July 2019

Economic Outlook: GCC & Egypt

2019-2021

National Bank of Kuwait
Economic Research Department

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GCC & Egypt Outlook

Amid higher oil prices, GCC economic growth and public finances improved in 2018, with governments advancing their ambitious infrastructure development and diversification programs while implementing some fiscal reforms. With possible softer oil prices over the forecast period, policymakers should balance spending needs with fiscal sustainability and the preservation of reserves in the sovereign wealth funds. Sensitivity to oil prices remains a significant downside risk to GCC countries, making the push for diversification all the more important. Egypt's significant progress on the macroeconomic front will need to be complemented by deep structural reforms to enhance the role of the private sector and create jobs for Egypt's youth.

The international setting

The global economic outlook is highly uncertain and confidence in the outlook seems to fluctuate with the frequent policy shifts on trade issues that have come to dominate the economic scene of late. The recent resumption of trade discussions between the US and China offers a glimpse of hope (for now) but the outcome is far from certain. Even if a deal is reached, other trade disputes with the EU and the US's other trade partners are looming.

The US has just recorded the longest and uninterrupted expansion on record (121 months) but recent economic data has been mixed and some believe that the next downturn is near. While the unemployment rate remains close to a record low, there are a few signs pointing to a possible slowdown, manifested mainly in weakening manufacturing and housing activities. The EU also risks slipping into a low-growth mode, with uncertainty over Brexit adding to the risks. Monetary policy loosening is expected in much of the developed world, with the Fed likely to cut the rate by 25bp by end July and the ECB ready to resume monetary stimulus if economic performance does not improve.

Oil outlook depends on OPEC+ balancing US supply gains

Oil prices have been caught between the crosscurrents of surging US oil output (shale) and supply management by OPEC and its partners. The OPEC+ group agreed in early July to extend their production cut agreement to March 2020 amid record US production growth and still-high global crude inventories. The extension also came despite above 100% average producer compliance, continued declines in Iranian and Venezuelan production due to US sanctions and/or economic mismanagement and visible signs of a tightening market. Our projection of $65/bbl for Brent to 2021 assumes OPEC+ continues to manage supply to offset expected non-OPEC and US production gains.

GCC non-oil activity and public finances improving

High-frequency indicators of non-oil activity so far point to general improvements in the GCC region's non-oil economies. Higher energy prices, expansive public investments coupled with private sector stimulus programs have spearheaded output gains over the last two years. In case oil prices soften over the forecast period, this will likely lead to a slower and more gradual improvement in GCC public finances than currently envisaged. GCC governments will need to strike a balance between the need for fiscal sustainability (e.g. subsidy reforms, new levies and taxes) and the drive to boost non-oil private sector growth through continued public investment and austerity-mitigating measures. The aggregate fiscal deficit should, nevertheless, narrow from 4.3% of GDP last year to 2.7% of GDP by 2021, reducing recourse to resources in the sovereign wealth (future generations) funds.

Global growth and energy prices could affect the region

Global developments could affect the region through three main channels. A slowdown could push down oil demand and prices, to which GCC countries remain very sensitive. Second, a reduction in US interest rates will entail a similar reduction in most GCC countries (Kuwait has more flexibility given its currency peg to a basket of currencies) with a positive impact on credit and growth. And a cut in US interest rates could encourage capital inflows to the region which offers relatively higher returns than other (emerging) countries as the prevailing tensions in the region do not seem to deter yield-starved investors. The opening up of the GCC economies and their inclusion in the main emerging market indices also facilitates such inflows.

Overall, the impact of external developments on the region seems to be balanced although a drop in the oil price would present a greater risk to the GCC outlook if not countered by production cuts by OPEC+. This calls for further efforts on diversification and continued progress in fiscal, private sector and regulatory reforms over the medium term.

Egypt on the right path, but challenges remain

Thanks to the significant progress that has been made so far, the outlook for Egypt looks promising. However, a number of risks and challenges could derail economic performance in the medium and long term if not addressed. Inflation has come down from its highs and interest rates should trend lower, but will likely remain relatively high over the next couple of years, restraining private sector growth and keeping the public debt burden high. There is a need for the private sector to assume a greater role in the economy and create jobs for the soaring number of entrants into the workforce, which would reduce the employment burden on the public sector. Moreover, as macroeconomic stability is taking root, attention needs to be given to structural reforms to reduce poverty, lift the standard of living of the population and ensure that the benefits of the reforms are more widely shared.

GCC key economic indicators

		2017	2018	2019f	2020f	2021f
Nominal GDP	$ trn	1.5	1.6	1.6	1.7	1.7
Real GDP	% y/y	-0.3	2.1	1.7	2.6	2.7
- Oil	% y/y	-3.4	1.5	-0.4	1.6	1.7
- Non-oil	% y/y	2.1	2.7	2.9	3.2	3.4
Inflation	% y/y	0.7	2.4	-0.7	1.2	1.6
Fiscal balance	% of GDP	-7.6	-3.6	-4.3	-3.4	-2.7
Current account bal.	% of GDP	2.8	8.1	6.8	7.1	7.3

Source: Official sources, NBK estimates

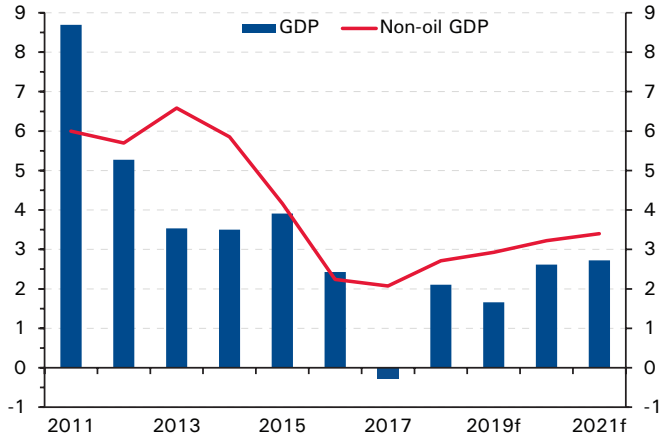
Chart 1: ICE Brent crude oil futures

($/bbl)

Source: Refinitiv

Chart 2: GCC real GDP

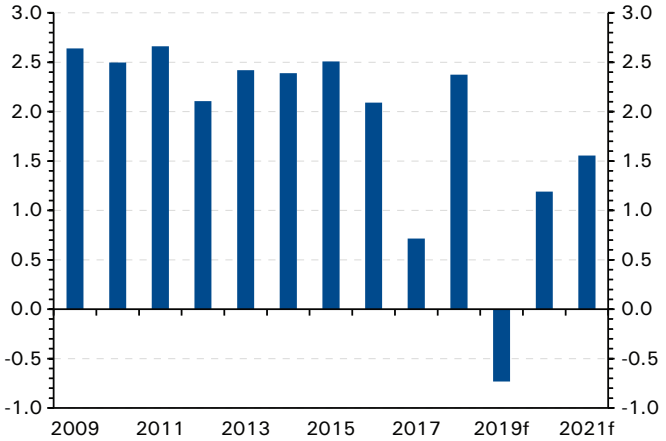
(%y/y)



Source: Official sources, NBK estimates

Chart 3: GCC inflation

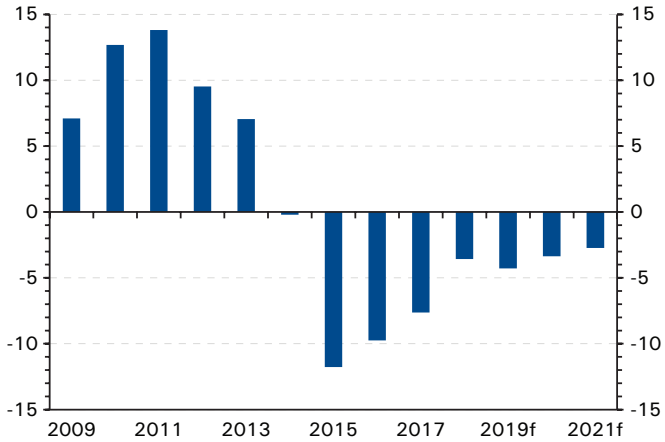
(% y/y, year average, weighted average)



Source: Official sources, NBK estimates

Chart 4: GCC fiscal balance

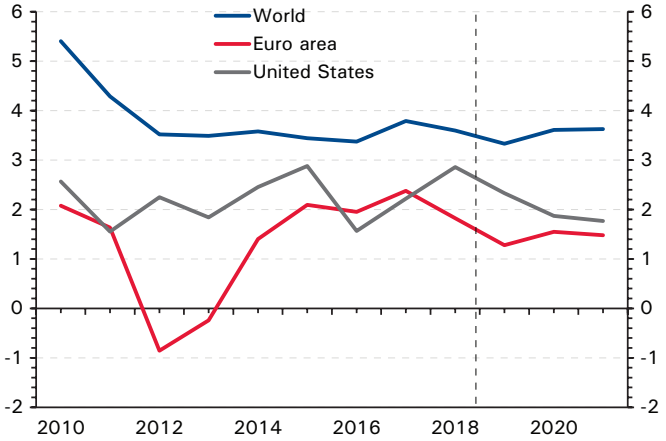
(% of GDP)



Source: Official sources, NBK estimates

Chart 5: International GDP

(% y/y)



Source: International Monetary Fund, WEO April 2019

Bahrain

Non-oil growth is expected to remain above 3% to 2021, with GCC investments supporting elevated infrastructure spending. This will offset continued oil sector weakness and keep headline growth at 2-3%. Inflation will moderate in 2019 as the VAT effect wears off, before rising next year. The budget deficit is projected to gradually narrow in line with reforms outlined in the Fiscal Balance Program. Adhering to this program will improve the external current account position and lessen the pressure on Bahrain's foreign reserves.

Infrastructure spending to remain supportive of growth

Bahrain's economy is projected to continue to grow at a decent 2.5-3% over 2019-2021. (Chart 1.) While real oil GDP growth is constrained by Bahrain's participation in the recently-extended OPEC+ oil production cut agreement, the non-oil economy is expected to hold firm at around 3% over the forecast period thanks to high levels of infrastructure spending and an increase in manufacturing output. The additional spending will likely be financed, at least in part, by the $10bn GCC support package announced in 4Q18, while manufacturing activity will be boosted by the $3bn expansion of the Alba aluminium smelter. This is one of the largest in the world, producing more than 2% of global output and 15% of Bahrain's GDP.

