

GCC Sovereigns' Funding Needs Are About \$300 Billion In 2018-2021

November 6, 2018

Key Takeaways

- Gulf Cooperation Council (GCC) sovereigns' cumulative financing needs will be around \$300 billion between 2018 and 2021, the majority pertains to Saudi Arabia.
- On average, we expect a 70:30 financing split between debt and assets over 2018-2021, with Qatar and Bahrain financing almost exclusively with debt and Kuwait and Abu Dhabi relying more on assets.
- We expect that the average GCC central government fiscal deficit will remain broadly stable over our forecast period, at 6% of GDP, and that the average GCC net asset position will deteriorate to 110% of GDP in 2021, from 130% in 2017.
- Notably, however, apart from Oman and Bahrain, GCC governments still have an exceptionally high level of government liquid assets at their disposal.

PRIMARY CREDIT ANALYST

Benjamin J Young

Dubai

(971) 4-372-7191

benjamin.young
@spglobal.com

SECONDARY CONTACTS

Christian Esters, CFA

Frankfurt

(971) 4-372-7169

christian.esters
@spglobal.com

Trevor Cullinan

Dubai

(971) 4-372-7113

trevor.cullinan
@spglobal.com

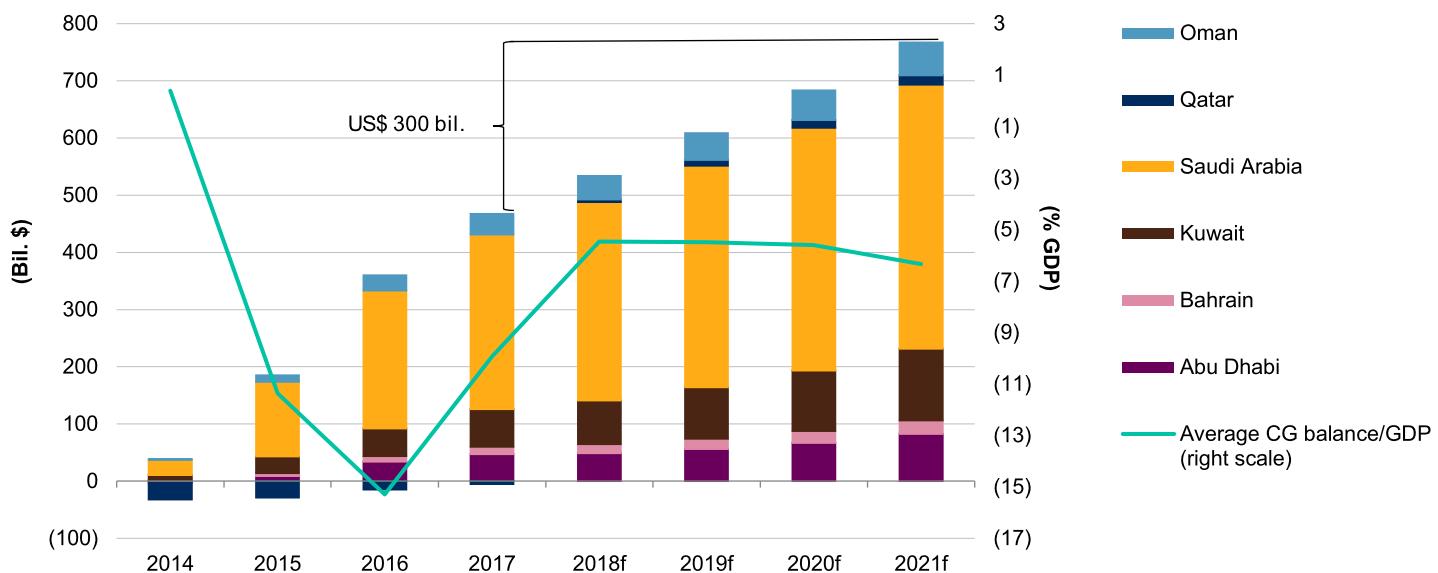
ADDITIONAL CONTACT

EMEA Sovereign and IPF

SovereignIPF
@spglobal.com

Chart 1

\$300 Billion Cumulative GCC Government* Funding Needs 2018-2021



Source: S&P Global Ratings. *Central government balances, excludes SWF-related income and debt refinancing estimates. f--Forecast. Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

Funding needs in the Gulf Cooperation Council (GCC) region are now accumulating at a slower pace thanks to higher oil prices and government policy responses. We estimate GCC sovereigns' cumulative funding needs at about \$300 billion between 2018 and 2021 (see chart 1). GCC sovereigns' combined central government deficit has much improved, and we estimate it will be around \$75 billion in 2019 (5.5% of combined GDP), way below the 2016 nadir of \$190 billion (16% of combined GDP).

