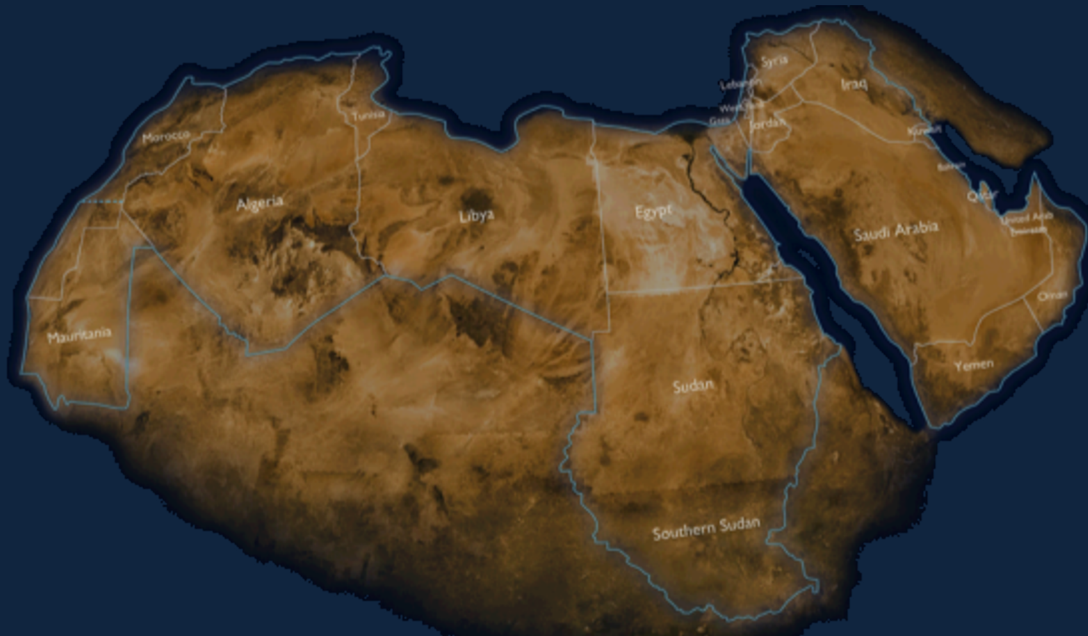
ARABIA MONITOR

ECONOMIC RESEARCH & STRATEGY

# GCC Banking & Finance: Ushering in the age of the consumer

*Middle East & North Africa Outlook*

*Q4 2020*




Florence Eid-Oakden, Ph.D
info@arabiamonitor.com
Tel: +44 203 239 4518

With Ghalia Al Bajali, Leila Lajevardi, Mingqiao Zhao, Bouchra Abaakil, Halimo Mohamud, Kevin Johnson & Rama Hojeij.

# Outline


| Topic | Slides | Topic | Slides |
|---|---|---|---|
| Our View: Strong banking fundamentals in GCC | 4 | Open Banking: Bahrain forges ahead | 14 |
| Global Outlook: Pandemic waves douse global growth | 5 | Green Finance: Seeking a sustainable recovery | 15 |
| MENA Energy Outlook : Eastern Med Offshore Gas Progress | 6 | Iran Market Monitor: COVID-19 does what sanctions could not | 16 |
| Islamic Financing: Weathering the COVID-19 storm | 7 | Sino-MENA: Oil trade up, downstream lingers | 17 |
| GCC Equity Markets: Rising again amid uncertainty | 8 | Special Feature with GEIDCO | 18 |
| GCC Debt Markets: Issuance at an all time high | 9 | MENA Macro Dashboard | 19 |
| M&A: Down but not out | 10 | Algeria: Bracing for constitutional change | 20 |
| Retail banking: Rapidly going digital | 11 | Bahrain: Embracing new ties | 21 |
| GCC Banks: Strong, but pandemic hots profits | 12 | Djibouti: Putative gateway to Africa's agriculture | 22 |
| Fintech: COVID-19 (and normalisation) driving growth | 13 | Egypt: Relatively robust | 23 |

# Outline

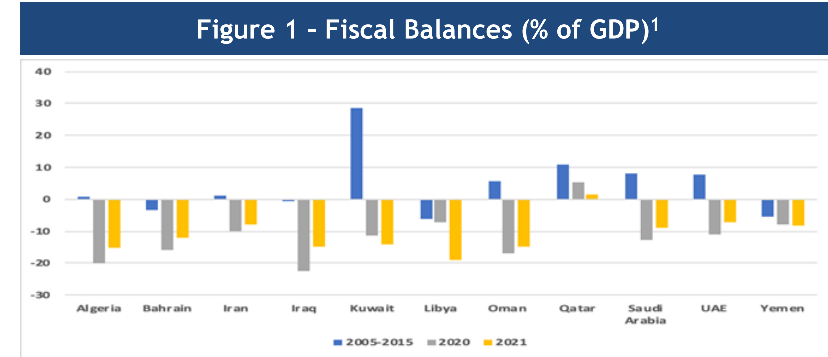

| Topic | Slides |
| --- | --- |
| Iraq: Turning the tide | 24 |
| Jordan: Debt, and discontent on the rise | 25 |
| Kuwait: When a rich state feels poor | 26 |
| Lebanon: Beyond resilience | 27 |
| Libya: Much ado, but no real change | 28 |
| Mauritania: Mining itself out of the pandemic slump | 29 |
| Morocco: Risking a recession | 30 |
| Oman: Cash-strapped and borrowing | 31 |
| Palestine: Deserted and declining | 32 |
| Qatar: Trading regional peace for neighbourly peace | 33 |

| Topic | Slides |
| --- | --- |
| Saudi Arabia: Turning austere | 34 |
| Somalia: Disasters decimate economy | 35 |
| Sudan: Pandemic threatens the transition to democracy | 36 |
| Syria: Russia to the rescue, again | 37 |
| Tunisia: Technocrats face a bumpy road | 38 |
| UAE: Testing a new regional paradigm | 39 |
| Yemen: Perilous plight | 40 |
| GCC Sovereign Ratings Update | 41 |
| MENA exc. GCC Sovereign Ratings Update | 42 |

# Our View: Strong banking fundamentals in GCC

- **Our regional theme this quarter looks at the banking and finance industry in the GCC. MENA is bracing for its largest economic slump in decades due to the double shock of low oil prices and COVID-19. This, in turn, is exposing the sector to funding and liquidity weaknesses. Stimulus measures implemented by GCC central banks along with easing capital requirements and prudential liquidity measures have to some extent absorbed the hit, proving the robustness of the banking system across the Gulf.**
  - ➢ The economic cycle is expected to turn at some stage, but, for now, we believe there will be low-single-digit growth across the sector, at least until 2021. This may be exacerbated if a second wave of virus infections is not effectively controlled.
  - ➢ The pandemic is expected to halt the profitability of Islamic and conventional banks across the GCC this year, particularly as the focus is shifting to preserving asset quality over generating new business activity.
  - ➢ Digital transformation for financial services was already taking place before COVID-19, but the lockdowns have sped this up, serving as a catalyst for growth.
  - ➢ We expect, going forward, to see Islamic and conventional banks increase investments in their digital infrastructures and accommodate for a shift in consumer demand.
    - In the long run, open banking is expected to stimulate business across the whole banking and finance sector.
    - The UAE-Israel peace deal is expected to improve the GCC's fintech regulatory framework and attract investment in the sector.
  - ➢ External headwinds have spurred a strong wave of merger and acquisitions across the GCC, with many shareholders reorganising their assets. After taking a sharp dip in H1, we see activity continuing on an upward trend. This will be driven by business rationalisations and opportunistic investors.
  - ➢ The appetite for sovereign debt issuance will remain high, with sovereign sukuk issuance expanding in particular for the rest of this year.
    - We expect GCC countries to encourage further activity to deepen their capital markets, fund widening fiscal deficits and expand on their diversification efforts.

**Figure 1 - Fiscal Balances (% of GDP)[1]**



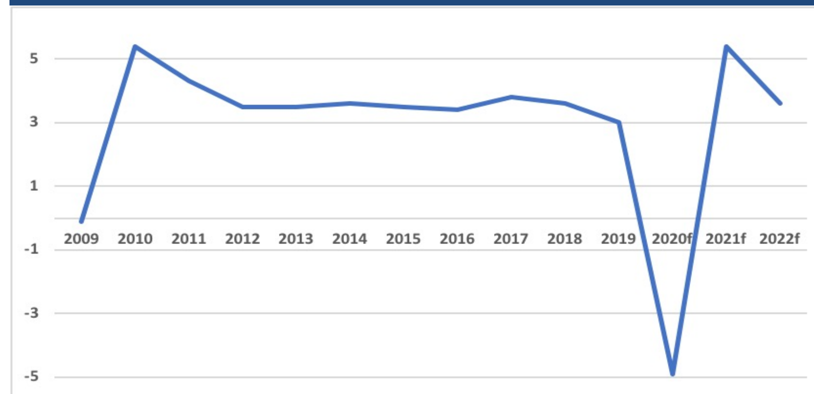

- **For our regional outlook, we examine how MENA countries are adjusting the prospects of lower oil prices and a potential second wave of the virus delaying overall economic rebound into the latter part of 2021. Past bouts of belt-tightening tended to rely on a fast rebound in oil prices to refill state coffers. This time around, the risks are greater as the gloomy demand outlook is clouding chances of a strong oil market recovery this year. It looks like a case of lower for longer for oil markets.**
  - ➢ The nature of the current crisis has profound consequences particularly as mounting fiscal pressures and rising inflation will soon start to increase strains on dollar pegs. One implication is that Saudi Arabia may reconsider its oil production policy and lapse back into efforts to regain market share.
  - ➢ It has long been known that Gulf states have had surreptitious dealings with Israel, but the UAE-Bahrain-Israel peace deal has shifted the geopolitics of the region, formalising new, implicit regional alliances against Iran's influence.
  - ➢ The period has also been characterised by political transitions as new leaders grapple with how to tackle corruption and fiscal deficits. Instability has instigated unrest on the street which will only get worse if governments do not find their footing and respond rapidly with urgently-needed reforms.

[1] Arabia Monitor; IMF.