Consumer price inflation remains soft despite VAT levy

Headline inflation has so far surprised on the downside, with continued softness occurring across most subcomponents, including food. This softness can be attributed to a stronger US dollar against Bahrain's main trade partners' currencies, which has brought down imported inflation, and more than offset recent price rises in housing and in the retail sector more broadly following the implementation of the 5% VAT in January. (Chart 2.) We expect inflation to moderate in 2019 as the VAT effect fades, before picking up speed over 2020-21 on increasing demand. A potentially dovish Fed may also put downward pressure on the US dollar (to which the dinar is pegged) and consequently raise the cost of imports and inflation.

Fiscal position to gradually improve but risks remain

The fiscal deficit is projected to gradually narrow, as outlined in the kingdom's Fiscal Balance Program (FBP). A series of reforms, mainly the introduction of VAT in January, were laid out in 4Q18 to balance the budget by 2022 from the current deficit of around 8% of GDP and reduce the public debt from the current 90% of GDP to 82% of GDP. (Chart 3.) However, in its recent budget report, Bahrain signaled that it may take longer to balance the budget.

In a further bid to ease the pressure on public finances and spur foreign investment inflows, Bahrain has reportedly approved a law that would allow foreign companies to set up independent subsidiaries and for these subsidiaries to also own 100% of domestic oil and natural gas extraction projects.

Business lending holding firm

Growth in credit to businesses continues to hold firm, underpinned by robust lending activity in the construction and manufacturing sectors. (Chart 4.) Private sector deposit growth is catching up, likely thanks to the aid installments Bahrain has received so far, which were disbursed as loans, deposits and grants. As of 1H19, the kingdom has received almost half of the $10bn support package; another $2.3bn is due this year.

Foreign reserves remain under pressure

Given large fiscal and current account deficits, international reserves remain under pressure. Going forward, a gradual improvement in both the fiscal and current account positions and the GCC financial support package should offer foreign reserves some reprieve. Indeed, as of April, reserves were at $2.4bn (1.5 months of imports), up from $1.8bn at the start of the year and higher than the $1.7bn average in 2018. (Chart 5.)

Economic outlook hinges on fiscal reforms

Soon after the announcement of the FBP, the kingdom's sovereign wealth fund issued a $600 million sukuk priced at 5.625%, 60 bps lower than what was expected. Bahrain is now in discussions to issue its first international bond since last year. But at the end, the kingdom's economic outlook hinges on its execution of the FBP. Any further deviation from the balanced budget target would adversely affect investors' confidence, the level of reserves (which remain low by international standards), and the rate at which they can borrow in the future.

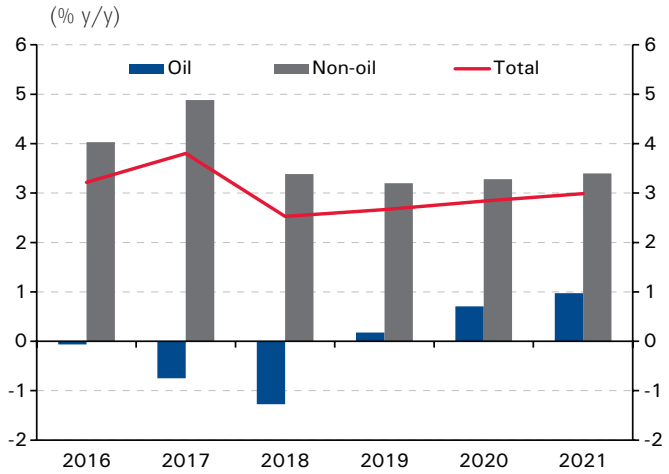
On the other hand, Bahrain's pledge to monetize newly-discovered hydrocarbon reserves of up to 80 billion barrels of tight shale oil and around 20 trillion cubic feet of tight natural gas within the next five years should improve its outlook.

GCC key economic indicators

		2017	2018	2019f	2020f	2021f
Real GDP	USD tn	3.8	2.5	2.7	2.8	3.0
- Oil	% y/y	-0.7	-1.3	0.2	0.7	1.0
- Non-oil	% y/y	4.9	3.4	3.2	3.3	3.4
Inflation	% y/y	1.4	2.1	1.5	2.0	2.5
Budget balance	% y/y	-10.0	-8.3	-6.4	-4.8	-3.7
Current account	% of GDP	-4.5	-5.9	-4.4	-4.1	-3.8

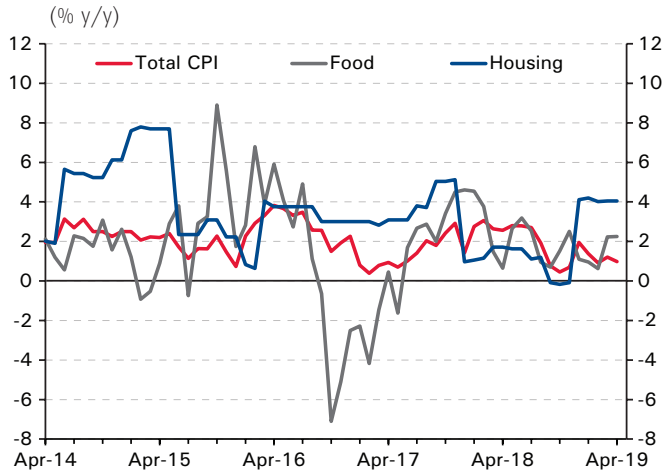
Source: Official sources, NBK estimates

Chart 1: Real GDP



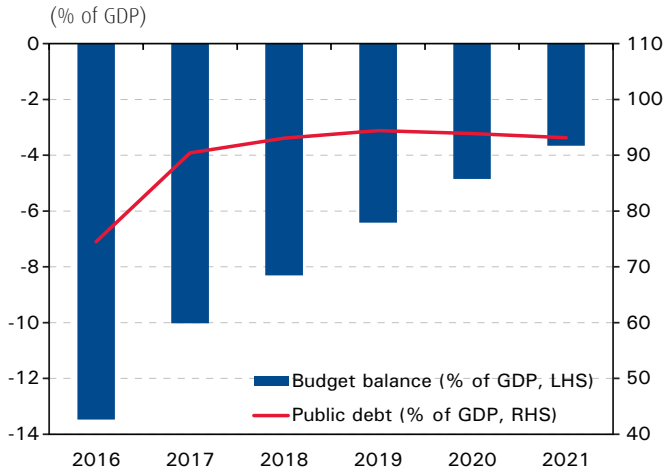
Source: Information & e-government Authority, NBK estimates

Chart 2: Inflation



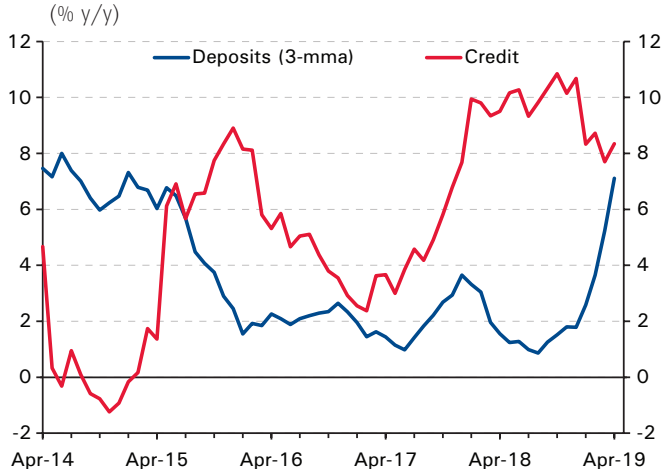
Source: Refinitiv

Chart 3: Budget balance & public debt



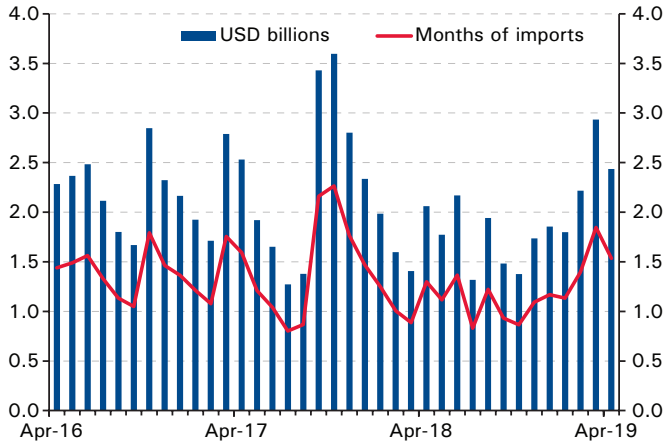
Source: Bahrain Ministry of Finance/ IIF / NBK estimates

Chart 4: Private credit & deposit growth



Source: Central Bank of Bahrain

Chart 5: Central bank foreign reserves



Source: Central Bank of Bahrain

Kuwait

A soft oil sector will weigh on GDP growth over the forecast period, with non-oil growth rising slightly to 2.8% by 2021. The fiscal position will likely be in deficit over 2019-21, to be financed by the General Reserve Fund (GRF) in the absence of a debt law. Credit growth has picked up supported by an accommodative monetary policy, though the boost from any Fed rate cut may be limited. Downside risks include lower oil prices, regional geopolitical tensions, slow reform progress and widening fiscal deficits that could use up most of the GRF resources in the medium term.

Oil sector weighs on growth performance

Economic growth is stuck in a modest 1-3% range over the forecast period, slightly below the regional average. This reflects the large size of the oil sector, where growth is capped by the recently-extended OPEC+ agreement. Hydrocarbon GDP will however be lifted as Kuwait looks to almost double gas output by FY2023/24. The start-up of the Clean Fuels Project (2020) and Al-Zour refinery (2021) will nearly double refining capacity.

Non-oil growth will remain moderate amid fiscal pressures and slow pro-growth reforms. Non-oil growth is seen at 2.5-2.8% per year, with steady oil prices underpinning confidence and public spending rising, albeit at a limited pace. Near-term prospects for consumer spending are decent, with consumer loan growth at a six-year high of 14% y/y in May, supported in part by easing lending restrictions and employment growth. Project implementation could improve given an ample project pipeline and a backlog from delays as well as the government's commitment to capex under Vision 2035 goals. However, we do not expect much stronger non-oil growth, absent large fiscal stimulus and progress on the reform agenda.

