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Research Briefing | GCC

GCC looking to fastest growth in three years

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- **GCC economies are starting to recover after two difficult years. Oil prices have picked up slightly and austerity is easing, so GDP growth in the region is seen rising to 2.7% in 2018 from just 0.3% this year. That said, the GCC still faces headwinds – inflation will rise and the US$ peg means the region will have to raise rates in tandem with the Fed, reinforcing the still-restrictive fiscal policy stance. And ongoing political uncertainty in the region generally may unsettle domestic and global investors.**

- **The outlook varies across the GCC states and resilience is uneven – but weak external and fiscal positions leave Bahrain and Oman exposed to further credit rating downgrades.**

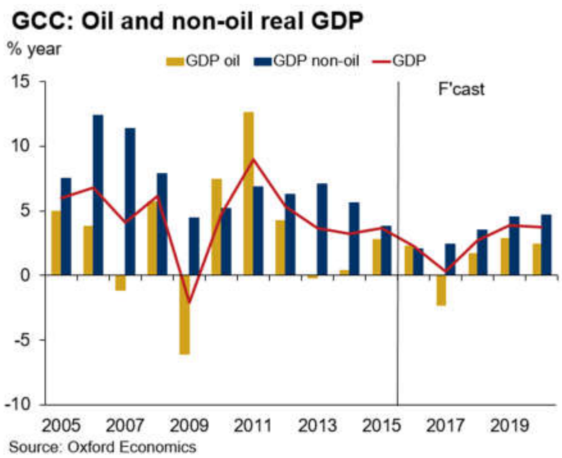
GCC prospects look brighter heading into 2018

GCC growth is ending a two-year downtrend as we head into 2018; rising oil prices will allow governments to move away from sharp austerity, facilitating a jump in the GCC growth rate to 2.7% from an estimated 0.3% this year. The extension of OPEC/non-OPEC production cuts implies only modest increases in oil output in 2018. But apart from Bahrain, the energy sector will no longer be a drag on growth in GCC countries and its contribution to growth will rise going forward.

The impact of fiscal consolidation will ease in 2018 as oil revenues rise

Slightly higher oil prices this year and in 2018-19 set the scene for a slower pace of consolidation. Fiscal consolidation has been the policy for many governments in the last few years against the backdrop of the 'new normal' of lower oil prices, with austerity having been extended this year and continuing subsidy and spending cuts and new excise taxes hitting households. Next year will see the introduction of a region-wide VAT, adding to the burden on consumers and businesses alike. But after a few years of sharp austerity, government spending growth will pick up, even though it will remain below the average in 2006-2014. In the medium term, the improving fiscal position will support the investment growth outlook.

Chart 1: GCC growth is ending a two-year downtrend



The drag from the oil sector is coming to an end.

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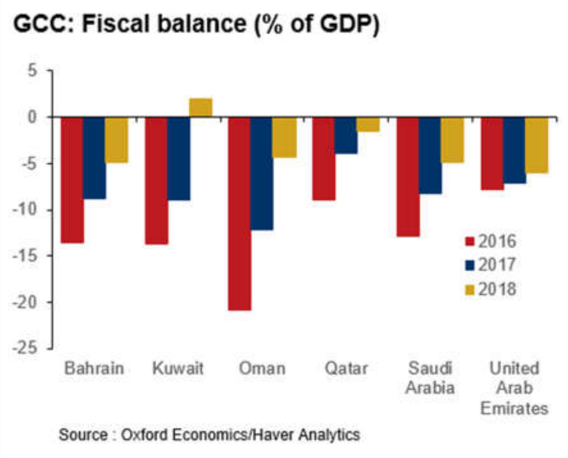
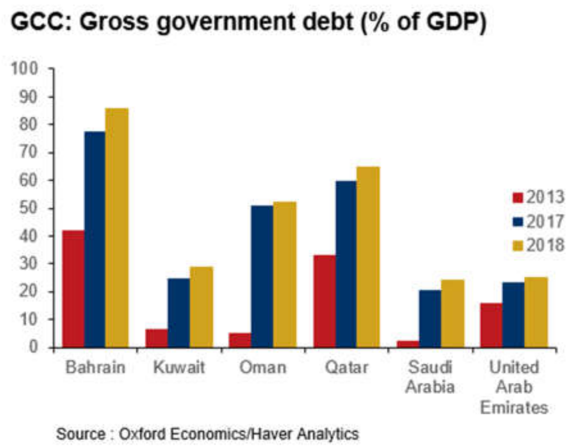
Chart 2: Fiscal space will improve, but only slowly



Fiscal deficits are narrowing only slowly; Kuwait aside, GCC countries are nowhere near a balanced budget.