# Global Outlook: Pandemic waves douse global growth

- **Despite unprecedented policy support, the high level of uncertainty regarding the length of the pandemic and potential renewed volatility in global oil markets continue to present a bleak economic outlook across the world. Although vaccine developments are under way, they will not be a panacea for the economy and recovery will take time. Adding to the uncertainty is the US presidential election which is expected to bring more pronounced market instability than in the past, likely to remain elevated through year-end.**
  - ➢ The IMF forecasts GDP for 2020 to register a 4.9% contraction, worse than the 3% decline seen in its April outlook. This would mark the deepest global recession in eight decades. In 2021, global growth is projected at 5.4% on base effects.
    - Fiscal, monetary and structural policy support will need to be kept in place to limit the uncertainty and preserve market confidence. This will mean lower interest rates for longer.
  - ➢ The policy shift of the US Federal Reserve to tolerate inflation overshooting 2% will provide some flexibility for economic recovery in the long term, but for now, it will have significant implications, including allowing US labour markets to overheat.
    - The persistent damage to the economy and job market -- together with a resurgence of contagion in the US -- will cause recovery to resemble an anaemic U-shape by Q4 at best; it will most likely be a wide-bottomed U-shape recovery into next year.
    - But if a safe and effective vaccine is not found by year-end, we could well be seeing a W-shaped double-dip recession in 2021.
  - ➢ Following the stellar gains in global equity markets in recent months, buoyed by vaccine hopes and the Federal Reserve's loose monetary policy, we expect greater stock market volatility, particularly as the US elections and their aftermath dominate the news.
  - ➢ The dollar index has fallen over 10% since the pandemic-induced peak in March. But the recent resurgence of COVID-19 cases across Europe and in the US has unsettled investor sentiment, driving buyers back into dollars as a safe – or, perhaps, "safer" -- haven choice.
  - ➢ The direction of the dollar is crucial for the MENA region, particularly for oil-exporting countries. Mounting fiscal pressure and inflation will once again place pressure on GCC dollar pegs.

**Figure 1 – Global Real GDP Growth (%)[1]**




    - Rising budget pressures have also been accompanied by a new wave of sovereign debt downgrades -- surpassing peaks during previous economic contractions. We expect default rates and debt restructuring to keep growing.

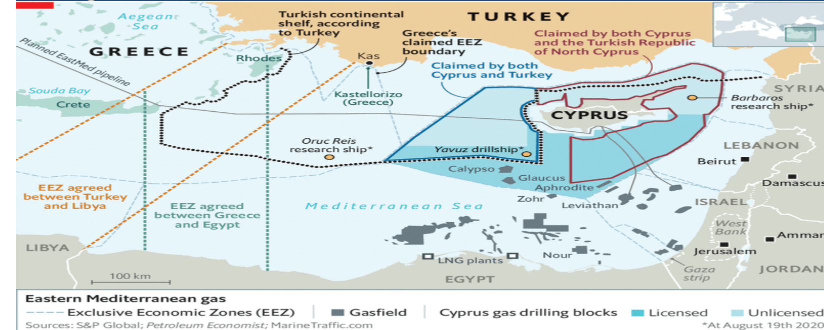
- **Additional downside risks to the global outlook include oil price volatility and trade-related uncertainty. Domino effects on global output and geopolitical tensions could also hamper confidence.**
  - ➢ Oil prices are struggling to break out of their tight trading ranges, but prices are not likely to firm as risks heighten around a second lockdown. The pandemic has exhausted oil demand, with oversupply dimming the outlook.
    - OPEC+ revised its global demand forecast in September to an average of 90.2M b/d, down 400K b/d from August estimates. This reflects a contraction of 9.5M b/d YoY.
  - ➢ On the back of already-weak trade in 2019, we expect a continued drag as trade tensions linger and US-Chinese relations remain inflamed.
    - Global FDI flows will plunge by 40% this year to below USD 1T for the first time since 2005.

[1] Arabia Monitor; IMF.

# Eastern Med Offshore Gas Progress

- **Eastern Med Gas is encountering its biggest challenge -- not from the coronavirus, but from rising regional tensions**
  - On August 18, Turkey dispatched the *Yavuz* drillship, flanked by naval vessels, to the southern coast of Cyprus to allegedly hunt for oil gas, immediately deepening its disputes with Cyprus and Greece.
  - The area is near the Calypso, Glaucus and Aphrodite gas fields, discovered by European and American companies licensed by the internationally-recognised Cypriot government.
  - The move follows a collision of the *Orus Reis* Turkish seismic ship with *Limnos*, a Greek frigate charged with protecting Greece's Exclusive Economic Zone (EEZ).
  - France has decided to "temporarily reinforce" its military presence in the region with two fighter jets and a pair of warships to "make sure international law is respected".
- **Oil and gas companies, already under pressure from low gas prices, might further delay drilling campaigns to avoid geopolitical dust-ups**
  - Momentum in offshore gas development has slowed down to a trickle ever since oil and gas firms slashed spending and put their drilling plans on hold.
  - A key contributor has been pressure for returns from investors, but firms could delay drilling campaigns further in a bid to avoid getting entangled in regional politics.
  - Major drilling campaigns pushed back include ExxonMobil and Qatar Petroleum's appraisal drilling at Glaucus in Cyprus' Block 10 in September, to September 2021
  - Three other exploration wells scheduled for 2020, including the Kronos target in Block 6, following the joining of forces by Total and Eni in seven blocks, with South Korea's KOGAS taking part in some of them, have also been pushed back to 2021.
- **Major players such as Egypt are facing low oil prices and elevated tensions**
  - Egypt announced expansions to its natural gas production in April 2020: one in Zohr and the second in the Baltim South West 7 concession area, to increase production of gas by 7.4%
  - Eni has made recent discoveries of 4 Tcf in the Greater Nooros area and 1-5 Tcf at Bashrush just offshore in the North El Hammad block.
  - However, the economic slowdown, low LNG prices and the disruption of demand in the country have caused national gas company Egas to exit talks on restarting critical gas infrastructure facilities, such as the Damietta LNG plant
  - Egypt has been seeking to rival Turkish influence in the region ever since Turkey took to drilling for gas in Cypriot waters. This has seemingly irked Turkey, causing it to announce a counter intent of exploring Libya's coast for gas after establishing an "illegal" maritime border with the Government of National Accord. While regional tensions could be allayed to an extent, due to the risk of sanctions, poor exploration results add to the diminished outlook for East Mediterranean gas development.

**Figure 1 - Contested maritime borders in the Eastern Med[1]**



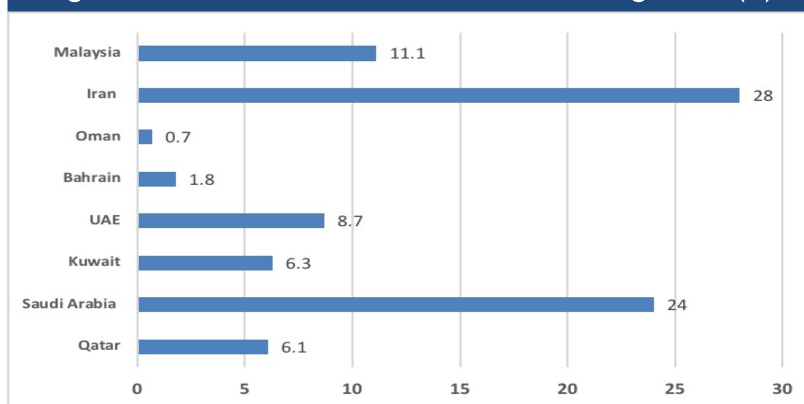

  - For example, in April, Shell announced disappointing results at its Montu-1 well on the West Delta Deep Marine in Egypt. The total depth was 7,000m, with the key target in the pre-Messinian reservoir.
  - UAE's Dana Gas also posted a negative result at its Merak-1 well, located in the offshore North El Arish concession, Block 6 (drilled to a total depth of 3,890 m, encountering 46 m of sand but no commercial gas despite a pre-drill estimate of 4 Tcf).
  - Lebanon's first-ever offshore exploration well, Byblos-1, drilled by Total and Eni up to a depth of 4,076 m in Block 4 also turned up dry, failing to prove the northern extension of the prolific Tamar Sands of Oligo-Miocene age, which holds discoveries like Tamar, Leviathan and Cyprus' Aphrodite.
- **The recent entry of Chevron into the East Med brings new challenges and opportunities on the geopolitical front**
  - Just 2 months after announcing its USD 5 B takeover of compatriot Noble Energy in the East Med, Chevron now wants to use its low debt levels to develop Phase-2 of the giant Leviathan gas field.
  - For Turkey, the presence of a new US firm in the region increases the Turkosceptic tenor of its rivals, who will rely on American firepower to deter Turkish incursions into their hydrocarbon assets.

[1] Qamar Energy Research; The Economist.

# Islamic financing: Weathering the COVID-19 storm

- **Islamic banking and the sukuk market suffered a slowdown earlier this year, but it is being somewhat counterbalanced by strong liquidity injections from the GCC's central banks. In the short-term, the complexity of the market and lower investor appetite are likely to stall full recovery. But the long-term outlook -- driven by strong market fundamentals -- remains positive.**
  - Islamic banking shares dominate the Islamic finance sector, amounting to roughly 85%, worth USD 1.7T, in 2019. Globally, this was just a 0.9% growth in assets from 2018, but growth in the sector in the GCC is more robust
    - Demand for Islamic finance services is increasing due to growing populations in Middle East, African and Asian countries. These currently account for over 95% of the world's Muslim population and are projected to grow by 35% by 2030.
  - Islamic banking penetration -- mainly in the GCC, Malaysia, Indonesia and Turkey -- was building steadily prior to the pandemic. Since 2013, penetration grew by 22% YoY, reaching over 30% of total banking in 2019, with annual global sukuk issuance increasing to USD 179B by Q4 of 2019. This reflects a nearly 40% increase over the last five years on average.
    - The largest Islamic banking markets are in MENA, with Iran accounting for 34.4% and the GCC a 37% share. The sector in the GCC is being shaped by consolidation either between conventional banks with Islamic windows or between full-fledged Islamic banks.
    - The GCC is well positioned at the heart of the Muslim world to serve as an Islamic finance hub linking Europe, Asia and Africa. The spread of subsidiaries around the world of GCC-based Islamic banks is a testimony to this development.
    - Islamic banking assets in the GCC amounted to nearly USD 855B in 2019, a growth of 8% YoY from 2018.
  - Before the pandemic, the IMF estimated that global Islamic financing assets would reach USD 3.5T by 2021. We still expect growth, but only marginal given that the market is not likely to fare as well as it did last year.
    - Strong performance across the GCC in 2019 -- registering 11.4% YoY growth-- was underpinned by a more dynamic sukuk market performance.

**Figure 1 - Global distribution of Islamic banking assets (%)[1]**



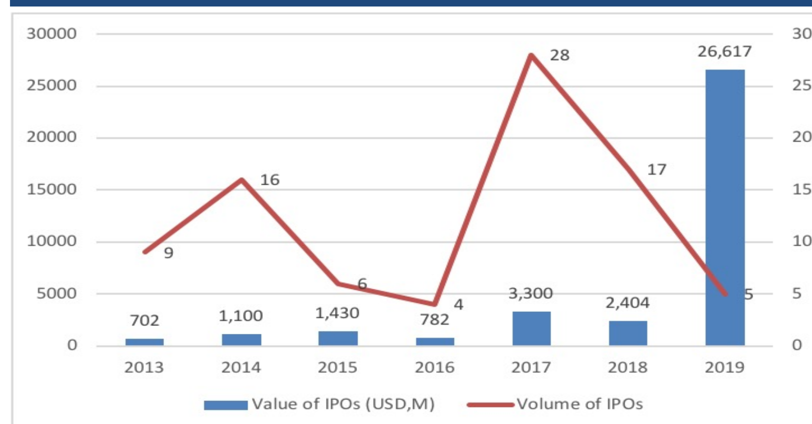

  - With the current volatility prompted by lower oil prices, subdued spending and geopolitical risk, lending growth will now be sluggish, holding back overall market growth this year.
  - The economic cycle will turn at some stage, but for now, we believe there will be low single-digit growth until 2021, as core Islamic banking countries grapple with the economic downturn.
  - This does not mean though, that Islamic banking will not outperform conventional banking. It should, mainly due to its structural advantage in the region.
    - In Q4 2019, for example, GCC Islamic banks had a slightly higher average loan-to-deposit ratio than conventional banks -- 82% against 80%, respectively.
    - Additionally, net interest margins for Saudi Arabia's Islamic banks stood at 4.2% during Q1 of 2020 compared with 3.4% for conventional banks.
    - This suggests that at a time when interest rates have slumped, this higher margin could provide a greater buffer to interest income compared with that of conventional banks.