Inflation is forecast to remain low at 1-2%. Downside pressures are coming from housing rents, which showed renewed weakness in 1Q19, and food prices, which are impacted both by international prices and local subsidies. Core inflation is expected to hover at around 2% reflecting moderate economic growth, a strong dinar with respect to trade partner currencies, and the absence of taxes (VAT, Excise) or large subsidy cuts.

Budget deficit will weigh on GRF reserves

Although the final figures are not out yet, the fiscal balance could register its first surplus in four years in FY2018/19 mainly due to higher oil prices and weak spending. Assuming some rebound in spending this year, a swing back into deficit is likely. Although the government's financial reserves provide a large near-term cushion and debt levels are low, underlying fiscal pressures are rising due mainly to the delay of reforms to broaden the tax base (mainly VAT and excise taxes), and continued pressures on spending including from further hiring in the public sector. We estimate assets in the General Reserve Fund – used to fund the budget shortfall – of KD24 billion (60% of GDP) in March 2019, which could finance the cumulative (after transfers) budget deficit of KD11 billion through FY2021/22. Pressure on reserves would be eased further if the new debt law is approved.

The external position by contrast is robust, with a large albeit declining current account surplus seen throughout the forecast period. As well as oil receipts, the surplus is supported by returns of around KD5 billion (12% of GDP) per year on the government's assets held abroad. The financial account will see continued large net outflows, especially in the absence of sovereign debt issuance or stronger inward FDI. The latter stood at $0.3 billion in 2018, reflecting in part Kuwait's low rank in measures of competitiveness and "ease of doing business".

Credit growth has picked up, seen steady this year

Credit growth has recovered, climbing back to 6% y/y in May after averaging 2.3% in 2018. We expect the trend to be broadly flat for the rest of this year, with stronger consumer lending more or less offset by a further cooling in housing loans. The central bank has used the flexibility of the dinar's peg to a currency basket to increase interest rates on just four out of nine US Fed's hikes. This in turn means that policy may be loosened less quickly when the cycle turns – thereby lowering the credit impact.

Kuwait would be included in the MSCI Emerging Market Index as of May 2020, conditional on meeting two conditions by November. This inclusion is expected to bring in about $2.8 billion in passive inflows and an estimated $7 billion in active inflows, although the latter is difficult to estimate with any reasonable degree of confidence.

Outlook stable but challenges remain

Kuwait's large financial buffers provide a cushion against any possible adverse external shock and should enable growth to be sustained at a fair pace ahead. However, with budget deficits widening against an unstable oil price outlook, and in the absence of meaningful fiscal reforms that reduce current spending (the wage and subsidy bill) and lift revenues, savings in the GRF will dwindle and could be depleted in the medium term, with adverse impact on foreign investor's confidence. Improving the business environment and boosting private sector growth to create jobs for the increasing number of young Kuwaitis entering the labor force would offset some of the risks and put Kuwait on a sustainable path.

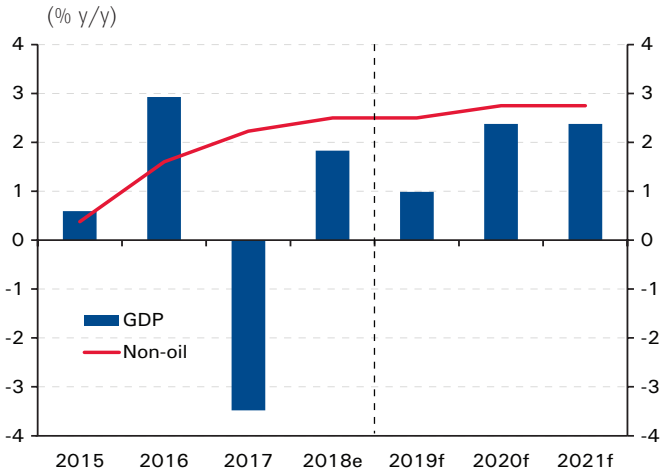
GCC key economic indicators

		2017	2018	2019f	2020f	2021f
Nominal GDP	$ bn	120	137	134	138	143
Real GDP	% y/y	-3.5	1.8	1.0	2.4	2.4
- Oil	% y/y	-7.2	1.2	-0.5	2.0	2.0
- Non-oil	% y/y	2.2	2.5	2.5	2.8	2.8
Inflation	% y/y	1.5	0.6	1.0	1.5	2.0
Fiscal balance[1] (FY)	% of GDP	-9.0	2.0	-3.0	-4.0	-5.0
Public debt (FY)	% of GDP	20.0	14.8	12.7	14.5	16.3
Current account bal.	% of GDP	8.0	14.8	8.0	7.0	6.0

[1] Before transfers to the sovereign wealth fund

Source: Official sources, NBK estimates

Chart 1: Real GDP

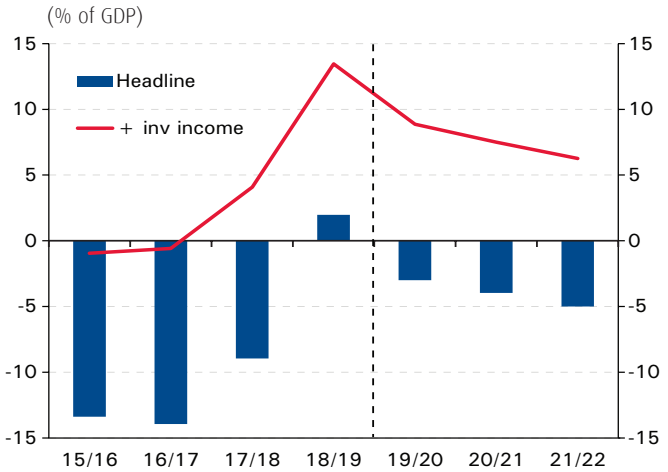


Source: Central Statistical Bureau / NBK

Chart 2: Crude oil output

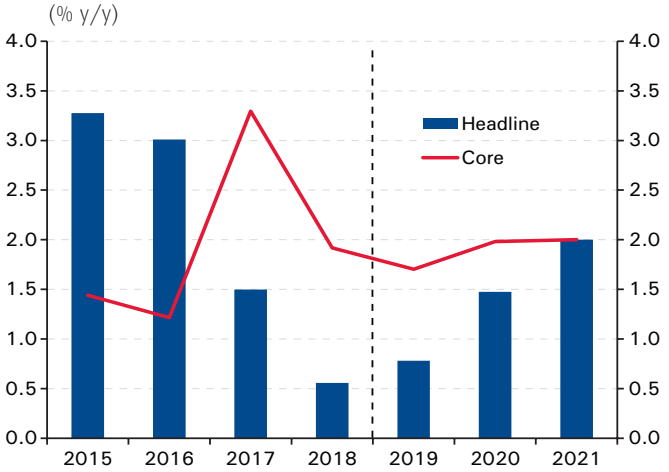
Source: OPEC

Chart 3: Fiscal balance



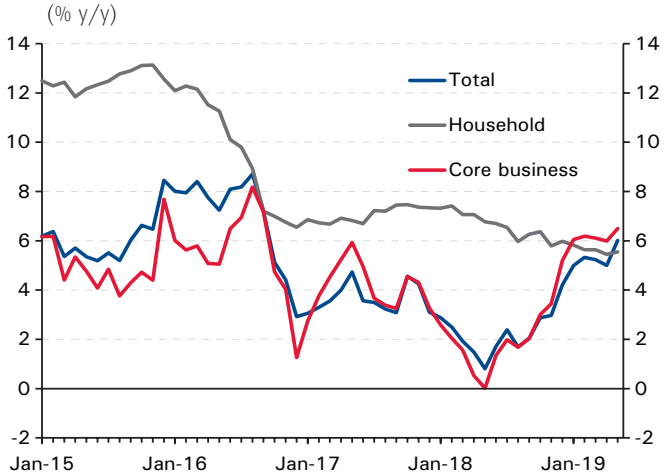
Source: Ministry of Finance / NBK

Chart 4: Inflation



Source: Refinitiv / NBK

Chart 5: Bank credit



Source: Refinitiv / NBK

Oman

Economic growth is expected to hold firm and average 3.6% over 2019-2021, supported by the government's diversification and infrastructure spending plans in both the oil and non-oil sectors. Elevated spending, however, will keep the fiscal deficit at high levels--averaging 6% over the forecast period--and raise public debt to around 50% of GDP over the next two years. These, declining reserves and sensitivity to oil price are risks to the medium-term outlook.

Growth-boosting reforms to support economy

Economic growth in Oman is expected to steadily edge higher over 2019-2021, led by pro-growth reforms aimed at diversifying the economic base. As such, we see growth rising to around 3.9% in 2021, on the back of continued gains in both oil and non-oil sector activity. (Chart 1.)

While Oman's oil production will remain capped by the OPEC+ production cut agreement, the ongoing expansion in gas production capacity should more than compensate, especially following recent non-associated natural gas discoveries and new project partnerships with international energy firms. As a result, we see real oil growth averaging 3-4% over the forecast period.

Non-oil activity is also likely to accelerate, averaging 3.6% y/y to 2021, as the government pushes ahead with developing its key sectors—manufacturing, transport, logistics and tourism, in line with its Vision 2020 plan.

Inflation to gather pace on excise tax and VAT

Consumer price inflation is expected to pick up speed in 2019 to 1.5%, following the excise tax levy on selected goods in June. The upward momentum is likely to continue into 2020 with the planned VAT coming into effect; this is expected to add some 1% to inflation for one year. We should see inflationary pressures subside somewhat in 2021 as the initial impact of the VAT fades. (Chart 2.)

Concerns over fiscal and external positions to persist

The fiscal deficit is projected to remain high amid ongoing fiscal stimulus measures and a softer oil price environment. (Chart 3.) Non-oil revenues should increase due to the implementation of the excise tax this year and VAT next year, which will temper some of the projected increases in spending. But in the absence of further significant fiscal reform, the budget deficit will likely remain high at around 6% of GDP on average over 2019-21. This will ultimately push public debt levels higher to around 50% of GDP. (Chart 4.)

Oman's current account deficit is expected to decline over the forecast period to average about 6% of GDP to 2021. Large fiscal and external current account deficits are likely to put foreign reserves under pressure. As of April, official foreign reserves at the central bank stood at $16.5bn, down 4.8% year-to-date, covering around eight months of imports. However, indications are that reserves in the sovereign wealth fund are on decline.

