Nuclear negotiations losing ground

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- **Ongoing protests in Iran could be a portent of things to come as nuclear negotiations stall and the potential for sanctions relief remains uncertain.**
- **Despite a tendency to alter its fiscal policy relative to oil prices, Saudi Arabia is expected to remain on its spending efficiency drive; fiscal strings are set to remain tight for now, even amid higher oil production.**
- **As China's regional and economic influence grows though its Belt and Road Initiative (BRI), so too do its security concerns. The big question is whether Beijing can achieve results different from well-trodden neo-colonialist paths.**

Iran: Hopes for transition drying up

Anti-government protests continue to escalate in Iran. This comes amid stalled Joint Comprehensive Plan of Action (JCPOA) nuclear talks, a pandemic that continues to ravage the country and a devastating water shortage. While regime change (or anything close to it) is certainly not on the cards, these crises set the foundation for further unrest.

- Protests began in Iran's Khuzestan province after water shortages hit the country during a sweltering heatwave, resulting in several casualties.
- The water shortages came after an electricity crisis caused blackouts earlier in the month. They sparked outrage at perceived government mismanagement and frustration at the country's leadership in general.
  - The protests quickly spread to Tabriz and Esfahan before reaching Tehran. Chants of 'death to the dictator' and 'death to the Islamic Republic' could be heard along the streets of the capital.
  - Protesters are also chanting 'neither Gaza nor Lebanon, my life for Iran'. Such slogans epitomise the public anger at the government's support for Hamas and Hezbollah.
  - While these protests are unlikely to maintain the momentum with which they developed this month (especially if the government starts to iron out infrastructure issues), the unrest could set a precedent in terms of public demonstrations; they may become more frequent under the tenure of the President-elect Ebrahim Raisi. Such a scenario is especially likely if prospects for sanctions relief wane.
- Nuclear deal negotiations in Vienna have stalled, partly due to the change in Iran's leadership. Talks are set to be delayed at least until Raisi takes his seat in mid-August.
  - Raisi's cabinet picks are now taking shape. The President-elect recently sent two representatives to join Iran's negotiating committee in Vienna before talks ended this month.

Table 1 – MENA Dashboard[1]

MENA Oil Exporters	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2020	2021f	2020	2021f
Algeria	-6.0	2.9	-12.7	-18.4
Bahrain	-5.4	3.3	-18.3	-9.1
Iran	1.5	2.5	-8.4	-6.8
Iraq	-10.9	1.1	-18.3	-9.2
KSA	-4.1	2.4	-11.1	-3.8
Kuwait	-8.1	0.7	-9.4	-6.9
Libya	-59.7	131.0	-103.0	0.3
Oman	-6.4	2.5	-17.3	-4.4
Qatar	-2.6	2.4	1.3	1.4
UAE	-5.9	3.1	-7.4	-1.3
Yemen	-5.0	1.2	-9.6	-6.1
Average	-12.2	8.1	-19.4	-11.8
Average Ex-Yemen	-12.9	9.6	-20.4	-12.4

MENA Oil Importers	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2020	2021f	2020	2021f
Djibouti	-1.0	5.0	-1.3	-2.0
Egypt	3.6	2.5	-7.0	-7.5
Jordan	-2.0	2.0	-8.9	-7.7
Lebanon	-25.0	…	-9.9	…
Mauritania	-2.2	3.1	2.1	-2.5
Morocco	-7.0	4.5	-7.6	-6.4
Palestine	-11.0	5.7	-10.7	-10.5
Somalia	-1.5	2.9	…	…
Sudan	-3.6	0.4	-5.9	-4.5
Syria	…	…	…	…
Tunisia	-8.8	3.8	-10.6	-9.3
Average Ex-Syria	-6.7	4.0	-9.4	-6.4

  - Additionally, the President-elect's foreign policy advisor, Ali Baqeri, is tipped to become Iran's new foreign minister.
  - Baqeri, who is related to Supreme Leader Ali Khamenei by marriage, has also been leading the team in charge of the governmental transition at Iran's Ministry of Finance.
- While the transition may have slowed the resumption of talks in Vienna, it seems unlikely that Raisi's team would reverse the current course and walk away from an opportunity to restore the JCPOA.
  - The deal is still moving, at least for now. Yet a resolution is almost certainly not on the cards until autumn at the earliest.
  - Even so, any such resolution is not guaranteed. This is especially true if Iran tries to flex its muscles as new negotiators take their seats opposite their US counterparts. Indeed, US patience is starting to wear thin.
  - Failure to reach a resolution would spell trouble for the new government. People are growing weary of living under sanctions and no resolution would only set the groundwork for yet more unrest.