[1] *Arabia Monitor*; Statista.

# GCC Equity Markets: Rising again amid uncertainty

- **Stock markets across the GCC have been on a rollercoaster ride since ending on an up note last year with the record-breaking Initial Public offering (IPO) of Saudi Aramco. The fall in oil prices and the pandemic lockdowns sent stocks tumbling before a slow, steady climb. Unless there is an unexpected global financial retreat, we expect GCC equity markets to continue their upward trend in the months ahead, boosted by recent and upcoming IPOs.**
  - Overall, global IPO activity is picking up after a slump earlier in the year. In Q2, 290 IPOs took place, raising USD 66B, a 48% decrease in volume and 67% decrease in proceeds compared with the same quarter last year. It was an improvement, however, on the 235 IPOs registered in Q1 which raised a relatively meagre USD 28.5B.
  - The MENA region has done relatively better; IPO activity in H1 is down 11% by volume and 43% in proceeds, with eight offerings raising USD 900M, compared to the same period last year.
  - Saudi Arabia's bourse led the region with net IPO proceeds this year of USD 748M. But with new IPO requests weak, the kingdom -- which wants to deepen its capital markets -- is pushing family-owned or closely-held companies to list publicly.
    - The Saudi Arabia Capital Market Authority (CMA) recently approved the listing of a 20% stake in BinDawood Holding Company, a local supermarket retailer that manages over 70 hypermarkets across the kingdom. It is seeking to raise USD 585M.
    - Earlier, Dr. Sulaiman Al-Habib Medical Services Group issued 15% of its shares for USD 700M, while Sumou Real Estate Development Company issued 30%, raising nearly USD 48M.
  - Oman Bourse expects to end the year with three more IPOs, a surge following years of weak equity-listing activity. Public listings will be mainly in construction, oil and manufacturing.
    - Oman Aman REIF, a real estate fund, drew investor attention earlier in the year, as it sold 50% of its shares, raising over USD 52M.
    - Last year, after Oman eased its foreign investment regulations, Musandam Power Company issued 40% of its shares, raising USD 23M. This was a significant result, garnering foreign interest, after zero IPOs in 2016.

**Figure 1 - GCC IPO Activity[1]**



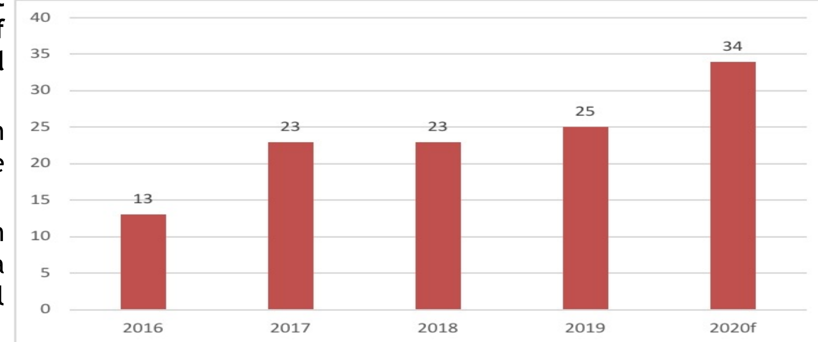

    - It is likely that state-owned Oman Oil Company will complete its planned 25% listing in Q4 of this year, given the need to sustain the sultanate's increasing debt levels and mounting budget deficit.
  - All this has left GCC stock markets rising steadily from their earlier slump. The MSCI GCC Countries Index is up around 10% over the past three months, although still down some 8% for the year-to-date.
    - We expect GCC countries to encourage further activity in capital markets to accelerate their diversification plans and deepen capital markets to fund their fiscal spending and deficits.
    - We also see the GCC's IPO market rebounding by the end of the year. This will be mainly driven by Saudi Arabia and the UAE but, given the uncertainties, many offerings across the region may well be pushed out till 2021.

[1] *Arabia Monitor*; PWC GCC Capital Watch Market.

# GCC Debt Markets: Issuance at an all time high

- **While global shariah-compliant sukuk issuance lagged in performance earlier this year, demand from Gulf sovereign borrowers is expected to rise by 36%. We expect regional debt issuance to remain strong, at least until mid-2021, as a result of increased financing needs arising from a longer-than-expected period of low oil prices and government budgets being strained by pandemic lockdowns.**
  - ➢ Debt issuance in the GCC so far this year has been heavily dominated by sovereign and quasi-sovereign paper, with the bulk fuelled by Saudi Arabia at USD 32B and the UAE at USD 26B.
    - Notable issuance this year included a USD 7B three-tranche Saudi sovereign Eurobond issued in April, a USD 9B riyal-dominated Saudi sovereign sukuk, and a USD 4B Eurobond from the UAE's quasi-sovereign Mamoura Diversified Global Holding.
  - ➢ Sovereign issuance in H1 was broadly flat given the complex requirements for sukuk compared with conventional debt instruments, but this is changing. The volume of issuance is expected to increase by 43% YoY to reach USD 94B by the end of the year.
    - Growth this year will mostly be driven by GCC sovereign borrowing. Issuance is expected to reach USD 34B from USD 25B in 2019 -- a 36% YoY increase.
    - Sukuk issuance tends to be more complex because special-purpose vehicles are required to meet borrowing conditions, with certain structures requiring the provision of physical assets to secure the borrowing.
    - A sharp slowdown in sukuk issuance earlier in the year reflected wider financial market volatility, which affects the sukuk market more than the conventional bonds market. The former is smaller, more concentrated and relatively less liquid.
    - During H1, sukuk issuance reached USD 77B, of which GCC issuers accounted for USD 28B, a 7% YoY increase from same period last year.
    - This was mainly driven by Saudi Arabia, whose sukuk issuance started picking up following the easing in lockdown measures and increases in capital outflow. The kingdom's issuance is expected to grow by around USD 8B this year to USD 27B. This will raise government debt to GDP sharply; it is forecast to reach around 40% of GDP by 2022 versus the low of 2% of GDP in 2014, and 22.8% of GDP in 2019.

Figure 1 - GCC Sukuk Issuance (USD, B)[1]




- ➢ The driving force behind the issuance is the high financing and refinancing needs coming from mounting fiscal pressures. These in turn are expected to increase the GCC's total outstanding debt, which currently stands at around USD 563B, a 10% rise from last year.
  - We believe, based on our macroeconomic indicators, that GCC government balance sheets will continue to deteriorate until 2023, as they are forecast to register an aggregate central government deficit of about USD 180 billion.
- ➢ The recovery in market conditions, along with stimulus measures implemented by central banks across the GCC, easing capital requirements and prudential liquidity measures, have normalised bond spreads and pricing correlations. We expect, going forward, that this will free up liquidity in the banking system, and support healthy demand for sukuk.
  - The slight premium over conventional counterparts remains a factor that may disincentivise issuers as they are already challenged by higher borrowing costs.
  - A new debt law in Kuwait, if approved, is expected to pave the way for the restart of issuance in the coming months.

[1] *Arabia Monitor*; Fitch Ratings.

# M&A: Down but not out

- **Merger and acquisition (M&A) activity in MENA is looking up, after taking a sharp hit in the first half of the year when many businesses ground to a halt. The pandemic and lower oil prices are now accelerating consolidation across various sectors and prompting the sale of non-core businesses. We expect this trend to remain strong, mainly boosted by activity in the industrial and technology sectors.**
  - During the first half of the year, the pandemic and the resultant economic crisis cut global M&A deal values by more than 41% YoY to USD 901B -- the lowest half-yearly total in 10 years. Volume also fell by 32% YoY to 6,943 deals, marking the lowest half-yearly volume since H1 2013.
  - In MENA, the decline was more severe -- but only because of an exceptional event a year earlier. The nearly 60% YoY fall in deal values in H1, was the direct result of the base effect from the huge USD 69B deal in H1 2019 when Saudi Aramco bought a 70% stake in Saudi Basic Industries Corp from Saudi Arabia's wealth fund.
    - MENA's 25% YoY fall in volume -- the number of deals -- in H1 was less than the global percentage decline. There were 109 deals in MENA during Q1, only slightly fewer than the 115 deals the same period last year.
    - Signs of recovery came early in Q3. Deal values in June jumped to more than USD 33B from a low of USD 3B in the same month in 2019. Although M&A comparisons can be highly volatile (like FDI flows), the jump in activity does suggest that M&A appetite across the region remains healthy, with Q4 likely to see even higher volume.
  - Looking ahead, we expect SMEs and several larger corporations to require more equity through capital injections to meet their working capital requirements. This will probably be met by bullish acquisitors seeking to take advantage of relatively discounted prices.
    - GCC governments will welcome this as an opportunity to expand their diversification portfolio with global conglomerates, especially as new, easier restrictions on foreign investors take effect in various countries.
    - Recent changes in the GCC business-practice environment and improvements within the legal framework are expected to attract more foreign capital and facilitate the completion of deals.

**Figure 1 - Closed GCC M&A Transactions[1]**

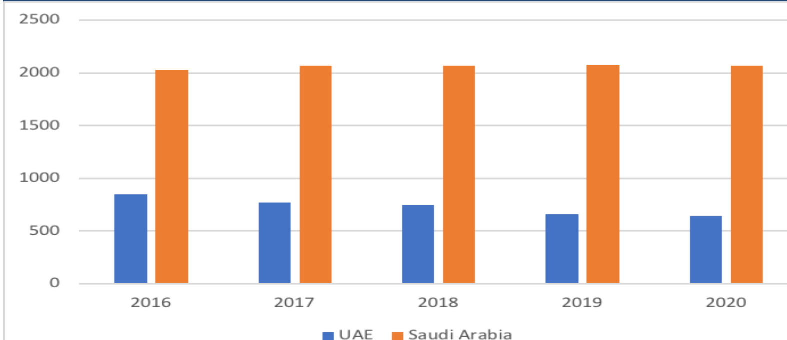
  - The growth in MENA deals was mainly on the back of strong activity in the industrial sector, accounting for 43% of total M&A activity in H1 (equivalent to USD 1B). Technology came second in deals but involved more money.
    - The technology sector saw 27 deals worth USD 2.2B, contributing 21% to H1 value – a 17% YoY increase.
    - Meanwhile, 15 deals in the energy, mining & utilities sector attracted USD 32B -- pushing this year's value up by 14% over 2019's full-year figure of USD 28B from 62 deals.
  - This sector distribution of M&A activity offers insight into where domestic and foreign investor interest will be most solid over the next few quarters.
  - While it is likely that many prospective deals will be delayed as investors remain cautious about overall global market uncertainty, M&A activity across the region is expected to continue rising, with the GCC taking the lead.
  - Going forward, we see businesses that are looking to sustain their liquidity focusing more on core services and divesting their non-core assets. Their goal will be to reduce drawdowns and raise much-needed cash.