Deficit to be financed by debt issuances and privatization

Oman is currently rated below investment grade by all three major rating agencies, which may make it more difficult for the kingdom to lower currently high cost premiums on any further debt issuances. Nonetheless, the government is reportedly in talks with foreign banks for a sovereign bond issue of up to $2 billion. This would be its first international debt issue of 2019, part of the government's plan to finance about 85% of this year's fiscal deficit through local and foreign borrowing.

In addition, the government is also furthering its privatization agenda and plans to attract foreign direct investments (FDI) to help relieve its financial constraints. It plans to privatize two electricity companies, Oman Electricity Transmission and Muscat Electricity Distribution ($3.2bn in total assets).

Liquidity conditions to remain tight

Liquidity conditions in Oman are projected to remain constrained over the medium term, as private credit growth and government borrowing outweigh deposit growth. (Chart 5.) Latest data showed growth in private credit averaging 2.1% in the first four months of this year, deposit growth in contrast logged an average of 1% during the same period. Private credit growth is set to be supported by healthy business and housing demand. Deposit growth will be limited by weaker government deposit growth (due to lower oil receipts).

Downside risks could impact the growth outlook

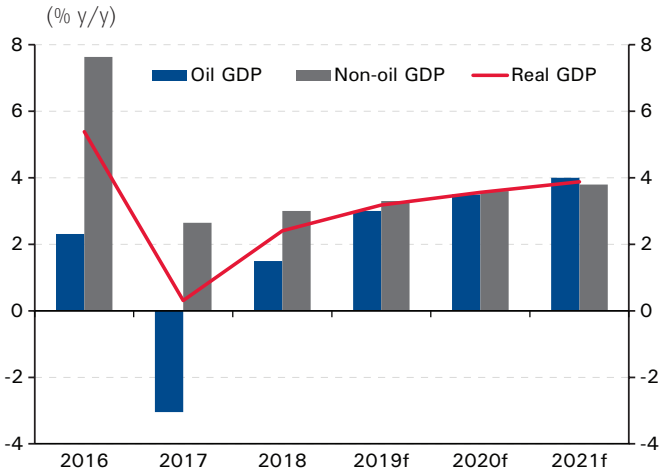
The economy is projected to register solid growth rates over the forecast period, as the government remains committed to its diversification plans. However, higher budget deficits and public debt as well as a weaker external position are a source of concerns for investors. Plans to boost non-oil revenues and foreign investment inflows should help alleviate some of these concerns and improve Oman's credit ratings.

GCC key economic indicators

		2017	2018	2019f	2020f	2021f
Nominal GDP	$ bn	70.7	75.0	80.0	84.0	84.0
Real GDP	% y/y	0.3	2.4	3.2	3.6	3.9
- Oil	% y/y	-3.0	1.5	3.0	3.5	4.0
- Non-oil	% y/y	2.6	3.0	3.3	3.6	3.8
Inflation	% y/y	1.6	0.9	1.5	2.5	1.5
Budget balance	% of GDP	-14.9	-5.0	-6.9	-5.8	-4.7
Current account	% of GDP	-15.2	-6.1	-7.7	-6.1	-4.2
Public debt	% of GDP	47.0	43.1	45.1	42.9	40.7

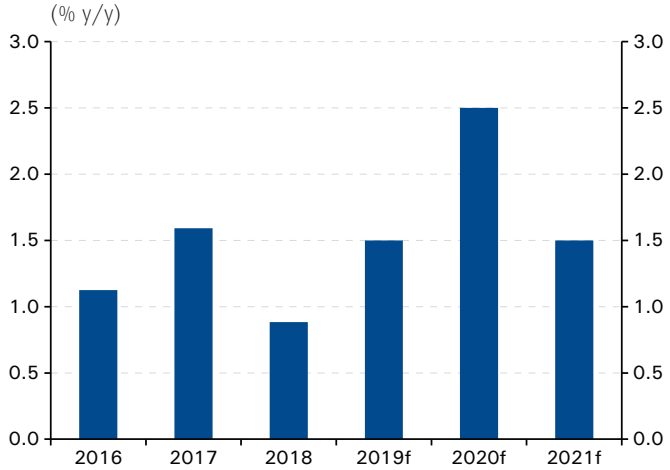
Source: Official sources, NBK estimates

Chart 1: Real GDP growth



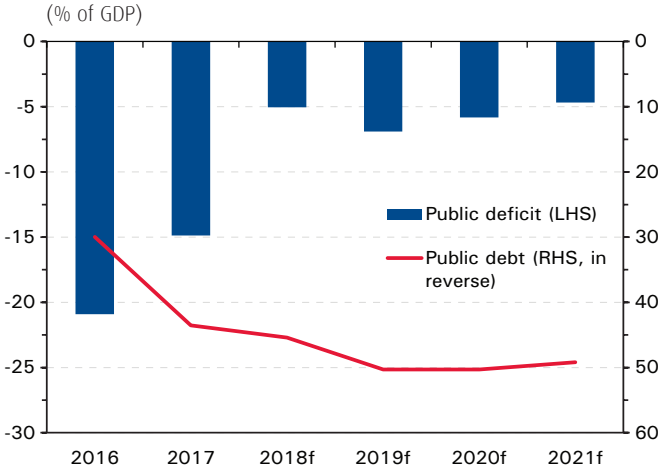
Source: Refinitiv / NBK estimates

Chart 2: Inflation



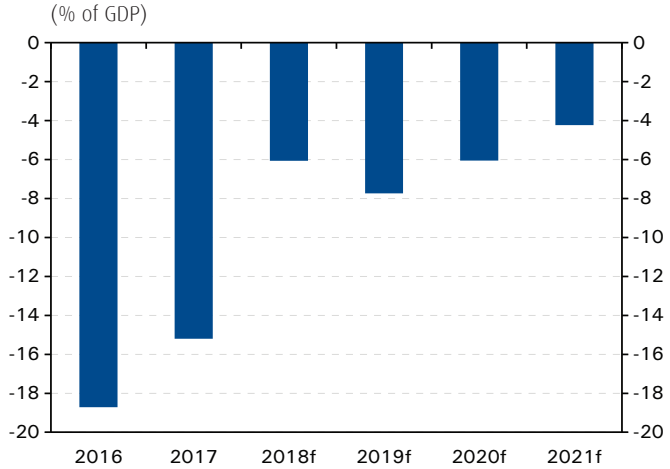
Source: Refinitiv / NBK estimates

Chart 3: Fiscal balance & public debt



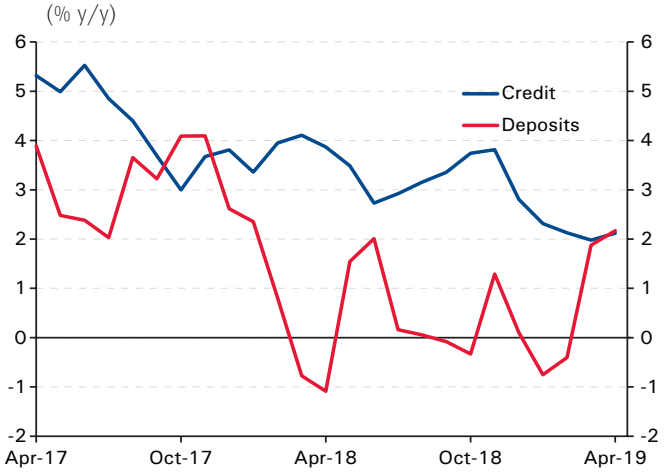
Source: Refinitiv / NBK estimates

Chart 4: Current account balance



Source: Refinitiv / NBK estimates

Chart 5: Private bank credit and deposits



Source: Central Bank of Oman

Qatar

Economic growth has accelerated as the government advances its second National Development Strategy that sees the private sector assume greater importance in driving diversification. Public finances and investor confidence have recovered since the 2017 GCC crisis after the government exercised spending restraint, injected liquidity into the banking system, rerouted impacted trade flows and benefitted from higher energy prices. Major risks to the outlook include sensitivity to volatile global energy and capital flows and increased LNG competition.

Non-oil activity buoyed by government investment

Growth is expected to accelerate to 2.6% in 2019 from 1.6% in 2018, driven by a recovery in hydrocarbon sector output (0.4%) and ongoing gains in non-hydrocarbon activity (4.4%) as the government's expansive public investments bear fruit. (Chart 1.)

Over the medium term, as infrastructure projects related to the FIFA World Cup 2022 and work on the broader Qatar National Vision 2030 advances, non-oil growth is expected to moderate to around 4% by 2021. By this time, the private sector should have assumed a greater role in driving diversification through greater-value added—in sectors such as manufacturing, services, transportation and real estate—as per 2018's Qatar National Development Strategy 2018-2022 (NDS-2). NDS-2 also prioritizes raising the average productivity of its local and foreign workers, which partly explains last year's decision to offer long-term, skilled expats permanent residency and permit 100% foreign ownership across all business sectors.

The hydrocarbon sector, meanwhile, should get a welcome boost in 2020 from the commissioning of the delayed $10bn Barzan gas production facility. This should raise gas output by 12% (2 bncf/d) and drive higher condensates and NGLs volumes. The most significant contribution, however, will come over the medium-to-long term when LNG capacity expands by over 40% to 110 mtpa, with the addition of 4 new LNG trains by 2024.

Inflation subdued on housing, food price weakness

Inflation has been in negative territory for six consecutive months (-1.2% y/y), weighed down by continued weakness in the housing/utilities (-1.6% y/y), transport (-2.3% y/y) and food (-0.6% y/y) categories (March data) in the context of slowing population growth (+0.3% y/y to 2.74m in May). (Chart 2.) Inflation will probably settle at an annual avg. of -0.2% this year before rising next year to 3.0% with the probable introduction of the VAT and faster economic growth.

Public finances benefit from spending restraint and reform

Qatar's fiscal position has strengthened since the authorities began the process of fiscal reform and consolidation (merging ministries, liberalizing fuel prices etc.) after the oil price downturn and as energy prices began to recover from their 2016 nadir. Qatar recorded a surplus in 2018 (2.2% of GDP); that should improve further to 3.2% by 2021 amid continued spending restraint and stable energy prices. (Chart 3.)

The improvement in government finances will also have a positive bearing on public debt. While the authorities accessed the debt markets in 2018 and early in 2019—securing favorable rates amid considerable investor demand—to the tune of $24bn, debt levels are expected to fall from 53% of GDP in 2018 to 41% of GDP by 2021.

