundamentals of economic diversification towards the promotion of the construction (including infrastructures) and tourism sectors. In the UAE, the primary driving force of infrastructure development is linked to the Etihad Rail Project, which aims to build an USD 11 billion railway network. On the residential construction side, however, activity is expected to decelerate due to an excess of residential buildings. The outlook for commercial and industrial buildings will continue to be supported by investors' interest and rising tourist arrivals. Nevertheless, this outlook is not guaranteed either, mainly due to rising competition from Saudi Arabia, which also based its Vision 2030 plans on the development of the construction (for instance, the launch of mega-projects like Qiddiya and NEOM city) and tourism sectors. One of the main challenges of these strategies is the one-off effect of construction activities on national income, which disappears the year after the project is completed (and therefore does not represent lasting diversification). To overcome this issue and ensure the continuity of foreign investments, Saudi Arabia announced in 2021 that, from that year onwards, it would exclusively collaborate with foreign companies that have their regional headquarters located in the Kingdom. This would also allow the Kingdom to compete with the UAE in terms of being a trading hub in the region.

Regarding tourism, the UAE's revenues are expected to rise by 7% to USD 43 billion (9% of GDP) in 2024 thanks to the country's cultural and entertainment sites, and its position as a transportation hub. Saudi Arabia has opened its doors to international visitors by introducing tourist visas in 2019. Total tourism receipts are estimated to increase by 12% to around USD 25 billion in 2024 (3.5% of GDP). By 2030, the government aims to increase the number of tourist arrivals to 100 million (both domestic and international) compared with 40 million in 2022. To achieve this ambition, the authorities are investing in giga projects, mainly through its flagship tourism project developer, The Red Sea Development. However, the number of international tourists who would be prepared to visit the Kingdom while the leisure tourism infrastructure remains limited is still uncertain, as Saudi Arabia is mostly known for religion-related tourism. Recently, special tourist zones exempting tourists from restrictive rules on dress codes have been created, but the strong competition from Qatar and the UAE will continue to be an important challenge for Saudi Arabia.

The same challenge applies to Qatar as well. The country has also invested in infrastructure, hosting major events like the FIFA World Cup 2022, boosting tourism and international recognition. However, Qatar's construction sector growth will moderate in the upcoming period due to the termination of World Cup-related projects and its small population (2.7 million in 2022). After 4.5% in 2022, the construction sector's growth will be more than halved in 2023 and 2024.

While Kuwait and Bahrein have not launched significant diversification plans, Oman is leveraging on its strategic location to develop its logistics and transport sectors. Additionally, the government is investing in sectors like fisheries, manufacturing, and tourism to reduce its reliance on oil revenues, but without much success so far. The share of oil and gas in Oman's GDP has even slightly increased since 2016, while the share of services stalled at around 45% of GDP.

As one can see, because all the GCC countries are targeting the same sectors to reach their economic diversification targets, the key risk resides in the creation of intra-competition within the region. Furthermore, the main financing of all diversification strategies relies on oil revenues. Considering these two factors, economic diversification strategies, although feasible, may not yield the desired results.

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