[1] Arabia Monitor; S&P Capital IQ, GCC Stock Exchanges.

# Retail banking: Rapidly going digital

- **Even prior to the pandemic, traditional retail banks across the GCC were embracing fintech and wider technological solutions. This has sped up under the COVID-19 lockdowns, with banks pioneering the adoption of digital channels to increase their online presence. As consumers are increasingly keen to go digital, opportunities for innovative financial services providers are being created and disrupting the markets. This is expected to continue.**
  - The adoption of digital channels in the GCC for everything from cash management to foreign exchange in consumer banking was spearheaded in the UAE, where different retail banks began promoting their digital presence to customers.
    - The increase was driven by the GCC's young population and rising per capita income. Online banking penetration reached 92% for UAE banks and 85% for Saudi banks in 2019.
    - Emirates Islamic Bank (EIB), named the most innovative retail bank in the UAE in 2019, made mobile banking one of the cornerstones of its approach to it retain business.
      - In 2019, 60% of EIB customers opted for the bank's mobile banking channel.
      - It was also the first Islamic bank in the UAE to offer digital mobile wallets from Apple Pay, Google Pay and Samsung Pay.
    - Emirates NBD launched Liv, an entirely digital bank with an explicit retail focus, in 2017. The digital bank became the fastest growing in the UAE, with 10,000 new customers every month, a faster growth rate than its parent bank.
      - We believe this process will be replicated across the region, as new and innovative entities replace semi-public banks and outdated approaches.
  - The fast growth and untapped market potential of the digital retail market in the UAE is explained by the fact that the country has one of the largest mobile penetration rates in the world; it reached 187% in 2020 (meaning many people had more than one phone).
  - Digitalisation was accelerated by the COVID-19 outbreak, which spurred a working-from-home economy and pushed banks to adjust to the new normal and move online across the region.

**Figure 1 - Number of Retail Banks[1]**




- Commercial Bank of Kuwait has partnered with French-based Thales to provide secure digitalisation of debit and credit cards, allowing customers to make payments on their smartphones.
- Abu Dhabi Islamic Bank has shifted 99% of its retail financial transactions to digital platforms.
- In Saudi Arabia, cashless transactions are growing at an impressive rate due to the pandemic, surpassing targets for 2020.
  - Cashless transactions currently make up 37% of total transactions in the kingdom, up from 16% in 2016.
  - The target of the government was 28% given the growth rate in the past few years, which has increased as the pandemic fast-tracked the digital transition.
- A continued upward trend in retail banking digitalisation will be integral to the overall recovery of the banking sector. This is expected to position GCC retail banks more competitively in the region and generate higher return on equity than for the laggards that fail to engage in the transformation.

[1] *Arabia Monitor* ;IMF.

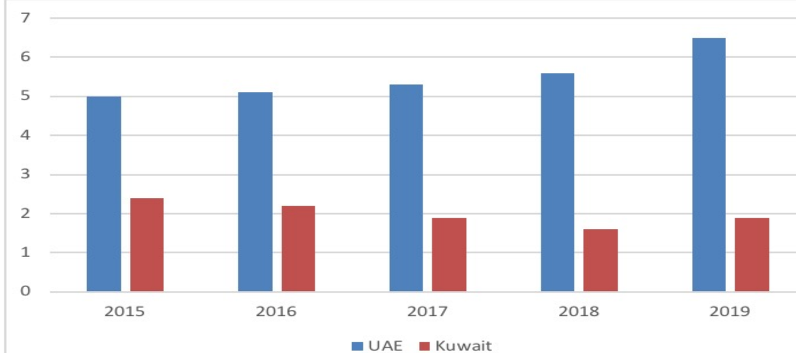
# GCC Banks: Strong, but pandemic hots profits

- **Banks across the GCC will see net profits shrink this year. The uncertainty around a second-wave of infections, in particular, is likely to slow lending growth and double non-performing loans. But given their adequate capital and liquidity buffers, we see GCC banks in a relatively better position to withstand the pandemic fallout than the rest of the MENA region. Further stress on the GCC banking sector, at least for now, should be offset by the sector's low loan-to-deposit ratios.**
  - ➢ On the back of the pandemic-induced lockdowns, GCC banking had a steep decline in revenue in Q2 dipping USD 18.7B for a nearly 10% QoQ decline. This came mainly from lower interest income: it reached USD 4.9B, a 24% YoY decline on the same period last year.
    - We expect revenue to remain limited, as banks will remain focused on preserving asset quality rather than generating new business, at least until early-to-mid next year.

➢ Net profits have also been hit, registering a six-quarter low of USD 4.3B at the end of Q2, a 53% YoY decline.

- The overall decline was inflated by the USD 1.8B Q2 loss registered to Saudi Arabia British Bank (SAAB), which took a goodwill impairment charge during the quarter.
  - o The booking of the goodwill impairment charge was driven by the short-term inflation of the bank's share price at the time SABB and Alawwal Bank merged, and Saudi Arabia was included in the MSCI Emerging Markets Index.
- Across the GCC, Kuwaiti banks had the largest hit, with an 81% Q2 QoQ decline in profits. Saudi Arabian banks were next with a 14.1% decline, followed by Qatar with 13.4%.
  - o By contrast, in 2019, the 11 Tadawul-listed Saudi banks made an aggregate profit of USD 3.3B in Q2, a 13% increase from the same quarter in 2018.
- Banks in Oman and the UAE banks fared better, managing to increase Q2 aggregate profits by 3.3% QoQ to reach USD 170M and USD 2B, respectively.
- Moody’s credit rating agency expects the decline in profits and a rise in provisions to lead to a 20% contraction in total profits this year for the GCC sector. Over the longer term, we expect the strong net income in 2019, which reached around USD 35B, will act as a buffer and absorb this year’s inevitable losses.

**Figure 1 - Non-Performing Loans Ratio[1]**




➢ We continue to see the GCC banking sector recovering more rapidly than in some other parts of the world, mainly due to good liquidity indicators and strength in customer deposits across the banks.

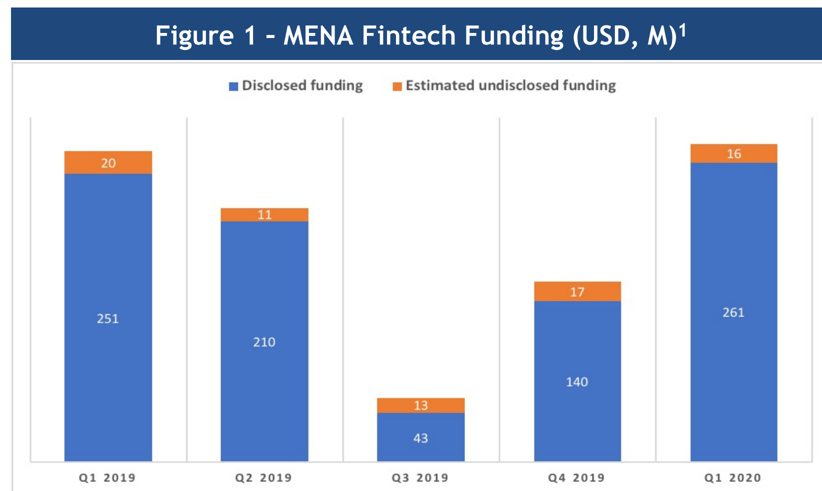
- The use of external funding sources by GCC banks remains limited, with the exception of Qatar, where the banking system holds a majority of net external debt. We do not expect external funding to increase in the short-term given the risk of further volatility.
- Deposits by customers also show a positive trend. Fuelled by the easing of pandemic restrictions and the restarting of some parts of the economy in Q2, deposits reached USD 1.87T, a 2.1% QoQ increase. This resulted in the aggregate loan-to-deposit ratio reaching a healthy 79.7% for the GCC sector (versus around 71% in the US).
- Despite the QoQ growth, we remain wary about the outlook for the GCC banking sector this year. We expect it will enter 2021 stable but subdued. Stimulus measures will help the sector navigate, but for banks to recover to pre-pandemic levels, we believe that further government support will be needed.

[1] *Arabia Monitor; IMF.*

# Fintech: COVID-19 (and normalisation) driving growth

- **The financial technology, or fintech, sector is growing at a 30% annual rate in MENA and is expected to take off even more as the pandemic forces people away from traditional face-to-face financial transactions. Fintech revenues are expected to reach USD 2.5B in 2022 in MENA, compared with just USD 80M in 2017. The growing rapprochement between GCC states and Israel could boost fintech investments, given that the latter has become one of the world's leading hubs for the sector.**
  - We believe that the COVID-19 crisis will accelerate the already fast-growing fintech industry. On the back of the pandemic and its accompanying lockdowns, online payments penetration in MENA rose to 76% and smart phone penetration to an estimated 133% in Q1. As a result, e-commerce volume grew by 45% YoY in Q2.
  - The potential for MENA is huge.
    - The vast majority of the GCC population is young and tech savvy, with an estimated 54% of the population under 25 years old in 2020, giving the region an edge to innovate and embrace the new digital era.
    - In 2019, the MENA region only received 1% of all venture capital fintech investments globally. This will change as investment in the region should rise, with estimated growth to 8% of total financial services revenue by 2022.
    - Growth potential is also reflected in the substantial increase in the region's fintech start-ups: the number has quadrupled from 46 in 2013 to 250 in 2020.
  - The UAE has been at the forefront of fintech innovation in the region. Dubai leads, closely followed by Abu Dhabi.
    - In Q4 2019,the Dubai International Financial Centre said it had surpassed 100 registrations for fintech firms.
    - Currently, the UAE hosts 46% of MENA fintech start-ups, and is responsible for nearly 50% of all fintech deals and 70% of all funding
    - As 75% of transactions in the UAE are still cash-based, we expect the fintech sector to grow quickly in the near future: the country's mobile wallet market is expected to reach USD 2.3B in 2022.
  - The growth of UAE fintech has been encouraged by a high degree of trust among Emiratis in handing over data. In a 2019 survey, 76% of respondents said they trusted technology companies with their money.