External account to remain in surplus

The external current account (CA) balance, which moved back into surplus in 2017 and reached an estimated 8.3% of GDP in 2018 should remain in surplus over the forecast period. (See Chart 3.) Notwithstanding a slight deterioration in 2019 to 6.4% of GDP on softer oil and gas prices, the CA will benefit in the medium-to-long term from higher gas exports and returns from QIA's overseas assets. QIA's assets are estimated to be around $320bn (167% of GDP), which is a sizeable buffer with which to absorb economic shocks. Moreover, as the CA has improved, official QCB foreign reserves have recovered, touching pre-2017 levels in March of $33.5bn (6.1 months of imports). (Chart 4.)

Robust credit growth as non-resident deposits recover

The banking sector has overcome the shock of non-resident capital flight and tighter liquidity of 2017. Foreign deposits have returned (+29% y/y in March), private sector credit growth is at a near-three year high (+12.6% y/y) and overall liquidity has improved. (Chart 5.)

Volatile energy prices and LNG competition are the main risks

Qatar faces some challenges including continued sensitivity to volatile global energy prices and capital flows as well as increasing LNG competition (especially from Australia and the US), which could put downward pressure on prices.

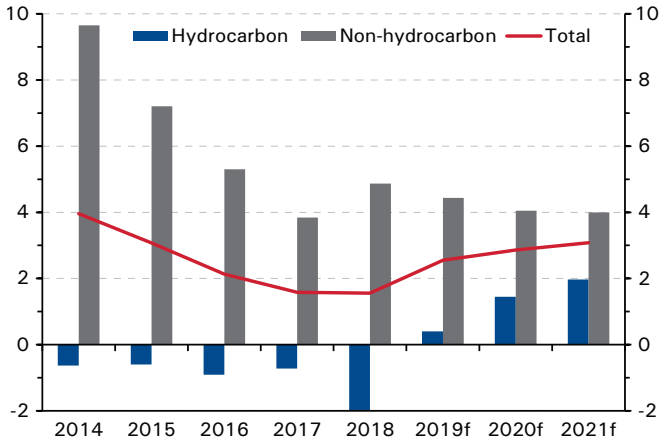
GCC key economic indicators

		2017	2018	2019f	2020f	2021f
Nominal GDP	$ bn	167	192	192	200	210
Real GDP	% y/y	1.6	1.6	2.6	2.9	3.1
- Oil	% y/y	-0.7	-2.0	0.4	1.4	2.0
- Non-oil	% y/y	3.8	4.9	4.4	4.0	4.0
Inflation	% y/y	0.4	0.3	-0.2	3.0	2.3
Fiscal balance	% of GDP	-6.5	2.2	1.7	2.2	3.2
Public debt	% of GDP	49.8	48.5	53.0	46.7	40.9
Current account bal.	% of GDP	3.8	8.3	6.4	4.0	4.4

Source: Official sources, NBK estimates

Chart 1: Real GDP growth

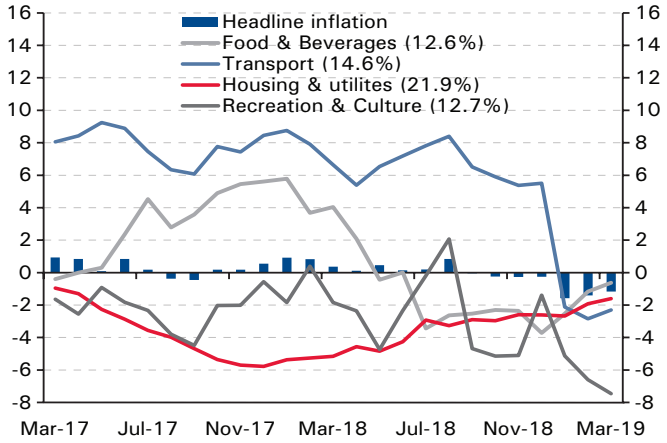
(% y/y; 2013 base year)



Source: Planning & Statistics Authority (PSA), NBK estimates

Chart 2: Consumer price inflation

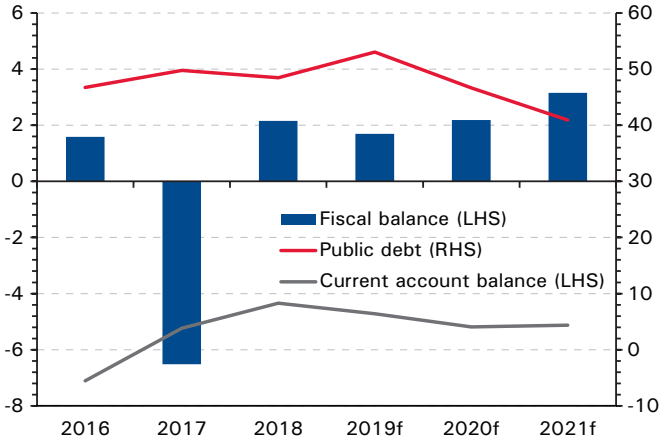
(% y/y; weights in brackets, 2013 base year)



Source: PSA

Chart 3: Fiscal balance, government debt & CA balance

(% of GDP)



Source: Qatar Central Bank (QCB), NBK estimates

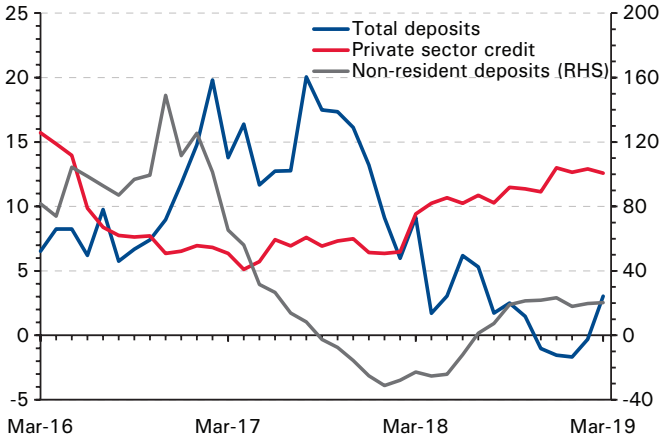
Chart 4: Official QCB reserves

($ billion)

Source: QCB

Chart 5: Deposit and credit growth

(% y/y)



Source: PSA

Saudi Arabia

Economic growth is recovering, driven by record government spending that aims to develop and stimulate the private sector, create jobs, cushion subsidy cuts and diversify the economy. Oil sector activity will remain subdued while the government is committed to active OPEC oil supply management. Public finances are improving thanks to higher tax revenues but the deficit will continue to weigh on public debt. Risks to the outlook stem from continued sensitivity to oil prices, slow diversification, limited private sector employment growth, and rising business costs mainly from expatriate levies.

Non-oil outlook improves, driven by public spending

The economy is well into its second year of recovery since contracting in 2017. With oil prices last year at least 31% higher than they were in 2017, the government has unveiled another record budget ($290bn) in support of consumption, jobs, the private sector (e.g. the private sector stimulus program) and economic diversification (e.g. National Industrial Development Program, NIDLP).

Non-oil activity has improved, and is expected to accelerate from 2.0% in 2018 to 3.2% by 2021. (Chart 1.) Recent (April) high frequency metrics, such as point of sales (POS) transactions (+24% y/y), cement sales (+5.2% ytd), private sector import letters of credit (+7.5% y/y Jan-Apr cumulative) and private credit growth (+2.1% y/y) all show gains. Also, PMI activity in June hit a 19-month high (57.4) on rising new orders. (Chart 2.)

Headline growth, in contrast, will lag non-oil growth at 1.0% in 2019 and 2.4% over 2020-21 due to Saudi Arabia's OPEC+ oil production cut obligations, under which the kingdom has so far over-complied by 293% (9.69 mb/d in May). While oil output will likely rise to near quota levels (10.3 mb/d), we don't believe that, given current and projected oil market dynamics to 2021, there is scope for further gains without pushing oil prices below the $70-80/bbl range that the authorities are thought to be comfortable with. OPEC on 1 July agreed to extend its oil production cut agreement to March 2020.

Consumer prices beset by deflation

Inflation has been negative since the start of 2019, weighed down by falling real estate prices and housing rents as well as by base effects related to the 2018 subsidy cuts and VAT rollout. Further energy/utility price hikes and another mooted sugary drinks tax will push inflation to 0.8% in 2020 from -1.5% in 2019.

Public finances more secure but debt levels rising

Public finances are on a more sustainable footing, despite continued sensitivity to oil prices (oil revenues account for 65% of total revenues). Spending has been rationalized, subsidies pared back and non-oil revenues boosted through excise taxes, expat levies and the VAT. The fiscal deficit narrowed to 6% of GDP in 2018, and, while expected to widen in 2019 on likely lower-than-budgeted oil revenues, should shrink further to 4.9% of GDP by 2021 as non-oil revenues increase (from 10.1% to 12.5% of GDP). (Chart 3.) Public debt will continue to rise, from 19.3% of GDP in 2018 to a peak of 27% of GDP in 2021, as the authorities tap the debt markets to finance the deficit (and draw down their deposits at SAMA). $13.5bn worth of debt has already been issued in 2019, including an oversubscribed $7.5bn international bond sale.

Current account surplus rises, capital outflows increase

The current account is in better shape, with higher oil prices helping the surplus extend from 1.5% of GDP in 2017 to 9.3% of GDP in 2018. (Chart 4.) An average of 8% of GDP is expected to 2021, which will bolster the official foreign reserves. These stood at $505bn in April (35% in US treasuries), equivalent to 28.8 months of imports. At the same time, resident capital outflows, mainly overseas investment by the Public Investment Fund (PIF), have increased. The PIF aims to increase its assets under management from around $300bn to $400bn by 2020. Inflows have been dominated by portfolio investment following the Saudi bourse's inclusion in the MSCI and FTSE EM indices. FDI doubled to $3.2bn in 2018 and should increase further by 2022 as CMA reforms proceed and if the Saudi Aramco IPO takes place.

