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The party is over for GCC growth, but the music plays on

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- **The MENA region has to adjust to lower oil prices while providing adequate stimulus to support domestic economies taking a hit from COVID-19. This means lower growth and larger fiscal deficits.**
- **Saudi Arabia's stimulus package makes up 4% of GDP and is equivalent to 13% of the 2020 budget. This will erode the kingdom's fiscal balance further, prompting it to issue more debt.**
- **The UAE's stimulus package -- which is equivalent to about 16% of GDP -- should start yielding fruit from the second half of the year, but the economy will have to reinvent itself once again, over a multi-quarter U-shaped recovery.**

Sharp downward growth revisions

The first indication of the speed and extent of COVID-19 on the economies of the MENA region has come from March's Purchasing Managers Indices (PMI). All four countries with PMIs -- Saudi Arabia, the United Arab Emirates, Egypt and Lebanon -- were in contraction territory (i.e. below 50) and some were at record lows. This decline was backed up by the IMF's latest World Economic Outlook. It was, as expected, replete with downward revisions to growth

- A prolonged COVID-19 outbreak will result in higher costs and could have a broad and lasting disruption to global trade and manufacturing output into 2021, which will inevitably act as a further drag on local economies. Policy mistakes could also impede recovery.
- The IMF has said that the global economic impact of COVID-19 could be worse than the 2008 financial crisis. Its overall 2020 global growth forecast is now -3.0%, 6.3 percentage points down from January 2020 and compared with -0.1% during the financial crisis.
- In MENA, we have warned that most countries will experience a double whammy from the pandemic and the accompanying decline of oil revenues, with some suffering third and fourth blows via collapses in remittances and tourism -- each being principal components of GDP.
  - The IMF's 2020 MENA growth forecast is now -3.3% versus 2.7% in its October 2019 outlook and 2.7% in 2009.
- Efforts to contain the coronavirus outbreak have already resulted in a sharp decline in activity in the MENA region's non-oil sectors, according to PMI prints. Note that these reflected a month when COVID-19 lockdowns had only just begun.
  - Indeed, across the region, containment measures have escalated since the PMI surveys were administered, and larger falls in output are in store.
- Saudi Arabia's PMI plunge was particularly dramatic -- throwing it deep into contraction territory of 42.4 from February's 52.5. March was the lowest in 11 years of Saudi PMI surveys.

[1] Arabia Monitor; IMF.

Figure 1 - IMF Growth Forecasts, GCC (%)[1]

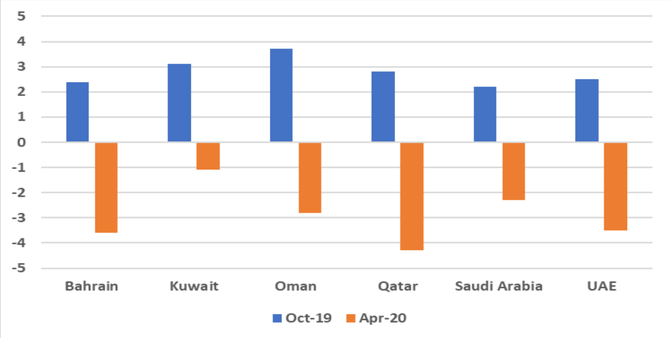
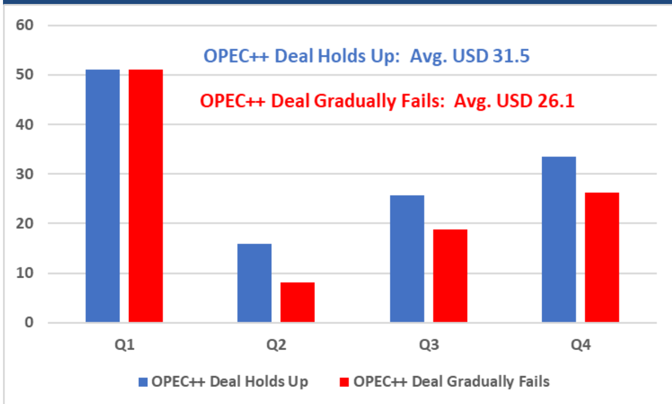


Figure 2 - Oil Price Assumptions 2020 (USD per Barrel)[2]



  - The kingdom sold USD 7B in 5-1/2-year, 10-year and 40-year dollar-denominated debt. Issuance was more than 7 times oversubscribed.
  - Developments around COVID-19 have contributed to YoY non-oil market growth simply grinding to a halt.
  - Specifically, we see lower than previously anticipated growth in the transport sector, wholesale/retail trade, restaurants/hotels, and some manufacturing industries. These factors could well drag the actual (as opposed to surveyed) non-oil economy into contraction.
- The UAE PMI slipped to 45.2 in March (vs February's 49.1). It was the largest overall decline ever, while the survey for employment in the non-oil private sector contracted at the most rapid rate ever.
- Egypt's non-oil private sector economy remains strained, with added disruptions to tourism and consumer spending causing marked falls in both activity and sales.
  - Egypt's PMI dropped to 44.2 in March, the lowest level since January 2017, compared with 47.1 in February of this year.
- The PMI in Lebanon, which was already in economic crisis before COVID-19, slipped to an abysmal 35.0 in March from a reading of 45.5 in February, recording the sharpest ever deterioration in business conditions. The new orders and output sub-indices fell to historic lows.
  - The pandemic will also add to the distrust in government coursing through Lebanese society, although for now it has severely limited street protests.