**Figure 1 - MENA Fintech Funding (USD, M)[1]**



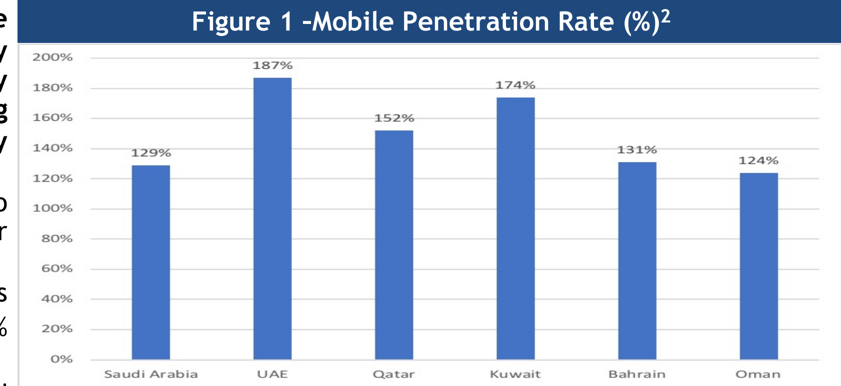

- The signing of the Abraham Accord peace deal in August between the UAE and Israel could expand investment opportunities in the sector.
  - Israel's fintech sector is among the strongest globally. It comprises 530 start-ups, including prominent business models such as trading app eToro and payment group Melio, with the latter raising USD 144M recently.
  - While the peace deal is in its early stages, the new bilateral cooperation -- now joined by Bahrain -- is expected to incentivise further improvement in the GCC's fintech regulatory framework and attract investment.
    - Barker and Booth Commercial Agency, a UAE-based company, has already announced a strategic investment in Israeli fintech start-up Fintica.
  - Israeli investors, at least in the medium-to-long-run, are expected to add MENA start-ups to their radar screens as they scout for deals and innovative business models.

[1] Arabia Monitor; Magnitt.

# Open Banking: Bahrain forges ahead

- **In tandem with the growth in fintech, financial institutions have been seeing a rapid increase in "open banking" -- the sharing of data with third parties to facilitate networks of money management. Globally, open banking is expected to expand by an annual rate of 24% by 2026 to reach a market value of over USD 43B. Growth in MENA, which is only just beginning to adopt the concept (with Bahrain ahead of others), should follow suit once regulatory obstacles have been removed.**
  - ➢ The global open banking market generated over USD 7B in 2018 and is expected to grow to USD 43.2B in 2026. It has required supportive government regulations as well as consumer engagement in order to grow.
    - Around half of the market last year involved the banking and capital markets sectors. The payments segment is expected to see the largest expansion with 27% annual growth.[1]
  - ➢ In the MENA region, open banking is very new, which means it both lags and has untapped potential. With the region's reputation for embracing new technologies, however, we believe the market will expand rapidly. By 2022, it is forecast that 71% of SMEs and 64% of adults across the region will be using open banking.
  - ➢ Bahrain is the regional pioneer, fuelled by the pro-innovation stance adopted by the Central Bank of Bahrain. In recent years it has mandated flexible and forward-looking regulations, setting up, for example, the first regulatory sandbox for cryptocurrency and fintech innovation in MENA.
    - Bahrain has already introduced open banking regulations with an eye to transforming the financial services industry. It has focussed on greater transparency and inclusivity in sharing data.
    - In December, the National Bank of Bahrain partnered with Tarabut Gateway, MENA's first licensed open banking platform, to roll out open banking with its clients. The platform is operating with more than half of the country's banks.
    - Islamic banks in Bahrain are also joining in, including Ithmaar Bank, Khaleeji Commercial Bank and Bahrain Islamic Bank, the leading provider of integrated sharia-compliant solutions. This adds yet more potential for data sharing.
    - For banks themselves, the digitalisation required to adopt open banking is expected to drive a 20% increase in revenue.

Figure 1 -Mobile Penetration Rate (%)[2]



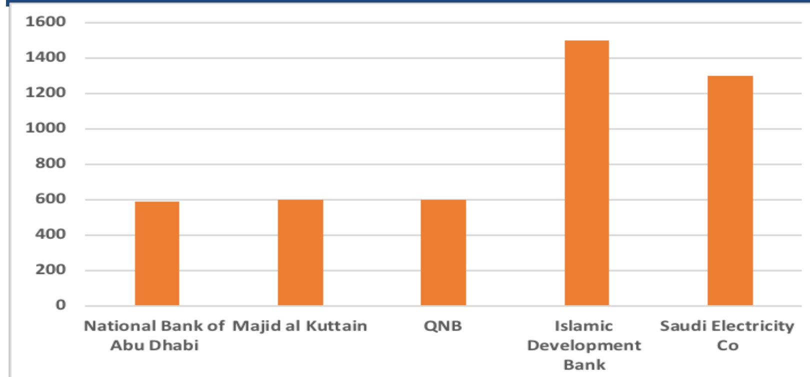

- **Bahrain's lead will force other countries, particularly in the GCC, to adapt and compete in open banking.**
  - ➢ Tarabut Gateway, a subsidiary of Bahrain's venture group Almoayed Technologies, is expanding its operations into Kuwait, where it launched its services with Kuwait Finance House and National Bank of Kuwait. Tarabut has also announced plans to expand in the UAE.
  - ➢ In the UAE, 88% of banks plan to adopt open banking in 2021. Service-related technologies (biometric software, government ID readers and access management apps) are already under way.
  - ➢ Despite the growing interest, challenges remain. The lack of homogenous technical standards and regulations in the region makes the nascent sector prone to fraudulent activity. This could hamper growth prospects and lower consumer buy-in as scepticism around data sharing lingers.
  - ➢ We believe governments will be forced to act, making at least some of the barriers to growth short-lived.
    - In August 2019, Bahrain become the second (after Qatar) in the region to issue a Protection of Personal Data law. More recently, in July 2020, the Dubai International Financial Centre enacted a new data protection law aligned with EU standards.

[1] North America is the open banking market leader with around two-thirds of global market share, followed by the UK, which is forecast to grow at annual rate of 24% by 2026. In the UK, open banking covers around 95% of the total current account market.
[2] Arabia Monitor; GSMA.

# Green Finance: Seeking a sustainable recovery

- **The urgency of addressing climate change has driven investors across the globe to prioritise green finance. To date, there are at least USD 31T held in sustainable or green investments globally, up 34% from 2016. In the GCC, the market remains limited -- green sukuks account for less than 3% of global sukuk issuance. Yet with demand for sustainable finance rising in the region, we believe deals will grow rapidly. The region's growing investments into the environmental, social and governance (ESG) area will also spur an increase in the green finance sector.**
  - Following the Paris Agreement in 2016, the GCC pledged to place climate change at the core of its economic growth strategy. As a result, renewable energy capacity grew by an annual rate of 179% between 2018 and 2020 to 7 GW. This is still relatively small (less than half that of Britain, for example), but it is creating new investment opportunities, particularly as economic diversification becomes ever more urgent.
    - The UAE aims to make 27% of its energy consumption "clean" by 2021 and 50% by 2050. This would require a yearly investment of USD 4.6B for the next 31 years.
    - Similarly, Saudi Arabia's Vision 2030 aims to increase the share of clean energy to 30% of its total energy mix -- necessitating USD 30B-50B in investment in renewables.
  - Green finance in the GCC is still at an early stage, but with government participation growing, this is expected to change.
    - Governments across the Gulf have prepared the necessary regulatory groundwork to build a green finance sector that would help reach the various targets.
    - The UAE in particular is emerging as a leader in this field. In 2018, it passed legislation providing the framework for bond and sukuk issuance for green financial markets.
      - The Dubai Electricity and Water Authority established the Dubai Green Fund, which aims to raise USD 27.2B in green assets to finance green projects.
      - Abu Dhabi is also replicating these steps. In 2018, Masdar City, a planned project, signed the first green revolving credit facility in the MENA region to fund the emirate's sustainability projects, totalling USD 75M.

**Figure 1 - GCC Green Bond Market (USD,M)[1]**




- The green bond market in the GCC has shown impressive growth over the past three years and is set to continue an upward trend, especially with the emergence of green sukuks.
  - The first green bond in the region was issued by the National Bank of Abu Dhabi in 2017, for USD 587M.
  - QNB successfully issued Qatar's first green bond in September 2020, worth USD 600M. This is aimed at achieving Doha's sustainable development goals.
  - Islamic green sukuks also offer the opportunity, to diversify the investor base, attracting those requiring Sharia-compliance.
  - We expect demand for issuance to continue gaining momentum; GCC governments want both to increase their focus on sustainable strategies internationally and to support the growth of Islamic capital markets.
- As GCC countries are only just beginning to embark on their ESG policies, we believe this sector will continue to grow, possibly exponentially, over the next decade as economies in the region try to move away from oil and invest in clean energy.

[1] *Arabia Monitor*; Moody's Investors Service.

# Iran Market Monitor: COVID-19 does what sanctions could not

- **Sanctions continue to batter the economy with Iran's GDP forecast to contract by 6% this year and likely to be revised down even further as the worst affected country in the region battles the virus and the ongoing effects of sanctions.**
  - ➢ While the Tehran Stock Exchange (TSE) reached record highs in Q3, growing for six consecutive months, the Q4 outlook looks bleak as the reality of arguably over-priced shares settles in.
    - The TSE TEDPIX index broke above the 2 million mark in early August but has dropped close to 25% since then.
    - The market was booming as public companies were funnelled through the stock market to raise cash for the government.
      - The stock market held its largest IPO in April. selling 10% of the government's shares of SHASTA (Iran's Social Securities Investment Company).
  - ➢ The rial has spiralled to a record low of 286,500 IRR per USD, from 110,000 IRR this time last year, and from 35,000 IRR per USD the year JCPOA was signed.
  - ➢ Devaluation and inflation can be attributed to Washington's sanctions, which have incrementally been piled on throughout the past four years, as well as to the coronavirus pandemic.
    - Inflation has now reached 30.4% and is expected to climb in the next quarter.
  - ➢ In 2020 alone, the rial has depreciated by 49%. It is likely to decline even further, contingent on US policy.
- **Iran will bear the brunt of the sanctions with strategic patience ahead of the US presidential election in November.**
  - ➢ President Donald Trump can pursue his "maximum pressure" strategy until the White House handover in January 2021, even if Democratic candidate Joe Biden wins the presidency.
  - ➢ Were Trump to win, the sanctions would continue. Biden might ease some of them, but it would be in exchange for some kind of deal which may or may not be palatable to Tehran.
  - ➢ Trump threatened to push through his latest round of sanctions via an executive order in September.
    - The sanctions, however, largely duplicate existing ones, penalising anyone who sells arms to Iran, re-establishing the arms embargo placed prior to the passage of the JCPOA nuclear deal. They are more indicative of Trump trying to flex his muscles pre-election than having much of a tangible effect.
  - ➢ Iran is likely to act with restraint as the country is hopeful a Biden win would re-establish some of the conditions of the JCPOA.
    - Iranian media and public opinion have endorsed a Biden victory. However, even though Biden has publicly acknowledged he would attempt to restore the JCPOA, this could be difficult.
    - For one thing, when President Hassan Rouhani leaves office in June 2021, a conservative president is likely to take over and be even more hostile towards the US.
    - For another, with other Gulf countries likely to join the UAE and Bahrain in recognising Israel, tensions will rise.
- **As divisions between Iran, the US and its regional allies widen, Tehran is inching closer to China and accelerating its engagement with Venezuela.**
  - ➢ Iran will continue to look east for support as the Rouhani administration pushes for the 25-year Iran-China agreement to be formalised under his government. In the meantime, it has also turned to Venezuela, sending tankers of crude to the energy-starved country since the early summer of 2020, defying US sanctions.