Nevertheless, GCC governments' net debt positions have significantly deteriorated since oil prices fell in 2015 and debt-servicing costs now account for a much larger proportion of fiscal revenue. Barring any significant fiscal consolidation or sharp rise in oil prices, we do not expect this situation to reverse. We forecast GCC central government balances to remain in deficit until at least 2021. We estimate previous funding needs in 2015-2017 were \$450 billion (or 12% of combined GDP), compared with an expected \$300 billion over 2018-2021 (5% of GDP), and that total funding requirements over 2015-2021 will come to around \$750 billion.

Fiscal Imbalances Persist

Two factors have supported the improved fiscal picture. First, the oil price has almost trebled from the \$29 per barrel (/bbl) trough and is currently \$80/bbl; that said, we assume the oil price will decline to \$55/bbl by 2021. We expect oil prices to decline over the forecast period, curtailing government deficit reduction (see "S&P Global Ratings Raises Brent Oil Price Assumptions For 2018 Through 2020; WTI Assumptions For 2018 And 2019; Natural Gas Price Deck Unchanged," published Sept. 17, 2018). Second, many GCC governments have enacted major fiscal

GCC Sovereigns' Funding Needs Are About \$300 Billion In 2018-2021

consolidation measures, including first-time value-added tax introduction.

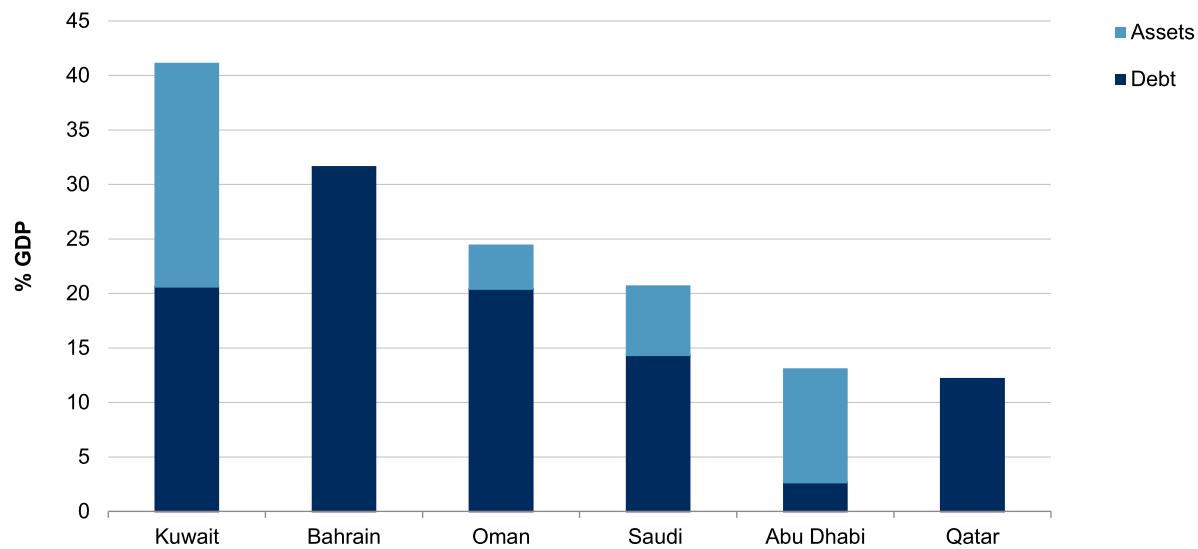
We expect the average GCC fiscal deficit will widen slightly over the forecast period to around 6% of GDP (from 5.5% in 2018), driving the \$300 billion financing requirement. Our assumption of falling oil prices and higher spending will likely offset planned revenue-raising measures and widen fiscal deficits in both Abu Dhabi and Kuwait. However, the denominator effect of rising GDP should maintain the fiscal deficit at the 6% of GDP level for the region as a whole.

We still believe that regional government consolidation measures will, for the most part, bear fruit over the medium-to-long term. Since 2015, governments have opted to avoid a sharp fiscal correction (which would have been both growth-sapping and politically sensitive). Instead, where available, they have deployed substantial stocks of assets to cushion the negative effects of the oil price shock. Growth-boosting capital expenditure (capex) is also embedded in strategic economic plans and is set to remain high. Finally, current expenditures could well be loosened in response to higher oil prices, as has been the case in Saudi Arabia over 2018.