[2] Arabia Monitor; Qamar Energy.

Lower energy prices

We are bound to see more flexibility in oil and gas policies as the market changes from a seller's to a buyer's one.

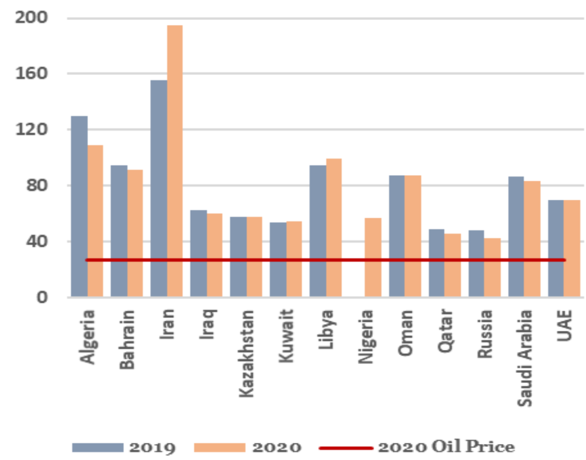
- Despite the new deal between OPEC+ and the new reluctant joiners (the short-lived OPEC++), the spread of COVID-19 is likely to continue to keep demand for oil low, and prices too.
  - Saudi Arabia and Russia reached a deal whereby OPEC+ members will cut output by 9.7 Mb/d in May and June. For the subsequent period of six months (until end-December), the total adjustment agreed will be 7.7 Mb/d.
  - As part of the deal, both Saudi Arabia and Russia will cut daily production by 2.51 Mb/d.
- OPEC on its own can no longer control the market as in the past, so such a larger grouping is necessary. But what is happening is partly a demand-side story, independent of what supply measures can be taken.
- We do not believe the production cuts will be enough to significantly lift low oil prices.
  - Global oil demand has dropped by as much as 30 Mb/d as measures to prevent the virus spreading have slashed demand for jet fuel, gasoline and diesel.
  - How well the price of oil can be supported by OPEC++ (and for how long) will depend on various factors, including:
    - Chinese growth and how much China buys this year and next;
    - How well India navigates coronavirus and restarts its economy, and;
    - What happens to global growth, 18% of which is determined by Europe and the US.

Airline M&A

We expect to see a series of mergers and acquisitions in the airline industry, despite the favourable price of oil.

- The near total stoppage of flights across the globe will take its toll on highly leveraged airline companies.
  - The International Air Transport Association forecasts that some 25 million jobs are at risk of disappearing with plummeting demand for air travel; of that 900,000 jobs in the Middle East are at risk.
- Flight cancellations and travel restrictions especially to Middle East-Asia routes have especially dented airline revenues in the GCC.
  - These GCC airlines will need cash injections; those that receive them, such as Qatar Airways and Emirates Airlines, will survive the downturn.
- The GCC aviation sector has been active in the M&A arena in recent years, with Etihad Airways making recent headlines.
  - A relatively late entrant to the GCC aviation market, the airline was part of the largest M&A transaction in the GCC aviation sector since 2011 with its recent acquisition of a 24% minority stake in India-based Jet Airways.

Figure 3 - Oil Exporters' Breakeven Price (USD per Barrel)[3]



Fiscal discipline will be tough as growth declines

There will be an overall decline in growth and a larger-than-budgeted fiscal deficit in Saudi Arabia. If oil prices do not recover rapidly, we could well see the IMF's revised forecast of a 2.3% contraction for 2020 materialise.

- This year's budget and those of the past five years have been based on an estimated oil price assumption ranging from USD 60 pb to USD 80 pb.
- In light of developments in the oil market and the pandemic, this year's budget will be cut by USD 13.3B (5% of overall expenditure).
  - The 2020 budget released in January forecast a deficit of 6.4% of GDP but was designed under the assumption that the global oil benchmark would average about USD 65 pb. No new deficit estimate has been announced by the MoF so far, but we expect a higher-than-budgeted figure despite expenditure cuts underway.
  - Based on our USD 31.5 pb oil price forecast for Brent this year assuming the OPEC++ deal holds up, and with 2.51 Mb/d less output in Saudi Arabia, the kingdom's oil revenue could decline to as much as 46% of what was originally budgeted.[4]
- Over the past few weeks, the government unveiled stimulus measures worth USD 32B to support the economy.
  - The stimulus package makes up 4% of GDP and 13% of the 2020 budget. These are expected to erode the kingdom's fiscal balance further, and we expect Saudi Arabia to issue more debt to help relieve the pressure on its finances. The kingdom raised its debt ceiling last month to 50% of GDP from 30%.
  - The stimulus package includes USD 13.3B for small and medium-sized businesses and the rest to support businesses in the form of postponement of tax payments and exemptions of various levies and fees.