**Table 1 - Iran Macroeconomic Indicators[1]**

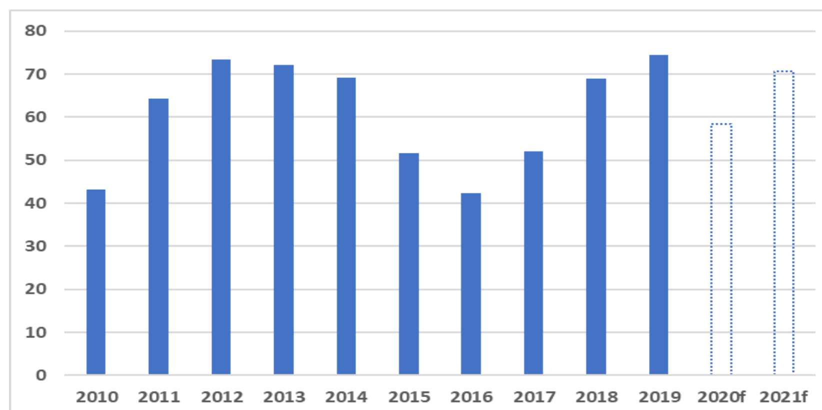
| | 2016/17 | 2017/18 | 2018/19 | 2019/20f | 2020/21f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 12.5 | 3.7 | -5.4 | -7.6 | -6.0 |
| Crude Oil Production (M Bpd) | 3.6 | 3.8 | 3.5 | 2.1 | 1.9 |
| CPI Inflation (%) | 9.1 | 9.6 | 31.2 | 41.1 | 34.2 |
| Fiscal Balance (% of GDP) | -2.3 | -1.4 | -2.1 | -5.7 | -9.9 |
| C/A Balance (% of GDP) | 4.0 | 3.8 | 2.1 | -0.1 | -4.1 |
| Total Gov't. Gross Debt (% of GDP) | 47.5 | 39.5 | 31.8 | 29.7 | 34.4 |
| Total Gross Extrn'l Debt (% of GDP) | 2.2 | 2.2 | 2.1 | 2.2 | 2.7 |
| Gross Official Reserves (Mos. of Imports) | 13.4 | 14.3 | 22.4 | 19.4 | 16.2 |
| Nominal GDP (USD B) | 404.4 | 430.7 | 443.9 | 491.0 | 439.2 |
| Population (Millions) | 80.2 | 81.1 | 82.0 | 83.2 | 83.9 |

[1] Arabia Monitor; IMF.

# Sino-MENA: Oil trade up, downstream lingers

- **China's crude imports hit a historic high in June, as low oil prices pushed up Q2 imports, which were offloaded at Chinese ports in Q3. Imports eased in July and August, although they were still well above levels from the same periods in past years.**
  - In June, China imported almost 13M/bd, before dropping to just over 12M/bd in July and then 11M/bd in August.
    - Chinese buyers bought up so much oil -- primarily from MENA and the US -- when the prices collapsed that storage facilities were filled and there was a shortage of tankers as some waited up to a month to offload at Chinese ports.
    - While imports probably remained strong in September, as the last batch of cheap crude was finally offloaded, we do not expect to see imports setting another record this year, even if Chinese buyers tend to stockpile towards year-end, ready for Chinese New Year.
    - This is mainly due to continued weaker demand, shortage of storage spaces and many independent refineries running out of their annual purchase quotas.
  - Likewise in the gas markets, Chinese buyers have also been taking advantage of the low prices.
    - Sinopec Corp has recently agreed to a 10-year tender to buy 1M tonnes of liquefied natural gas annually from Qatargas, at a slope of 10.19% which is deemed well discounted.
    - Over the past months we have also seen a lot of activity in gas tanker capacity and storage-facility building, much of it with Qatar.
    - In April of this year, Qatar Petroleum reserved the bulk of shipbuilding capacity of Chinese shipbuilder Hudong Zhonghua up to 2026 for USD 3B. It is China's largest shipbuilding export contract to date.
    - Growing energy trading relations and financing opportunities have helped China beat traditional competitors such as South Korea in winning this major contract.
- **In the downstream market however, some high-profile deals risk being delayed.**
  - Aramco had some ambitious plans for downstream expansion in China's Zhejiang Province, including acquiring a 9% stake in the 400,000 b/d ZPC refining complex led by private-sector firm Rongsheng.

**Table 1 - China-Saudi Arabia Bilateral Trade (USD, B)[1]**




  - The acquisition has been delayed without much clarity as to why. Some say it is due to local bureaucracy, while others believe it is to do with oil price conditions. Part of the agreement involves Saudi Arabia supplying crude, which is at a very low price at the moment.
  - Saudi oil exports to China have grown significantly over the past decade, driving up bilateral trade.
    - Between 2008-2019 Sino-Saudi trade grew on average by approximately 8% per annum.
    - In the past three years, bilateral trade grew by 27% annually on average, driven by the volume of oil exports to China. In 2019, Saudi overtook Russia to become the top supplier to China.
  - Aramco has a USD 500B global investment plan for the next 10 years. We believe that even with the current collapse in price, a significant tranche of the investments will still go to China. We do not think these projects risk being cancelled.

[1] Arabia Monitor; IMF Direction of Trade Statistics.

# Special Feature with GEIDCO:
## Global Energy Interconnection: Sustainable Development Approach for MENA region

**Arabia Monitor spoke to Mr. Yan Tao, Director of MENA at GEIDCO:**

*Launched in March 2016 with its headquarters in Beijing, China, Global Energy Interconnection Development and Cooperation Organization (GEIDCO) is a non-profit international organization dedicated to promoting the sustainable development of energy worldwide. The purpose of GEIDCO is to promote the establishment of a Global Energy Interconnection (GEI) system, to meet global power demand with clean and green alternatives, to implement the United Nations "Sustainable Energy for All" and climate change initiatives, and to serve the sustainable development of humanity.*

**Q: In which ways are traditional economic structures and energy consumption patterns facing challenges?**

**A:** The MENA region is home to half of the world's proven oil and gas reserves. The region also exports over 90% of its oil and gas production, accounting for 70% of MENA's GDP. However, the MENA region is facing many challenges in a post-pandemic world. With the region already susceptible to the volatility of oil and gas markets, recent shifts in global oil and gas dependence driven by a focus on renewables has placed the MENA region at an economic crossroad.

However, the MENA region has excellent potential to develop renewable energy, especially solar and wind. The Global Horizontal Irradiance (GHI) in MENA is from 2000kWh/m$^2$ to 2500kWh/m$^2$, which is distributed across the Gulf, Yemen, and much of North Africa. The Direct Normal Irradiance (DNI) in the region ranges from 2000kWh/m$^2$ to 3000kWh/m$^2$. Wind speeds of over 7m/s annually can be found in in land areas across the region.

Developing renewable energy resources to promote economic diversification and drive a transition in energy consumption patterns is quickly becoming an important element of the region's development. An increased focus on reducing oil dependency and promoting economic diversification creates a positive outlook. Several notable projects are already in the pipeline in the UAE, Egypt, Saudi Arabia, and Morocco, with more projects set to follow.

**Q: How has the push for a reduction in oil and gas dependence impacted cross-border connections in the MENA region?**

**A:** States around the region are committed to connecting their power grids and increasing intra-regional cooperation.

The Gulf states are already interconnected through a 400kV grid in addition to another 400kV grid running along the North African coastline, connecting the Maghreb with the Mashreq. Despite advancements in operation stability, these grids cannot entirely meet the needs of the region's future development. To combat this, several interconnection projects are under development throughout the region.

**Q: How important is Global Energy Interconnection in driving sustainable economic development?**

**A:** Global Energy Interconnection represents a sustainable method to promote green development, increase energy efficiency, and promote social equality in addition to deepening regional collaboration. As the region embarks on ambitious socio-economic development projects, it is estimated that by 2035 MENA will have consumed 3.275 PWh, a figure which is expected to increase to 5.1PWh in 2050. Global Energy Interconnection Development Cooperation Organization (GEIDCO) recognises these benefits and has created an energy interconnection roadmap for the MENA region.

By 2035, the inter-continental power flow in West Asia will reach 31GW, increasing to 57GW in 2050. This figure is reflective of Saudi Arabia's 8GW export to Pakistan and Turkey via two ±800kV DC projects. The UAE will also export 8GW of power to India via a ±800kV DC project. Additionally, the region will receive 4GW hydropower from Ethiopia.

In North Africa, the wind and solar energy bases are expected to transit 23GW to Europe. Specific projects include Morocco exporting 3GW to Portugal by ±500kV DC project and Egypt delivering 4GW to Turkey via ±660kV project. Additionally, there will be 3 major intercontinental transmission lines in North Africa by 2050. These DC projects will be able to improve the transmission capability from North Africa to Europe.

# MENA Macro Dashboard

| Table 1 – MENA Oil Exporters[1] | Real GDP Growth (%) | | CPI Inflation | | Fiscal Balance (% of GDP) | | C/A Balance (% of GDP) | | External Debt (% of GDP) | | Reserves (Mos. of Imports) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2020f | 2019 | 2020f | 2019 | 2020f | 2019 | 2020f | 2019 | 2020f | 2019 | 2020f |
| Algeria | 2.6 | -5.2 | 2.0 | 3.5 | -9.3 | -20.0 | -9.6 | -18.3 | 1.7 | 3.0 | 16.1 | 8.2 |
| Bahrain | 1.8 | -3.6 | 1.0 | 2.6 | -10.6 | -15.7 | -2.9 | -9.6 | 205.5 | 230.0 | 2.5 | 1.1 |
| Iran | -7.6 | -6.0 | 41.1 | 34.2 | -5.7 | -9.9 | -0.1 | -4.1 | 2.2 | 2.7 | 19.4 | 16.2 |
| Iraq | 3.9 | -4.7 | -0.2 | 0.8 | -0.8 | -22.3 | -1.2 | -21.7 | 31.8 | 43.8 | 9.8 | 4.8 |
| KSA | 0.3 | -6.8 | -1.2 | 0.9 | -4.5 | -11.4 | 6.3 | -3.1 | 23.2 | 28.9 | 33.2 | 28.0 |
| Kuwait | 0.7 | -1.1 | 1.1 | 0.5 | -18.3 | -19.8 | 8.9 | -10.2 | 48.2 | 63.7 | 8.1 | 7.0 |
| Libya | 9.9 | -58.7 | 4.6 | 22.3 | 8.8 | -7.2 | -0.3 | -6.6 | … | … | … | … |
| Oman | 0.5 | -2.8 | 0.1 | 1.0 | -7.0 | -16.9 | -5.2 | -14.2 | 91.7 | 116.7 | 7.1 | 6.0 |
| Qatar | 0.1 | -4.3 | -0.6 | -1.2 | 4.1 | 5.2 | 2.4 | -1.9 | 122.3 | 145.9 | 9.6 | 7.9 |
| UAE | 1.3 | -3.5 | -1.9 | -1.0 | -0.8 | -11.1 | 7.4 | 1.5 | 77.7 | 94.0 | 4.7 | 3.1 |
| Yemen | 2.1 | -3.0 | 10.0 | 26.7 | -3.8 | -8.0 | -7.4 | -2.8 | 18.9 | 24.4 | 1.4 | 2.1 |
| Average | 0.9 | 1.8* | 5.1 | 8.2 | -4.4 | -12.5 | -0.2 | -8.3 | 62.3 | 75.3 | 11.2 | 8.4 |
| Average Ex-Yemen | 1.4 | 1.8* | 4.6 | 6.4 | -4.4 | -12.9 | 0.6 | -8.8 | 67.1 | 81.0 | 12.3 | 9.1 |