Saudi Arabia's deficit makes up the majority (50%) of the GCC sovereigns' expected \$300 billion financing needs in nominal terms, but as a proportion of GDP is similar to that of Abu Dhabi and Oman in 2021, at 5%. Kuwait, however, represents 20% of the total, reflecting fiscal deficits widening to about 13% of GDP, at least in part linked to mandatory transfers into the Future Generations Fund (10% of revenue).

Chart 2

2018-2021 Cumulative Fiscal Deficit Financing Mix 70:30 (Debt:Assets)



Source: S&P Global Ratings.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

There are two main mechanisms through which governments can meet their financing requirements, both of which directly influence our ratings. A government may issue debt instruments to balance its books or draw on assets. Larger financing needs therefore imply an

GCC Sovereigns' Funding Needs Are About \$300 Billion In 2018-2021

increase in the annual incurrence of debt, a weakening asset position, or both. These factors feed into our net government debt calculations and our fiscal and debt-risk analysis.

A government's funding mix will likely reflect available resources and appetite for debt. For Kuwait, our forecasts assume that the parliament will pass a new debt law in 2019 after the previous one expired in October 2017, in the absence of which the government would not be able to issue any new debt. Other factors could include whether there are restrictions or ring-fences around assets and related income. For example, in Qatar the underlying mandate of the Qatar Investment Authority--the manager of sovereign assets--is to ensure future savings for the country, except, as recently demonstrated, in exceptional circumstances. This partly informs its policy decision to borrow, rather than use assets.

Another factor could be cost, in that it may be cheaper to issue debt than to forego investment earnings on assets. A sovereign's ability to raise funding through debt issuance can also depend on how receptive various markets might be. This can, among other factors, be a product of liquidity conditions in local banking systems and international investors' appetite for increasing their GCC sovereign exposure over a relatively short space of time. It may also reflect investors' perception of regional geopolitical risks, which we view as being elevated in the GCC following the boycott on Qatar, and the heightened tensions surrounding Saudi Arabia and its relations with Iran. Local and U.S. monetary policies could also be a consideration, although we do not expect any changes to regional currency pegs. A sharply increased reliance on domestic debt financing could result in the crowding-out of the private sector and hamper overall economic growth.

For most GCC sovereigns, we include in our projections a funding mix of asset drawdowns and debt issuance. We expect that debt issuance will meet 70% of the \$300 billion financing requirement. We base these assumptions on the financing trends of the past few years, governments' explicitly stated policy decisions, and our view of the availability of assets. Gross debt has increased on average from 14% of GDP at the end of 2014 to an estimated 38% of GDP by the end of 2018, as a result. We expect that Bahrain and Qatar will finance the vast majority of their deficits through debt, Abu Dhabi and Kuwait will draw more on their assets, and Saudi Arabia (and Oman) will show a 70:30 split.

Changes in domestic and international liquidity conditions could present challenges for sovereign issuance and tilt the financing balance toward assets from debt, or increase debt-servicing costs, as is particularly the case in Bahrain (where interest payments account for 23% of government revenue). We note that global liquidity is becoming scarcer and more expensive, while regional banking sector liquidity remains adequate.

The scale of financing needs also offers potential upside for regional sovereign sukuk issuance, particularly as this could offer some diversification to investors or attract liquidity from investors in Islamic products. Work has been carried out by GCC governments over the past few years to establish the necessary legal frameworks for sukuk issuance programs in domestic and external markets. However, the complexity and slow speed to market of Islamic products continue to inhibit the industry's widespread growth, in our view.

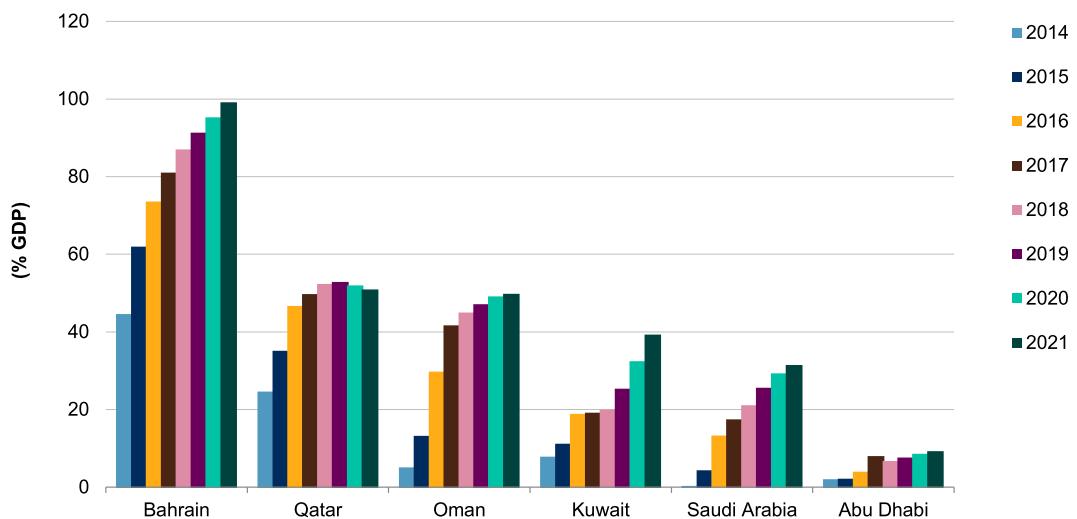
The Changing Face Of Regional Balance Sheets