[3] Arabia Monitor; IMF.

[4] Arabia Monitor; Qamar Energy.

- To prevent companies from laying off their staff, Saudi Arabia's King Salman Bin Abdulaziz Al Saud also unveiled an economic stimulus valued at over USD 2.4B to cover a portion of private sector salaries in the industries most impacted by the virus. The royal order covers all Saudi employees at establishments hiring five Saudi workers or less.

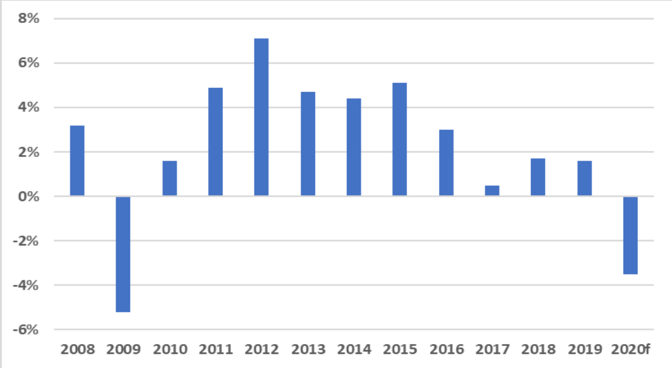
➢ Independently of the oil market, Saudi Arabia is on a diversification drive that is quite aggressive under Crown Prince Mohammad Bin Salman's Vision 2030. If anything, a collapsed price of oil, only reinforces the need for Saudi Arabia to diversify.
  - We believe this drive is real, and that there is no way back, even if the path sometimes suffers non-linearity or appears to experience setbacks.

Forecasts for overall growth in the UAE have been revised downwards from 3% to -3.5%, meaning three lacklustre years will now be followed by a contraction. The UAE's stimulus package -- which is equivalent to about 16% of GDP -- should start yielding results from the second half of the year, but until then the economy will have some serious adjustments to go through.

➢ The plunge in oil prices will also affect the UAE's fiscal balance. This year's budget and those of the past five years have been based on an estimated oil price assumption averaging USD 63.5 pb.
  - While the pandemic is adding pressure to funding needs, and even though Abu Dhabi has tapped debt markets, a return to the international bond market for Dubai is unlikely given its high debt burden, (estimated at about 125% of GDP, with almost half due for repayment before the end of 2024).
  - Dubai has, however, sold a USD 272M eight-year sukuk to banks within the emirate, for the first time in four years.

➢ The impact of the Expo postponement will be much less serious than it would have been if it had gone ahead with low attendance. This is not the first time an Expo/World's Fair has been cancelled; the St. Louis World's Fair was delayed from 1903 to 1904, for cost and scale reasons.
  - Nonetheless, the delay did not compromise the economic impact nor participation as close to 20 million people still attended in addition to 60 countries and 43 states partaking as participants.
    - It was also the first such fair to turn a profit and its attendance overshadowed the Olympics that took place that year in the same city.
  - Dubai's Expo 2020 was expected to draw the equivalent of 1.5% of the UAE' s annual gross GDP (~USD 6.5B).
    - However, an unsuccessful Expo would have compromised this hugely. A successfully staged postponed one, could potentially buttress the UAE's economic recovery at a time when governments will be keen to re-launch growth in their own economies and look to have a good showing at the Expo.

Figure 4 - UAE Real GDP Growth (%)[5]



  - It would also give the emirate ample time to repurpose the event and maximize value from it, as it coincides with the 50th anniversary of the UAE as a nation.

➢ On 15 March, the Emirati Central Bank announced a stimulus package of AED 100B (USD 27B) and on 22 March, the Cabinet approved an additional economic stimulus plan worth AED 16B (USD 4.3B), as well as new policies to drive infrastructure development and reduce cost for micro and small enterprises. These measures will help practically all firms, but temporarily.
  - More than 94% of the companies operating in the UAE are SMEs and together they account for more than 86% of the total private sector workforce as well as more than 53% of the country's current GDP.
  - In Dubai alone, SMEs make up nearly 95% of all companies, employing 42% of the workforce and contributing around 40% to Dubai's GDP.
  - Construction companies considered SMEs could benefit, especially those in the design, contracting and fit-out industries (interior design).
    - In further steps, the UAE stepped up with additional measures for the construction sector, notably improving payment terms for contractors in government projects as well as exempting companies from fines that accrue from any delays caused by the pandemic.
    - There are more than 600 high-value projects (with a contract value of more than USD 25M) currently in execution, with a combined value of USD 939B. The total value of the entire pipeline, including projects at early stages of development, is USD 1.1T.[6]
    - Postponing the Expo for 2021 could be positive as many construction companies would then have more time to complete their projects.

➢ Because we will see negative global growth this year, and have our doubts about the chance of a meaningful and long lasting OPEC++ deal, we expect the UAE economy to bounce back less rapidly than in previous, v-shaped recoveries, such as after the financial crisis. This time around, the relatively more diversified nature of the UAE economy could make for a multi-quarter recovery, at best.

[5] Arabia Monitor; IMF.

[6] GlobalData.

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