| Table 2 – MENA Oil Importers[1] | Real GDP Growth (%) | | CPI Inflation | | Fiscal Balance (% of GDP) | | C/A Balance (% of GDP) | | External Debt (% of GDP) | | Reserves (Mos. of Imports) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2020f | 2019 | 2020f | 2019 | 2020f | 2019 | 2020f | 2019 | 2020f | 2019 | 2020f |
| Djibouti | 7.5 | 1.0 | 3.3 | 2.9 | -0.8 | -2.7 | 24.7 | -0.8 | 66.0 | 71.7 | 1.1 | 0.8 |
| Egypt | 5.6 | 2.0 | 9.2 | 5.9 | -7.4 | -7.7 | -3.6 | -4.3 | 34.1 | 31.9 | 7.4 | 7.0 |
| Jordan | 2.0 | -3.7 | 0.3 | 0.2 | -6.1 | -6.7 | -2.8 | -5.8 | 68.5 | 76.2 | 9.2 | 9.0 |
| Lebanon | -6.5 | -12.0 | 2.9 | 17.0 | -10.7 | -15.3 | -20.6 | -12.6 | 196.3 | 186.6 | 20.5 | 16.0 |
| Mauritania | 5.9 | -2.0 | 2.3 | 3.9 | 2.1 | -3.3 | -10.6 | -17.3 | 58.1 | 66.5 | 3.7 | 3.4 |
| Morocco | 2.2 | -3.7 | 0.0 | 0.3 | -4.1 | -7.1 | -4.1 | -7.8 | 33.0 | 35.1 | 6.4 | 4.1 |
| Palestine | 0.9 | -5.0 | 1.6 | 0.1 | … | … | -10.7 | -11.7 | … | … | … | … |
| Somalia | 2.9 | -2.5 | 3.0 | 2.7 | 0.1 | 0.2 | -13.7 | -11.4 | … | … | … | … |
| Sudan | -2.5 | -7.2 | 51.0 | 81.3 | -10.8 | -16.9 | -14.9 | -15.2 | 198.9 | 299.2 | 4.9 | 2.0 |
| Syria | … | 3.0* | … | … | … | … | … | … | … | … | … | … |
| Tunisia | 1.0 | -4.3 | 6.7 | 6.2 | -3.9 | -4.3 | -8.8 | -7.5 | 90.3 | 109.9 | 5.2 | 3.6 |
| Average Ex-Syria | 2.0 | 2.0* | 8.6 | 13.1 | -5.1 | -7.6 | -10.0 | -10.4 | 97.0 | 115.1 | 8.2 | 6.4 |

[1] Arabia Monitor; IMF.
* Subject to downward revision.

# Algeria: Bracing for constitutional change

NR/NR

- **Economic prospects in Algeria were already worsening before the pandemic. In 2019, GDP growth was a mere 0.7%, following 1.4% in 2018. With the combined effect of the COVID-19 crisis and falling oil prices, the economy is set to shrink by 5.2% this year. The government is trying to step in.**
  - Algeria, which depends on hydrocarbon exports for 60% of its national income, has been hit particularly hard by the pandemic-inflicted global economic downturn.
    - The energy sector contracted by 13.4% in Q1 2020, nearly double the 7.1% decline in the first quarter of 2019.
    - The government is implementing measures to diversify the economy away from energy and aims to increase non-energy exports to USD 5B in 2021 from the current USD 2B. Fractured politics may hamper this, however.
  - Foreign exchange reserves dipped to USD 44.2B in August, from USD 51B in May. In 2014, by contrast, Algeria had USD 200B in foreign reserves. Unless this decline is halted, the country could face a balance of payments crisis by 2022.
  - The government has responded to the crisis by implementing measures to cushion the economy. Any impact, however, will not be felt in the short-term.
    - Government spending has been reduced by 50% in 2020 and the import bill by 25%.
    - The administration of President Abdelmajid Tebboune has launched an initiative to support the private sector and diversify the economy -- the aim is to reduce hydrocarbon dependency from 98% of export revenues to 80% by 2022. This target is ambitious, particularly considering the global economic downturn and the short timeframe in which the government wishes to achieve its goal.
    - Another component of the government initiative is a USD 15B fund to finance loans taken out by investors, with a potential USD 12B to be tacked on, depending on its success.
      - 20,000 jobs are to be created by the government next year to mine iron, zinc and copper in the provinces of Tindouf and Béjaïa.

**Algeria Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 3.2 | 1.3 | 1.4 | 2.6 | -5.2 |
| Crude Oil Production (M bpd) | 1.0 | 0.9 | 0.9 | 0.9 | 0.7 |
| Oil GDP Growth (%) | 7.7 | -2.4 | -6.4 | -5.5 | -17.7 |
| Non-oil GDP Growth (%) | 2.2 | 2.1 | 3.3 | 2.5 | -2.3 |
| CPI Inflation (%) | 6.4 | 5.6 | 4.3 | 2.0 | 3.5 |
| Fiscal Balance (% of GDP) | -13.4 | -8.6 | -6.9 | -9.3 | -20.0 |
| C/A Balance (% of GDP) | -16.5 | -13.2 | -9.6 | -9.6 | -18.3 |
| Total Gov't. Gross Debt (% of GDP) | 20.5 | 27.1 | 38.1 | 46.3 | 61.0 |
| Total Gross External Debt (% of GDP) | 2.4 | 2.4 | 1.8 | 1.7 | 3.0 |
| Gross Official Reserves (Mos. of Imports) | 22.5 | 19.2 | 17.8 | 16.1 | 8.2 |
| Nominal GDP (USD B) | 160.0 | 167.4 | 173.8 | 169.0 | 146.3 |
| Population (Millions) | 40.5 | 41.3 | 42.2 | 43.1 | 43.8 |

- **The Hirak protests, which were going strong after 57 weeks, were only halted due to the coronavirus restrictions. They are now set to pick up momentum as the government prepares to organise a referendum on constitutional amendments.**
  - Algeria's parliament has responded to the demands of the Hirak movement by adopting constitutional reforms.
    - On 10 September, an amended constitution was approved by 256 members of the People's National Assembly, out of 462 members in total. The new constitution will be put to a referendum on 1 November, a symbolic date which marks the start of Algeria's war of independence.
    - The revised constitution is set to reinforce the separation of powers and provide more transparency in the management of public funds, the two key factors contributing to recent Algerian protests.
    - Although the new constitution was given the green light by parliament, we believe the public will be harder to convince, as several Hirak protesters are demanding a complete overhaul of the system, including a dissolution of parliament.

[1] Arabia Monitor; IMF.

# Bahrain: Embracing new ties

**B2/B+**

- **Bahrain's economy is set to shrink by 3.6% this year -- the first and deepest contraction since 1994. The decline in oil revenue and subdued spending is expected to nearly double the budget deficit. While the Israel-Bahrain normalisation deal is prompting some unrest at home, it has the potential to yield economic returns in the future.**
  - Current economic conditions suggest that the fiscal consolidation target set in the 2018 Fiscal Balance Programme for a balanced budget by 2022 is unlikely to be met.
    - Bahrain is on course for one of its highest budget deficits -- 15.7% of GDP, a 48% YoY increase.
    - We do not believe plans for another bailout from Bahrain's richer neighbours to be in sight, at least this year, as they are grappling with their own economic recessions.
      - In 2018, Bahrain was pledged a USD 10B support package by Saudi Arabia, Kuwait and the UAE to support its economy.
    - Government revenues in H1 fell by USD 2.4B, or around 29%, from a year earlier, with oil revenue down by 35%. Oil revenue was around 70% of total revenue in 2019.
    - With its oil and gas reserves limited compared with others in the GCC, the economy will need government intervention.
      - In late March, the government announced a USD 11.3B stimulus, around 30% of GDP, slashed expenditures by 30%, and delayed several projects until later.
  - The financing strategy will focus on foreign funding, which may reach USD 3.4B, around 10% of GDP. With expenses high and revenues low, Bahrain re-entered the debt market with a second offering of the year.
    - The kingdom increased its debt ceiling by 15% to nearly USD 40B to help finance public spending.
    - Bahrain issued a dual tranche bond, which comprised a USD 1B 7-year sukuk, sold at 3.95%, and a USD 1B 12-year conventional bond at 5.45%.
    - Yet with Bahrain receiving its first credit downgrade this year, we believe it will need to seek further Gulf backing next year - although this is likely to be contingent on the kingdom enacting further fiscal reforms for the time being.

**Bahrain Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 3.5 | 3.8 | 2.0 | 1.8 | -3.6 |
| Crude Oil Production (M bpd) | 0.20 | 0.20 | 0.19 | 0.20 | 0.20 |
| Oil GDP Growth (%) | -0.1 | -0.7 | -1.3 | 2.2 | -1.0 |
| Non-oil GDP Growth (%) | 4.3 | 4.9 | 2.7 | 1.7 | -4.1 |
| CPI Inflation (%) | 2.8 | 1.4 | 2.1 | 1.0 | 2.6 |
| Fiscal Balance (% of GDP) | -17.6 | -14.2 | -11.9 | -10.6 | -15.7 |
| C/A Balance (% of GDP) | -4.6 | -4.5 | -5.9 | -2.9 | -9.6 |
| Total Gov't. Gross Debt (% of GDP) | 81.3 | 88.2 | 95.0 | 103.3 | 128.8 |
| Total Gross Extrn'l Debt (% of GDP) | 183.6 | 181.2 | 187.8 | 205.5 | 230.0 |
| Gross Official Reserves (Mos. of Imports) | 1.2 | 1.2 | 1.0 | 2.5 | 1.1 |
| Nominal GDP (USD B) | 32.3 | 35.4 | 37.7 | 38.6 | 35.2 |
| Population (Millions) | 1.4 | 1.4 | 1.5 | 1.6 | 1.7 |

    - The increase in the 2020 budget deficit is expected to propel government debt to GDP to nearly 130%. We think this will remain high until at least 2022.
    - External debt will increase from 205.5% of GDP in 2019 to 230% this year, with interest payments on debt accounting for 20% of government revenue.
  - The Israel-UAE-Bahrain deal could provide some of the economic gains the country is seeking, in addition to the political gains.
    - It is expected, at least in the long-term, to strengthen its strategic partnership with the US, improving security cooperation as well as trade ties.
    - It is helped that the new economic ties could chart a new path for investments, trade and increase Bahrain's banking competitiveness.
  - Normalisation has heightened tensions with Iran and will continue to do so. But the Islamic Republic -- less than 1,000 km across the Gulf -- is only likely to engage in tough talk rather than in any physical offensive for now.