External and labor market risks weigh on outlook

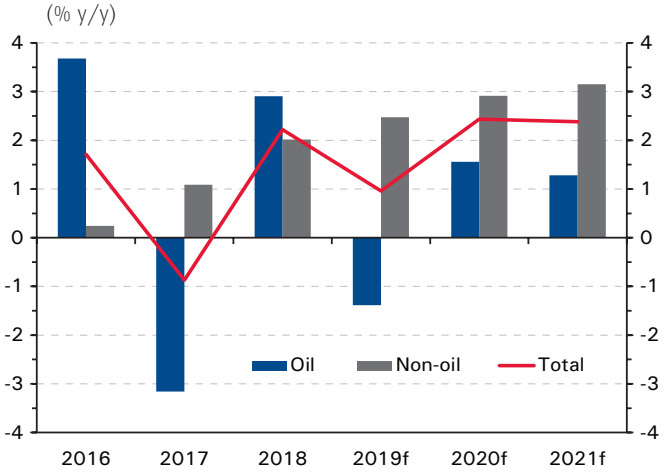
External risks to the Saudi outlook emanate from a possible deterioration in the global economy and the regional geopolitical environment as well as any shock to oil prices. With an estimated average fiscal break-even oil price to 2021 ($83.7/bbl) above our oil price forecast, the authorities will need fiscal restraint and/or higher non-oil revenues in order to meet their 2022 balanced budget target and keep public debt at a sustainable level in the medium term. But expat levies have raised costs for businesses and impacted consumption as expatriates leave the kingdom (net 1.2mn employment reduction since 4Q16) amid accelerated Saudization. The Saudi unemployment and female labor force participation rates, at 12.5% and 20.5%, respectively, in 1Q19, are slowly improving. (Chart 5.) However, the authorities will need to step up the rate of private sector job creation (diversification) as Saudi private sector employment growth remains low.

GCC key economic indicators

		2017	2018	2019f	2020f	2021f
Nominal GDP	$ bn	687	775	756	780	808
Real GDP	% y/y	-0.9	2.2	1.0	2.4	2.4
- Oil	% y/y	-3.2	2.9	-1.4	1.6	1.3
- Non-oil	% y/y	1.1	2.0	2.5	2.9	3.2
Inflation	% y/y	-0.8	2.5	-1.5	0.8	1.3
Fiscal balance	% of GDP	-8.2	-6.0	-6.8	-6.0	-4.9
Public debt	% of GDP	17.2	19.3	23.9	26.1	27.1
Current account bal.	% of GDP	1.5	9.3	7.8	8.0	8.0

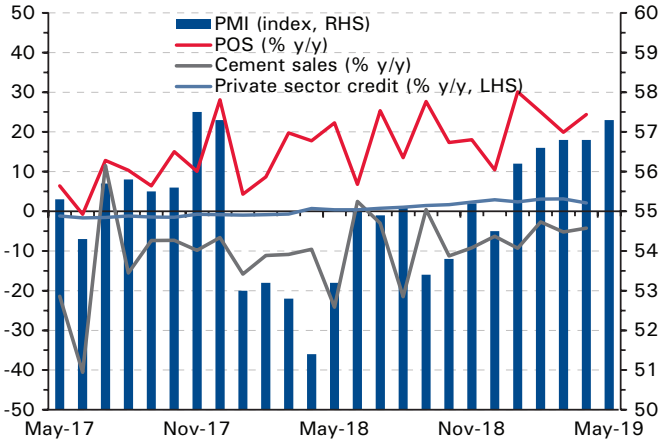
Source: Official sources, NBK estimates

Chart 1: Real GDP



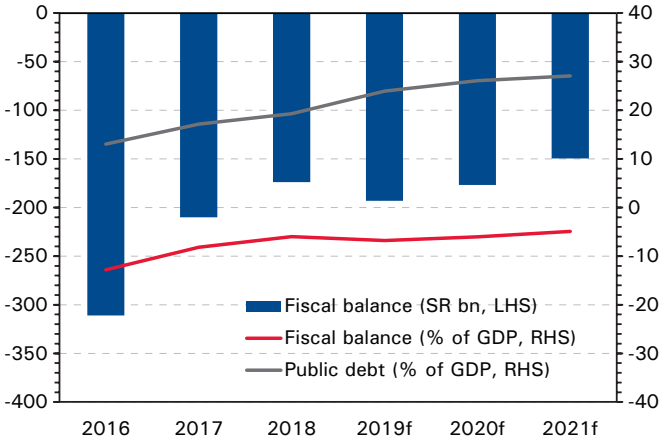
Source: Saudi General Authority for Statistics (GASTAT), NBK estimates

Chart 2: POS, cement sales, private credit and PMI



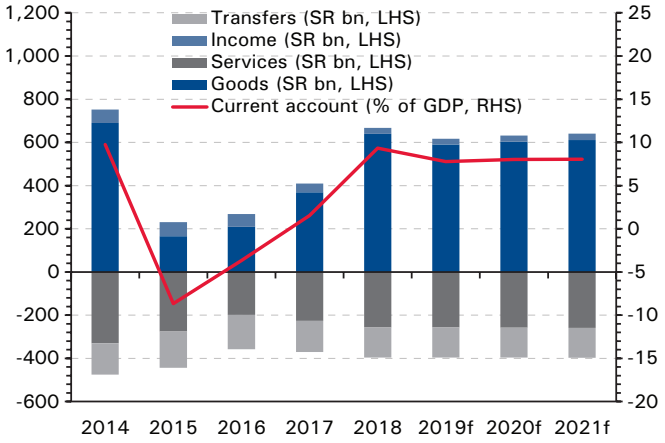
Source: SAMA, ARGAAM, Markit/Emirates NBD

Chart 3: Fiscal balance and government debt



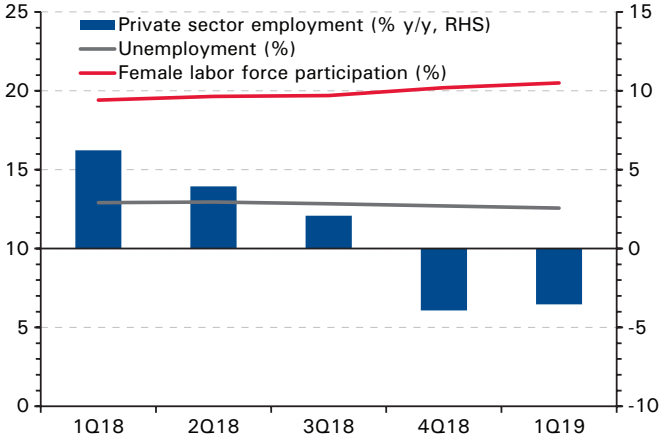
Source: Ministry of Finance, NBK estimates

Chart 4: Current account balance



Source: GASTAT, SAMA, NBK estimates

Chart 5: Saudi labor force indicators



Source: GASTAT

UAE

UAE economic performance is expected to steadily improve, with non-oil economic growth reaching 3.6% by 2021; inflation should remain subdued over the coming two years. Accommodative monetary policy, supported by the low global interest rate environment, improving public finances, policy-making agility and pro-investment reforms will provide the impetus for stronger economic performance. A possible global slowdown, reduced housing activity and lower oil prices could temper the outlook.

Growth to be supported by gains in the non-oil economy

UAE economic growth should trend higher over 2019-2021, led mainly by ongoing gains in non-oil sector activity and by a pick-up in the oil economy. We foresee real GDP growth edging up from 2.2% in 2018 to around 3.0% in 2021. (Chart 1.)

Real oil sector growth is projected to remain capped by the OPEC+ production cut agreement, which has been recently extended until March 2020. But with some increase in oil production to reach the quota set in the current agreement, oil growth could average 1.2% over the forecast period.

The non-oil economy is forecast to maintain a stronger growth momentum, as the transport, construction and tourism sectors (large contributors to non-oil GDP growth) gather pace, including in the run-up to the Expo 2020 event in Dubai. The non-oil sector will be further supported by growth-boosting initiatives launched at the federal level, including the adoption of a new investment law to facilitate investment inflows and the issuance of long-term visas for highly skilled workers and high-net worth individuals. This, the authorities hope, will lead to the retention of expertise and investment and boost longer-term growth.

Some high frequency data bode well for future performance. The recent Markit Purchasing Managers' Index (PMI) surged to a multi-year high, led by robust gains in new orders and output. However, hiring remains sluggish, which continues to limit gains in domestic demand.

Real estate sector prices continue to decline

Residential property prices in Dubai have been in decline since 2014 due mainly to oversupply and somewhat tighter regulations. Besides presenting some credit risks, the fall in real estate prices could eventually lead to lower activity in the sector over the medium term, with negetive impact on non-oil growth. (Chart 2.)

Price growth slips into deflation

Consumer price growth in the UAE has been in deflationary territory since the start of 2019, as the effects of 2018's tax/fuel hikes waned and as housing costs fell more steeply than expected. We are likely to see prices beginning to rise again only slightly towards the end of 2019, but inflation will be restrained by continued declines in the housing component. As such, we have revised down our inflation forecast for 2019 from 2.0% previously to -1.0%. Inflation will likely pick up to 1% and 1.5% in 2020 and 2021, respectively. (Chart 3.)

Fiscal position and current account improving

The fiscal balance should improve and return to surplus in 2020 on the back of higher oil and non-oil revenues, the latter helped by higher taxes and fees due to a pick-up in economic activity. (Chart 4.) Last year, the UAE embarked on a fiscal adjustment and reform program: VAT was introduced (its impact was larger than anticipated); subsidies were cut; and fees on certain services were levied. Thanks to its sizeable fiscal buffers, the UAE is well placed to withstand negative shocks, and both Dubai and Abu Dhabi should be able to sustain high levels of public spending, particularly on infrastructure.

The surplus on the current account is gradually recovering, as both oil and non-oil export earnings increase. We expect the CA surplus to rise to an average of 9% over 2019-2021.

Low interest rates support stronger business activity

In tandem with improvements in business activity, credit growth remained relatively firm at 4.4% y/y in April. (Chart 5.) With the US Fed holding off recently on tightening and with the expected loosening of monetary policy, the cost of funding will fall as the UAE Central Bank follow the US rate cut, providing further support to lending and non-oil sector growth.

Good outlook but some risks remain

In view of its relative openness, the UAE economy will be affected by trade tensions and any slowdown in global economic growth. Transport, logistics, tourism, and foreign investment could all be impacted. Besides the ever-present geopolitical dimension and sensitivity to oil price movements, a slowdown in construction activity over the medium term is another risk. However, recently announced growth-enhancing structural reforms across the UAE are likely to temper these risks and support economic growth going forward.