Chart 3: Debt levels have ballooned since 2013



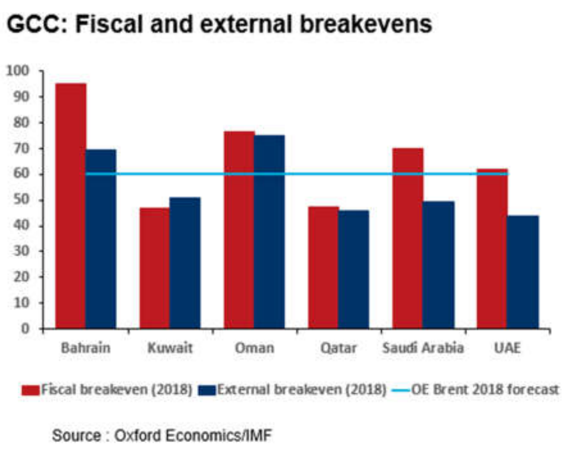
Debt issuance will continue amid large financing needs.

Fiscal deficits will remain as the GCC adjusts to new realities

Lower oil prices pushed the GCC governments to resort to alternative financing to fund their external and fiscal deficits, primarily through issuing international or domestic bonds and drawing down their foreign reserves.

We expect governments to continue to tap international and domestic capital markets, leading to higher debt levels throughout the region. Liquidity pressure on the banking sector is set to continue due to the expected government financing needs and the rise in financing costs associated with tighter monetary policy.

Chart 4: Brent crude at US$60 insufficient for most countries to balance their budgets



With the exception of Kuwait and Qatar, GCC countries need an oil price of over US$60pb (our 2018 Brent forecast) to balance their budgets.

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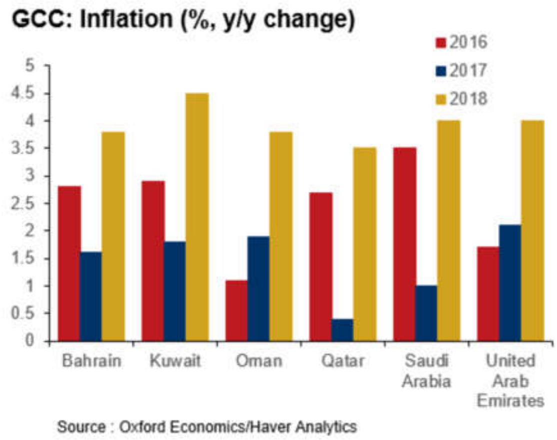
Inflation will spike temporarily...

Unfortunately for the consumers and businesses, the era of subdued inflation is coming to an end; upcoming policy measures will raise costs in 2018. Most importantly, the introduction of a 5% VAT in GCC countries will lift regional inflation to 4% in 2018, with potential further upside risk from energy and utility price reforms. Combined with a much-reduced pace of public sector job creation and limited wage growth, this will constrain household expenditure in the years ahead.

Chart 5: Inflationary pressures have been largely absent but will pick up in 2018



VAT introduction will lift the cost of living in 2018, posing a further burden on consumers and businesses

...but it will not be the main driver of higher local interest rates

Although the spike in inflation may be temporary, local central banks will mirror the US tightening cycle to protect their US$ currency pegs, reinforcing the still-restrictive fiscal policy. De-pegging will not occur in 2018, but is more possible by 2020 (Bahrain and Oman are the most likely targets). We now expect three US rate rises next year, with the GCC central banks following suit, modestly increasing domestic financing costs and dampening overall consumption and investment levels. Tighter monetary policy, continued fiscal austerity measures, albeit at a slower pace, and only a modest recovery in oil prices and output will keep a lid on the recovery in growth in 2018.

Political tensions may undermine optimism

But the recent rise in geopolitical risk in the region could undermine the brighter outlook for 2018; the GCC's perceived internal and regional stability may no longer provide a 'risk discount'. Increased tensions between Saudi Arabia and Iran are spilling over into the politics of other countries across the Middle East (Yemen, Qatar, Lebanon), while the GCC dispute with Qatar continues, with little sign of progress, weighing on confidence. Meanwhile, political challenges continue to pose a downside risk. In Saudi Arabia, there has been an anti-corruption purge and a crackdown on the religious authority, with potential implications. In Kuwait, the resignation of the government in late-October has added to uncertainty. In Oman, the continuing absence of a clear succession plan is worrying. And the worsening health of Shaikh Issa Qassim, the spiritual leader of the Shia population in Bahrain who has been under house arrest, is also a concern.

GCC Forecasts

	GDP growth (% y/y)			Inflation (% y/y)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018
Bahrain	3.2	1.8	1.8	2.8	1.6	3.8	-4.6	-1.3	-3.4	-12.6	-8.9	-4.8
Kuwait	3.5	-1.7	2.4	2.9	1.8	4.5	0.6	5.2	9.0	-13.8	-8.9	2.0
Oman	1.5	0.2	5.0	1.1	1.9	3.8	-18.6	-11.9	-7.8	-20.8	-12.2	-4.3
Qatar	2.2	1.3	3.1	2.7	0.4	3.5	-5.5	2.9	5.6	-9.0	-3.9	-1.5
KSA	1.7	-0.3	2.0	3.5	1.0	4.0	-4.2	-0.4	0.7	-12.8	-8.3	-4.9
UAE	3.0	1.7	3.3	1.7	2.1	4.0	3.3	3.5	3.2	-7.8	-7.1	-6.0
GCC	**2.3**	**0.3**	**2.7**	**2.9**	**1.3**	**4.0**						

Source: Oxford Economics

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