[1] Arabia Monitor; IMF.

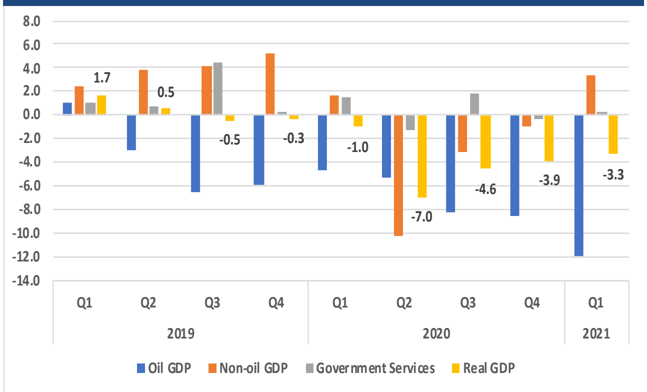
Saudi Arabia: Squaring the fiscal circle

After revising down Saudi Arabia's 2021 GDP growth three times this year, the IMF now forecasts growth at 2.4% from 2.1% in April. The upward revision is underscored by the promising rebound in the non-oil private sector. The prospect of a softening to oil production cuts will also provide a buffer.

- While Saudi Arabia's fiscal policy has traditionally been procyclical with oil prices, we expect the kingdom to remain committed to fiscal sustainability and spending efficiency going forward. This is underscored by Riyadh's ambition to reach a balanced budget by 2030 under its Fiscal Balance Program.
  - Nonetheless, the recent decision by OPEC+ to phase out oil production cuts by 5.8M bpd until September 2022 will inevitably provide the kingdom with further fiscal space, added to recovery in oil prices. This supplements the Public Investment Fund's (PIF) growing investments as it helps offset the fiscal consolidation drag on growth.
  - Oil GDP growth was projected at -0.4% in 2021 as production is assumed to remain in line with the OPEC+ agreement, however this will now be revised up. Non-oil growth is expected to peak at 3.9%, before slowing to an average of 3.5% for both 2022 and 2023.
  - The 2021 budget forecasts a deficit of 3.8% of GDP (around USD 38B), compared with 10.6% in 2020 but we would not exclude an even narrower deficit for 2021.
- Government spending is expected to remain anchored to budget plans this year given that the medium-term oil price outlook continues to be uncertain.
  - Total expenditure in 2021 is budgeted at around USD 264B (34.5% of GDP), a 7.3% YoY cut from 2020's actual spending and 2.5% lower than the planned spending budget.
  - To offset the high spending measures, the cancellation or postponement of several capital expenditure projects is required. At USD 26.9B (10% of total expenditure), CAPEX this year is set to decline by around 27% YoY.
- We, however, do not dismiss that if this year's higher oil prices are sustained, Saudi Arabia's plans to reduce the wage bill and to cut subsidies could well be slowed.
  - Spending on subsidies in 2021 is budgeted at nearly USD 6B, 21% lower than last year's figures. However, we are already witnessing the government gradually reversing its decision with regard to spending.
  - In response to rising inflation, and with the headline rate peaking in June at 6.2% YoY, the government has set an upper limit for domestic petrol prices and will bear the burden of higher prices.
  - The move to soften energy subsidy cuts, however, comes days after the IMF urged the government to continue to implement stringent austerity measures including subsidy cuts.
  - Effective this month, Saudi Arabia's gasoline prices will be set at June 2021 levels, namely USD 0.58 per litre for 91 octane and USD 0.62 per litre for 95 octane.

[2] Arabia Monitor; GSTAT.