There are pros and cons to drawing from assets or issuing debt, with implications for GCC sovereigns' gross debt and net asset positions (see charts 3 and 4). For example, an accelerated reduction of gross assets could put pressure on sovereigns for whom our estimate of very large liquid asset stock is a ratings support: stocks are a buffer against future shocks and are a backing for currency pegs. A rapid rise in debt could, among other things, increase the sensitivity of governments' finances to higher interest rates.

GCC Sovereigns' Funding Needs Are About \$300 Billion In 2018-2021

Chart 3

Gross Central Government Debt (% GDP)

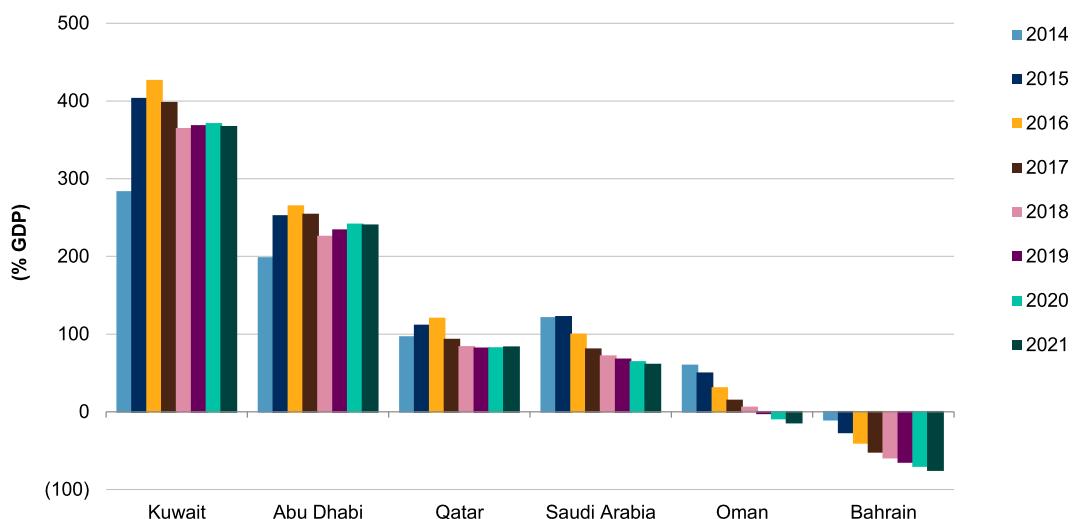


Source: S&P Global Ratings.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

Chart 4

GCC Government Net Asset Positions (% GDP)