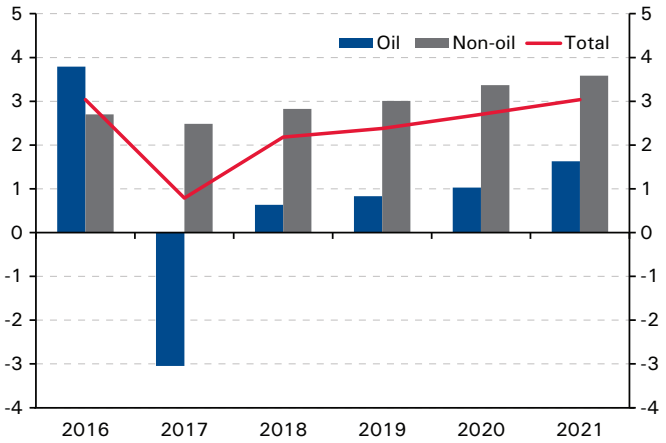
GCC key economic indicators

		2017	2018	2019f	2020f	2021f
Real GDP	% y/y	0.8	2.2	2.4	2.7	3.0
- Oil	% y/y	-3.0	0.6	0.8	1.0	1.6
- Non-oil	% y/y	2.5	2.8	3.0	3.4	3.6
Inflation	% y/y	2.1	3.5	-1.0	1.0	1.5
Budget balance	% of GDP	-3.8	-1.2	-0.7	1.2	1.2
Current account	% of GDP	6.9	7.6	8.2	8.9	9.7

Source: Official sources, NBK estimates

Chart 1: Real GDP

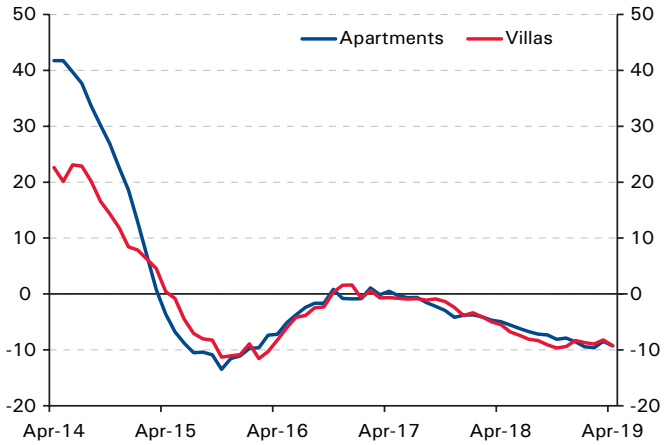
(% y/y)



Source: UAE Federal Competitiveness & Statistics Authority / NBK estimates

Chart 2: Dubai residential property sales prices

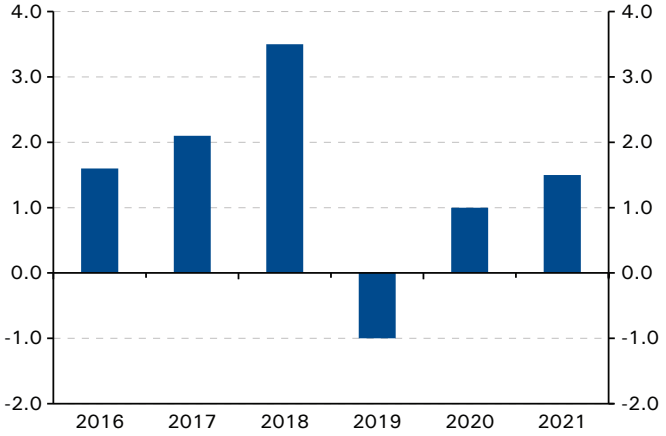
(% y/y)



Source: Reidin

Chart 3: Inflation

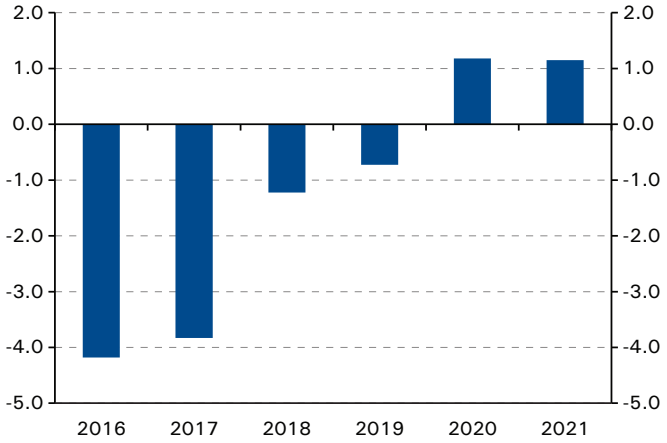
(% y/y)



Source: Refinitiv / NBK

Chart 4: Fiscal balance

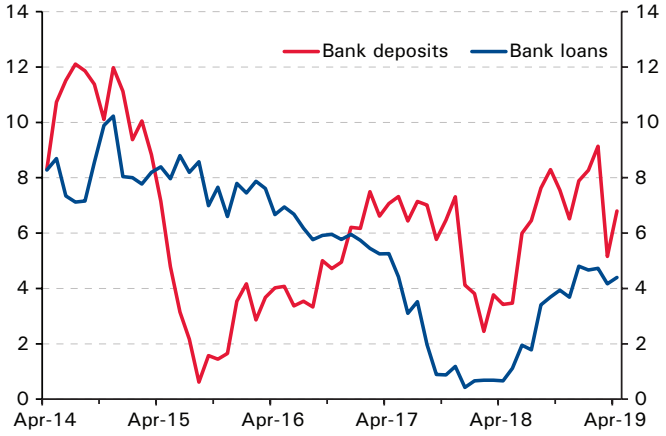
(% of GDP, revenues include ADNOC profits & investment income)



Source: Ministry of Finance / NBK estimates

Chart 5: Bank credit and deposits

(% y/y)



Source: Central Bank of the UAE

Egypt

Significant progress has been made under the authorities' reform program. Robust economic growth is expected to continue over the forecast period, and inflation, having come down from its highs in 2017, should trend lower, although it could inch up temporary due to the just announced increase in electricity tariffs and fuel prices. The budget deficit and the external current account have also improved. High domestic interest rates, large debt service, and unemployment are risks to the otherwise promising outlook.

Egyptian economy on the right path

As Egypt continues to implement its ambitious economic reform program, GDP growth accelerated from 5.3% in FY17/18 (July-June) to 5.6% by the end of March 2019. Looking forward, we expect growth to remain robust at around 5.2% in FY19/20 and 5.0% in FY20/21. (Chart 1.) Growth will be driven by a strong pick-up in capital spending, a continued recovery in the tourism sector and continued increases in natural gas production, which turned Egypt into a net gas exporter in the second quarter of FY18/19.

The IMF has supported the authorities' reform program since end-2016. The intention now is to move to a non-financial program where the IMF will play an advisory role that could help the authorities in their reform efforts.

Easing inflation could support further rate cuts

Since the energy subsidy cuts in mid-2018, urban inflation started to decelerate, standing at 9.4% y/y in June 2019. In this context, prices will likely remain susceptible to upward pressures in the second half of 2019, due mainly to the increase in average electricity tariffs (14.9%) and the elimination of fuel subsidies (16-30%). We expect inflation to average 12.5% in FY19/20 and 9% in FY20/21, down from 20.9% in FY17/18. (Chart 2.) These projections are subject to uncertainty linked to movements in oil prices and the exchange rate as well as to volatile food prices, given the latter's large weight in the consumer basket.

The CBE cut the interest rate by 100 bps in February 2019 (Chart 3), and has since kept it unchanged. Following the sharp fall in the June inflation rate to single digit, the CBE opted to wait and to assess the impact of electricity and fuel tariffs hikes on prices before easing monetary policy. Once the impact of the price hikes wear off, a 100-200 bps of cuts is likely by mid-2020, which should help reduce Egypt's debt service cost and boost private sector activity.

High debt service is weighing on the fiscal position

Egypt's government continues to consolidate its fiscal position through higher tax revenues and cuts of energy subsidies. This has led to a primary budget surplus of 0.2% of GDP in the FY17/18, for the first time in 15 years. (Chart 4.) Nevertheless, the deficit will likely remain relatively high due in part to high debt service. For FY19/20, Egypt's parliament just approved the country's largest ever budget of EGP1.6 trillion ($95bn), which includes an 11.4% hike in the wage bill. Still, the government is targeting a deficit of 7.2% of GDP for the year, thanks to the reduction in fuel subsidies from $5.37bn in FY18/19 to $3.18bn this fiscal year. We believe these targets are achievable, especially if oil prices remain close to the budget's benchmark oil price ($65-$67/bbl; in line with our assumption) and if government reforms remain on track.

The public debt ratio has declined from 108% of GDP in FY16/17 to an estimated 86% of GDP in FY18/19, driven by fiscal consolidation and strong economic growth. We expect the debt-to-GDP ratio to move up to around 90% of GDP next fiscal year. The government planned to issue about $7.0 billion in international bonds in different currencies with a view to diversifying its debt instruments, improving the debt structure and reducing borrowing costs, benefiting from the downward trend in global interest rates. With domestic rates remaining high, borrowing in EGP is a burden on public finances, although this is expected to decline if inflation and interest rates fall over the medium term.

The external sector to improve further

The external sector has continued to strengthen as the trade deficit narrows and remittances and tourism continue to recover as the economy has become more competitive following the depreciation of the EGP. Fiscal consolidation has also played a role in reducing the current account deficit, which narrowed to 2.4% of GDP from 6.1% of GDP a year ago. It is expected to shrink further to 2% of GDP in the FY18/19 and to 1.5% of GDP in FY20/21 if gas exports continue strong. (Chart 5.)

Favorable outlook, but challenges remain

While significant progress has been made, a number of challenges need to be addressed so as not to derail the reform program in the medium and long term. Higher interest rates would dampen economic growth and add to the already-high public debt burden. With the number of entrants into the workforce soaring, boosting private sector growth and employment is critical. As macroeconomic stability is taking root, attention needs to shift to structural reforms to reduce poverty, lift the standard of living of the population and ensure that the benefits of reforms are more widely shared.