Figure 1 – Saudi Arabia GDP Growth Rates (YoY, %)[2]



Egypt: Renewed prudence

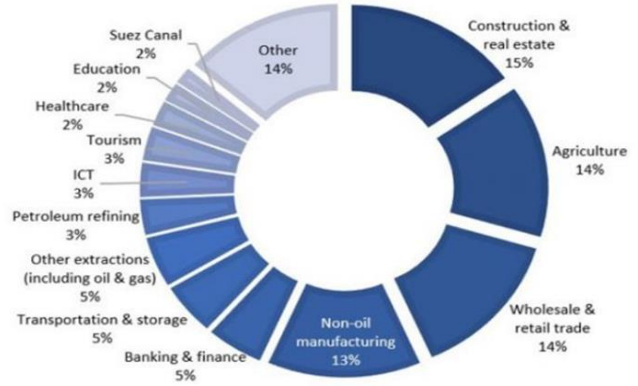
Egypt's recently approved FY 2021/22 budget underscores Cairo's commitment to fiscal consolidation[3]. Anchored by the successful execution of the Central Bank of Egypt's (CBE) monetary policy and IMF economic aid, this commitment will help Egypt to regain growth momentum thereafter.

- Based on revenues of around USD 83B (an 11% YoY increase), the government is budgeting for a deficit of 6.6% of GDP (around USD 157B) in FY 2021/22. This figure is slimmer than the estimated 7.9% of GDP in FY 2020/21 and 8.2% in FY 2019/20. Furthermore, a primary surplus of 1.5% of GDP in 2022 compares with around 0.9% in 2020.
  - The government's budget figures are less optimistic than those of the IMF, which estimates a deficit of 6% and 7.5% of GDP for FY 2020/21 and 2021/22, respectively.
  - The government's caution stems from ongoing fiscal reform measures and a lower increase in total spending, which reached 24.6% of GDP during FY 2020/21, a 5.7% YoY reduction from FY 2019/20.
- Despite the economic drag of 2020, the previous fiscal budget outturn that total revenues increased by 3.6% YoY to reach around USD 70B (16.7% of GDP). This represents a substantial increase over the last ten years; revenue stood at around USD 17B in 2010.
  - The growth in revenue last year was driven by a 15% hike in non-tax proceeds, as well as a 23.3% increase in financing investments.
  - In the coming years, the government aims to raise tax revenue by about 2% of GDP with the support of several bold fiscal measures. This is likely to be achieved through a strengthened customs administration and an electronic tax collection system.
  - Revenue in FY 2021/22 is expected to continue on this upward trend, and to grow to roughly USD 86B.
    - Tax revenue, which makes up over 70% of total revenue, is forecast to reach around USD 62B, a significant 18.3% YoY increase.
    - This includes the collection of around USD 29B in VAT, 17% higher than in FY 2020/21.

[3] Egypt's fiscal year runs from 1 July to 30 June.

- Expenditure is expected to rise as well, but at a slower pace than revenue. Spending is projected to grow by 16% YoY to USD 117B (25% of GDP).
    - The new budget is shifting the spending focus towards capital projects, which will be key for long-term growth potential.
    - CAPEX is set to increase to 5% of GDP in FY 2021/22, up from 3.6% and 3.3% in FY 2020/21 and 2019/20, respectively. Wage and salary expenditure is projected to remain flat.
- While the COVID-19 pandemic interrupted Egypt's progress on debt reduction, the new FY2021/22 budget target presents an appropriate balance between supporting economic recovery while keeping public debt on its projected path. Debt to GDP is forecast to decline to 88% after rising to 90% last year.
    - Yet the budget still forecasts a 7.1% increase in funding needs to around USD 68B, which it aims to mostly cover with EGP bond market funding, a challenging proposition in the absence of weak foreign participation.
    - Market structure reforms and high carry trades have contributed to keeping frontier EM investors in the game, but the proportion remains limited.
- For now, this has been mitigated by the CBE’s ability to stabilise the Egyptian pound (EGP) against the USD; this has helped to restore investor confidence and to reverse the two-year inverted yield curve.
    - Foreign investor holdings of government treasury bills and bonds recovered by about USD 28B (roughly 10% of government debt) from a trough of USD 10B in June 2020.
    - However, these flows could rapidly reverse in response to shocks, contributing to renewed pressure on Egypt's exchange rate.

Figure 2 – Egypt GDP breakdown by sector[4]



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