Source: S&P Global Ratings.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

GCC Sovereigns' Funding Needs Are About \$300 Billion In 2018-2021

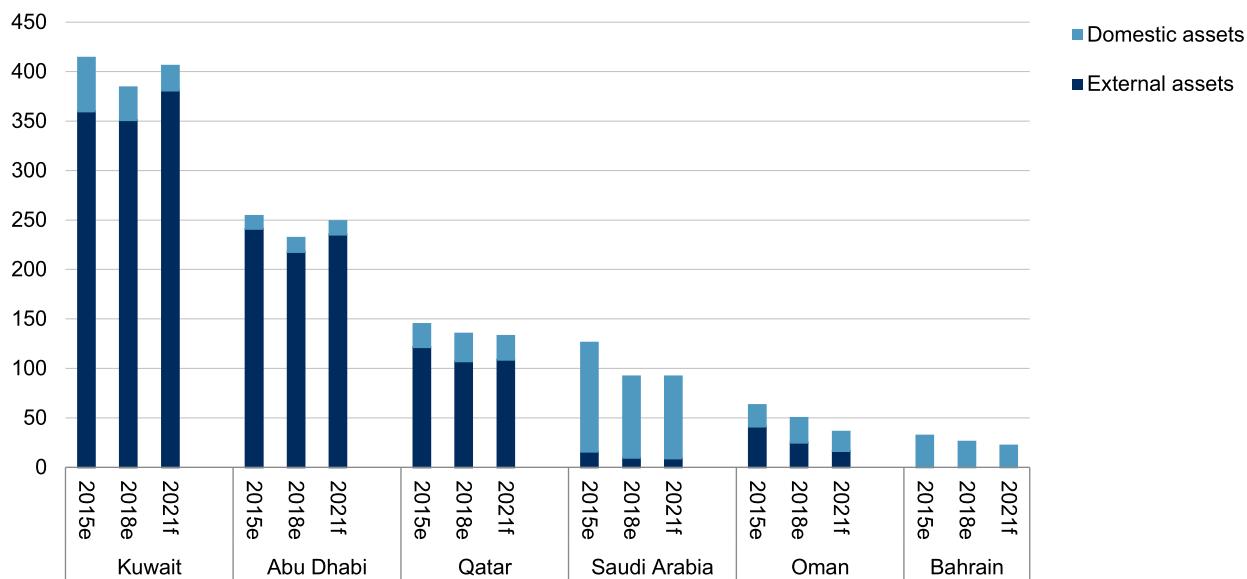
As things stand, we expect Bahrain's net debt will have nearly tripled between 2015 and 2021 and that Oman will slip into a net debt position in 2019. We forecast Saudi Arabia's net assets to have nearly halved to 65% of GDP by 2021 (71% of GDP in 2018). For Abu Dhabi, Kuwait, and Qatar, we expect the impact of deficits will be more muted because of their larger asset stocks, highlighting a fiscal bifurcation in the region, which is reflected in our ratings. In our view, regardless of the method used, financing substantial multi-year deficits is gradually reshaping sovereign balance sheets in the GCC.

Liquid Assets Are The Great Stabilizer

No region illustrates the support that large government liquid assets can provide to a sovereign rating better than the GCC. All GCC members have liquid assets exceeding 25% of GDP, and three of them have liquid assets worth more than 100% of GDP. Our ratings on Kuwait and Abu Dhabi remained at 'AA' (with a stable outlook) throughout the recent slump in oil prices, underlining the rating stability provided by having large liquid assets. Our rating on Qatar moved to 'AA-' from 'AA' in August 2017, but this was largely because of increased geopolitical risk following the imposition of a boycott by several countries (see "Qatar Long-Term Rating Lowered To 'AA-'; On Watch Negative After Six Arab Countries Sever Ties," June 7, 2017). By comparison, countries with lower levels of assets as a percentage of GDP--Bahrain, Oman, and Saudi Arabia--felt the drop in prices more keenly (see "Middle East And North Africa Sovereign Rating Trends Midyear 2018," published July 16, 2018), and their stock of liquid assets is below 100% of GDP. We expect Kuwait, Abu Dhabi, and Qatar to maintain liquid assets above 100% of GDP.

Chart 5

General Government Liquid Assets (% GDP)



Source: S&P Global Ratings.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

Related Research

- S&P Global Ratings Raises Brent Oil Price Assumptions For 2018 Through 2020; WTI Assumptions For 2018 And 2019; Natural Gas Price Deck Unchanged, Sept. 17, 2018
- Middle East And North Africa Sovereign Rating Trends Midyear 2018, July 16, 2018
- Saudi Arabia 'A-/A-2' Ratings Affirmed; Outlook Stable, Oct. 5, 2018
- Sovereign Ratings List, Oct. 3, 2018
- Barring Oil Or Geopolitical Risks, Gulf Banks' Financial Profiles Should Stabilize In 2019, Oct. 1, 2018
- Government Liquid Assets And Sovereign Ratings: Size Matters, Aug. 27, 2018
- Qatar Ratings Affirmed At 'AA-/A-1+'; Outlook Remains Negative, July 27, 2018
- Kuwait Ratings Affirmed At 'AA/A-1+'; Outlook Stable, July 20, 2018
- Middle East And North Africa Sovereign Rating Trends Midyear 2018, July 16, 2018
- Why The Global Sukuk Market Is Stalling In 2018, June 19, 2018
- Abu Dhabi 'AA/A-1+' Ratings Affirmed; Outlook Stable, June 8, 2018
- Bahrain 'B+/B' Ratings Affirmed; Outlook Remains Stable, June 1, 2018
- Sultanate of Oman 'BB/B' Ratings Affirmed; Outlook Stable, May 11, 2018
- Sovereign Debt 2018: MENA Borrowing To Decline By 6% To \$181 Billion, Feb. 22, 2018
- GCC Economic And Social Structures Will Likely Curb Tax Reforms, Jan. 25, 2018

This report does not constitute a rating action.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software, or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com and www.spcapitaliq.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.