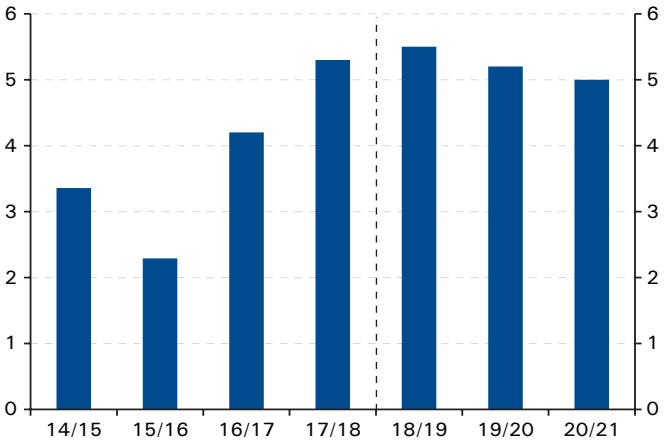
GCC key economic indicators

		FY16/17	FY17/18	FY18/19	FY19/20	FY20/21
Nominal GDP	$ bn	251	248	296	349	398
Real GDP	% y/y	4.2	5.3	5.5	5.2	5.0
Inflation	% y/y	23.5	20.9	14.0	12.5	9.0
Budget balance	% of GDP	-10.7	-9.7	-8.5	-7.4	-6.5
Primary balance	% of GDP	-1.6	0.2	1.8	2.4	3.1
Current account	% of GDP	-6.1	-2.4	-2.0	-1.7	-1.5

Source: Official sources, NBK estimates

Chart 1: Real GDP

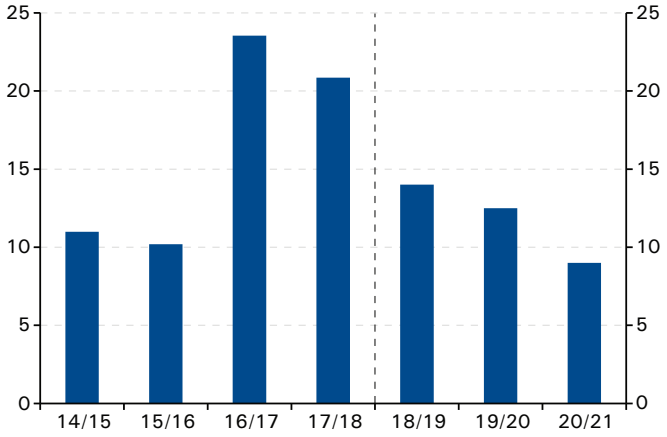
(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 2: Inflation

(% y/y)



Source: Capmas, Central Bank of Egypt, NBK estimates

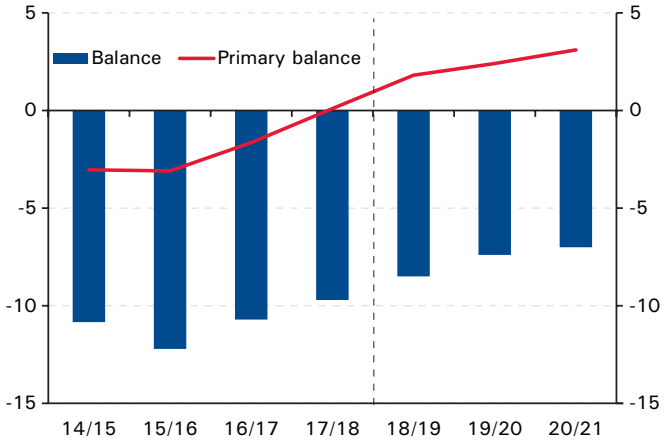
Chart 3: Interest rates

(%)

Source: Refinitiv / Central Bank of Egypt

Chart 4: Fiscal balance

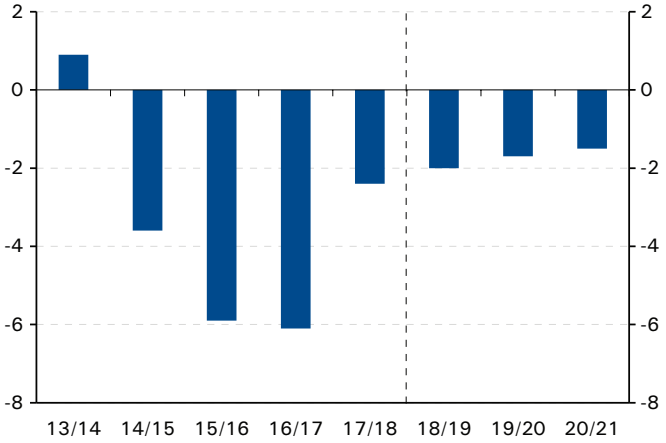
(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 5: Current account balance

(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Regional economic data and forecasts

	Unit	2015	2016	2017	2018	2019f	2020f	2021f
Bahrain								
Nominal GDP	USD bn	31.0	32.2	35.3	37.8	39.1	40.9	42.4
Real GDP	% y/y	2.8	3.5	3.8	2.5	2.7	2.8	3.0
Oil sector	% y/y	-0.1	-0.1	-0.7	-1.3	0.2	0.7	1.0
Non-oil sector	% y/y	3.6	4.3	4.9	3.4	3.2	3.3	3.4
Budget balance	% of GDP	-13.0	-13.5	-10.0	-8.3	-6.4	-4.8	-3.7
Current account balance	% of GDP	-2.4	-4.6	-4.5	-5.9	-4.4	-4.1	-3.8
Inflation	% y/y	1.8	2.8	1.4	2.1	1.5	2.0	2.5
Kuwait								
Nominal GDP	USD bn	114.6	109.4	119.5	137.4	133.6	138.0	142.9
Real GDP	% y/y	0.6	2.9	-3.5	1.8	1.0	2.4	2.4
Oil sector	% y/y	-1.7	3.9	-7.2	1.2	-0.5	2.0	2.0
Non-oil sector	% y/y	0.4	1.6	2.2	2.5	2.5	2.8	2.8
Budget balance	% of GDP	-13.4	-13.9	-9.0	2.0	-3.0	-4.0	-5.0
Current account balance	% of GDP	3.5	-4.6	8.0	14.8	8.0	7.0	6.0
Inflation	% y/y	3.7	3.5	1.5	0.6	1.0	1.5	2.0
Oman								
Nominal GDP	USD bn	69.0	65.9	70.7	75.0	80.0	84.0	84.0
Real GDP	% y/y	4.7	5.4	0.3	2.4	3.2	3.6	3.9
Oil sector	% y/y	4.4	2.3	-3.0	1.5	3.0	3.5	4.0
Non-oil sector	% y/y	5.0	7.6	2.6	3.0	3.3	3.6	3.8
Budget balance	% of GDP	-17.4	-20.9	-14.9	-5.3	-6.8	-5.9	-5.9
Current account balance	% of GDP	-15.9	-18.7	-15.2	-6.4	-7.6	-6.1	-4.7
Inflation	% y/y	0.1	1.1	1.6	0.9	1.5	2.5	1.5
Qatar								
Nominal GDP	USD bn	161.8	151.7	166.9	192.0	192.4	200.3	210.2
Real GDP	% y/y	3.6	2.2	1.6	1.6	2.6	2.9	3.1
Oil sector	% y/y	-0.5	-1.0	-0.7	-2.0	0.4	1.4	2.0
Non-oil sector	% y/y	8.2	5.6	3.8	4.9	4.4	4.0	4.0
Budget balance	% of GDP	-10.2	1.6	-6.5	2.2	1.7	2.2	3.2
Current account balance	% of GDP	8.5	-5.5	3.8	8.3	6.4	4.0	4.4
Inflation	% y/y	1.8	2.7	0.4	0.3	-0.2	3.0	2.3
Saudi Arabia								
Nominal GDP	USD bn	654.2	647.6	686.5	774.6	756.1	780.4	808.1
Real GDP	% y/y	4.1	1.7	-0.9	2.2	1.0	2.4	2.4
Oil sector	% y/y	5.3	3.7	-3.2	2.9	-1.4	1.6	1.3
Non-oil sector	% y/y	3.2	0.2	1.1	2.0	2.5	2.9	3.2
Budget balance	% of GDP	-15.1	-12.8	-8.2	-6.0	-6.8	-6.0	-4.9
Current account balance	% of GDP	-8.7	-3.7	1.5	9.3	7.8	8.0	8.0
Inflation	% y/y	1.2	2.1	-0.8	2.5	-1.5	0.8	1.3
UAE								
Nominal GDP	USD bn	358.1	357.0	382.5	418.7	425.4	440.6	459.4
Real GDP	% y/y	5.1	3.0	0.8	2.2	2.4	2.7	3.0
Oil sector	% y/y	5.2	2.6	-3.0	0.6	0.8	1.0	1.6
Non-oil sector	% y/y	5.0	3.2	2.5	2.8	3.0	3.4	3.6
Budget balance	% of GDP	-3.4	-4.2	-3.8	-1.2	-0.7	1.2	1.2
Current account balance	% of GDP	22.2	14.3	6.9	7.6	8.2	8.9	9.7
Inflation	% y/y	4.1	1.6	2.1	3.5	-1.0	1.0	1.5
Egypt (fiscal year)								
Nominal GDP	USD bn	331.6	331.8	251.0	248.0	296.4	348.9	397.7
Real GDP	% y/y	3.4	2.3	4.2	5.3	5.5	5.2	5.0
Budget balance	% of GDP	-10.8	-12.2	-10.7	-9.7	-8.5	-7.4	-6.5
Current account balance	% of GDP	-3.8	-6.0	-6.1	-2.4	-2.0	-1.7	-1.5
Inflation	% y/y	11.4	14.0	23.5	20.9	14.0	12.5	9.0

International data

	Unit	2015	2016	2017	2018	2019f	2020f	2021f
Brent crude oil spot price (year average)	$ p/b	53.5	45.7	54.9	71.5	65.0	65.0	65.0
CRB commodity price index*	Index	374.8	423.1	432.5	409.2	-	-	-
Eur/USD*	1$ = €	0.921	0.951	0.833	0.872	-	-	-
US Fed Fund Rate	%	0.5	0.75	1.5	2.5	-	-	-
MSCI World stock market index*	Index	1,663	1,751	2,103	1,884	-	-	-
MENA real GDP (IMF/NBK)	% y/y	2.6	5.2	1.8	1.4	1.3	3.2	2.8
World real GDP (IMF)	% y/y	3.4	3.3	3.8	3.6	3.3	3.6	3.6

Source: Thomson Reuters Datastream, official sources, IMF, NBK estimates; * Latest available data

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