[1] Arabia Monitor; IMF.

# Djibouti: Putative gateway to Africa's agriculture

NR/NR

- **The effects of the COVID-19 pandemic mean real GDP in Djibouti is expected to contract by 1% in 2020 following 6% growth in 2019. Recovery is not expected to begin until 2021. However, the medium to long-term prospect is more encouraging as the country's Vision 2035 strategy targets the development of the domestic economy and the country's position as a trade and logistics hub.**
  - ➢ As with the various visions that have been drawn up throughout the MENA region, the objective of Djibouti's Vision 2035 is to facilitate growth via economic diversification.
    - The core objective is to triple the country's annual per capita income, which at the launch of the strategy was around USD 1,580. The goal is to raise it to nearly USD 4,740 by 2035.
  - ➢ The latest development is the establishment of a sovereign wealth fund.
    - The announcement, made in the summer, targets USD 1.5B in funding in 10 years.
    - The money is to be reinvested in the country's assets, mainly the growing logistics industry.
  - ➢ A key element of this will be positioning Djibouti as an export hub for others.
    - At the end of August, the first refrigerated container travelled from Ethiopia to Djibouti on the Cool Logistics corridor
    - The shipment, made up of 24 tonnes of avocados, travelled along the Ethio-Djibouti train line in refrigerated containers before then being exported to Europe via the Netherlands.
    - The port authority of Rotterdam -- the recipient of the shipment -- said it will be followed by "many others" as the demand in Europe for African agricultural products increases.
  - ➢ The new capability paves the way for more traffic through Djibouti as Ethiopian agriculture accelerates its expansion.
  - ➢ Djibouti is a gateway for landlocked countries in Africa to export agricultural produce. The country's transport and logistics sector holds massive potential for investment and growth.

**Djibouti Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 6.5 | 5.4 | 8.4 | 7.5 | 1.0 |
| CPI Inflation (%) | 2.7 | 0.6 | 0.1 | 3.3 | 2.9 |
| Fiscal Balance (% of GDP) | -8.3 | -4.5 | -2.8 | -0.8 | -2.7 |
| C/A Balance (% of GDP) | -1.0 | -4.8 | 18.0 | 24.7 | -0.8 |
| Total Gov't. Gross Debt (% of GDP) | 45.7 | 48.2 | 46.5 | 38.5 | 40.9 |
| Total Gross Extrn'l Debt (% of GDP) | 62.9 | 70.9 | 69.2 | 66.0 | 71.7 |
| Gross Official Reserves (Mos. of Imports) | 1.1 | 1.6 | 1.2 | 1.1 | 0.8 |
| Nominal GDP (USD B) | 2.6 | 2.8 | 3.0 | 3.3 | 3.5 |
| Population (Millions) | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |

    - China has been instrumental in developing the country's port and port authority.
    - Inward investment from China reached over USD 1.5B from 2000 to 2018.

- **On the political front, President Ismaël Omar Guelleh will not face any serious threats to his power, although small protests have occurred against his and his party's dominance. These protests could pick up as the country approaches its scheduled presidential election next year.**
  - ➢ Whether the election will actually take place was, however, thrown in doubt when President of the National Assembly Mohamed Ali Houmed said that Guelleh will call for elections when the time is right.
    - Houmed specifically spoke of Djibouti's COVID-19 situation.
    - Although we do not expect that an election will result in substantial political change, delays could stir discontent, pushing critics of the government onto the street in protest.

[1] Arabia Monitor; IMF.

# Egypt: Relatively robust

B2/B

- **Egypt is faring better than other MENA countries: it is set to be one of only two countries in the region (the other is Djibouti) with positive GDP growth this year, at 2% -- this is lower than the pre-pandemic forecast by the IMF of 5.9%, but growth nonetheless. We expect a strong recovery at the onset of 2021, mainly due to the successful execution of central bank monetary policy and IMF aid.**
  - At the start of the pandemic, the Egyptian pound weakened against the dollar, but it has appreciated by 2% in recent months as remittances, tourism receipts and business activity have recovered to a degree. This, in turn, is shoring up reserves and improving investor risk appetite.
    - There have been inflows from overseas into local markets, mainly because Egypt is offering some of the highest carry trades among emerging markets, with short-term debt yielding around 13%.
  - Egypt's foreign reserves rose during H1 and into Q3. We expect this to continue through the rest of the year.
    - In August, foreign reserves reached over USD 38B, rising by USD 113M from June after a USD 10B loss earlier in the year that mainly stemmed from halted tourism revenue.
    - Egypt's relative economic stability is attributed to both IMF financing and the Central Bank of Egypt's (CBE) successful execution of monetary policy.
    - At its most recent meeting (24 Sept), the bank cut interest rates by 50 basis points for the first time since March as consumer price inflation fell in August to 3.4% from 4.2% the month before. This is the second lowest inflation rate in over 14 years.
      - The CBE cut the interest lending rate to 9.75% and the deposit rate to 8.75%, marking both as the lowest rates since early 2016.
    - With annual inflation expected to hover between the 6%-12% target, we believe the new interest rates are likely to be kept steady at this level until the end of the year.
      - Stability will encourage foreign investment. Capital outflows reached USD 20B in Q2 but have rebounded since, reaching USD 10B in August. With expat remittances gradually returning, capital flow will improve.
    - We expect the CBE will continue to provide a stable anchor for inflation expectations and financial stability while it rebuilds its reserve buffers.

**Egypt Macroeconomic Indicators[2]**

| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 4.3 | 4.1 | 5.3 | 5.6 | 2.0 |
| CPI Inflation (%) | 14.0 | 29.5 | 14.4 | 9.2 | 4.8 |
| Fiscal Balance (% of GDP) | -12.5 | -10.6 | -9.5 | -7.4 | -7.7 |
| C/A Balance (% of GDP) | -6.0 | -6.1 | -2.4 | -3.6 | 5.9 |
| Total Gov't. Gross Debt (% of GDP) | 96.9 | 103.2 | 92.7 | 83.8 | 87.4 |
| Total Gross Extrn'l Debt (% of GDP) | 18.3 | 41.3 | 37.4 | 34.1 | 31.9 |
| Gross Official Reserves (Mos. of Imports) | 3.0 | 5.0 | 6.7 | 7.4 | 7.0 |
| Nominal GDP (USD B) | 332.0 | 236.5 | 250.3 | 302.3 | 349.9 |
| Population (Millions) | 92.0 | 94.8 | 97.0 | 99.2 | 101.5 |

    - We also expect that lower oil prices will help improve the fiscal balance, but reduced capital and remittance flows, especially from GCC countries, combined with reduced revenue from major sectors such as tourism, will still weigh this year.

- **As Egypt, Sudan and Ethiopia remain firm in their positions on the Grand Ethiopian Renaissance Dam, the three countries have reached an impasse, with no prospect of a resolution in the foreseeable future.**
  - Following nine years of failed negotiations, the latest round of talks, which were held in July and August, represented a newfound optimism, as the three countries had agreed to present draft proposals for a resolution.
  - However, a resolution has not been reached and Ethiopia went ahead to begin filling the dam despite warnings from Egypt, Sudan and the US.
    - In turn, the US has cut aid to Ethiopia, but the amount remains unknown. Ethiopia is unlikely to bend the knee to meet Egypt's demands.
    - Egyptian officials fear that the upstream dam will threaten the country's water supply and are applying increasing pressure for any agreement to include measures to protect downstream countries in case of drought.
  - We do not expect this row to escalate to a conflict on the ground, as the diplomatic route is still preferred by all parties.

[1] Fiscal year beginning 1 July.
[2] Arabia Monitor; IMF.

# Iraq: Turning the tide

**Caa1/B-**

- **It has been close to six months since Iraq's latest prime minister, Mustafa al-Kadhimi, took office and, as we expected, the road to an "independent" Iraqi state has been marked by an uptick in violence by militias on the ground. This is likely to continue in the coming months, especially as Iraq attempts to inch further away politically from Iran and closer to the US and its Gulf neighbours.**
  - Iraq has been used as a proxy battlefield by Iran, and Al-Kadhimi is likely to continue to struggle to disarm the country's Iran-backed Shia militias.
    - IED[1] attacks have picked up in the last few months, targeting contractors working for coalition forces as well as diplomatic missions in Iraq.
      - In the past month, a British diplomatic convoy was hit, as was the American Institute for English Learning, a school in Najaf.
    - Shi'ite cleric Muqtada al-Sadr -- who has aligned himself with Iran in the past -- has called on the groups to stop.
    - Armed militias have become increasingly rogue, splintering away from organised groups such as the Iran-backed Popular Mobilisation Unit, causing concern for even more random and frequent attacks.
- **The attacks can be partially attributed to reform measures linked to al-Kadhimi's attempts to emphasise Iraqi sovereignty, root out corruption and reform the public sector.**
  - Iraq has largely been reliant on Iran for electricity.
    - However, the new federal budget draft for 2020 includes USD 12.3B to expand the electricity sector with USD 4.8B set aside for new investments.
    - This reflects a 45.5% increase for the sector from last year and signals another step away from the Islamic Republic.
  - The move came after al-Kadhimi visited Washington, signing USD 8B-worth of energy deals and paving the way for new cooperation between the countries. It also accelerated ties between Iraq and its anti-Iran, pro-US Gulf neighbours.
    - Omer Al-Waeli, head of the Iraq Border Ports authority, announced that the Arar border crossing with Saudi Arabia will open in the coming weeks for trade, following nearly three decades of closure.
    - This is a major step in strengthening bilateral trade and diplomatic ties.
    - The border closed in 1991 under President Saddam Hussein and has since opened only once a year for the Hajj pilgrimage.

**Iraq Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 15.2 | -2.5 | -0.6 | 3.9 | -4.7 |
| Crude Oil Production (M bpd) | 4.6 | 4.5 | 4.4 | 4.6 | 4.5 |
| Oil GDP Growth (%) | 24.6 | -3.5 | -1.3 | 3.7 | -2.3 |
| Non-oil GDP Growth (%) | 1.3 | -0.6 | 0.8 | 4.3 | -9.0 |
| CPI Inflation (%) | -1.5 | 0.1 | 0.4 | -0.2 | 0.8 |
| Fiscal Balance (% of GDP) | -13.9 | -1.6 | 7.9 | -0.8 | -22.3 |
| C/A Balance (% of GDP) | -8.3 | 1.8 | 6.9 | -1.2 | -21.7 |
| Total Gov't. Gross Debt (% of GDP) | 64.2 | 58.9 | 49.3 | 44.3 | 82.2 |
| Total Gross Extrn'l Debt (% of GDP) | 38.1 | 35.6 | 30.6 | 31.8 | 43.8 |
| Gross Official Reserves (Mos. of Imports) | 7.8 | 7.3 | 8.4 | 9.8 | 4.8 |
| Nominal GDP (USD B) | 175.2 | 195.4 | 224.1 | 227.2 | 174.4 |
| Population (Millions) | 37.2 | 38.2 | 38.4 | 39.3 | 39.5 |

- Iraq Is likely to continue relying on Iran for its energy in the next quarter, but this dependency is likely to drop slowly with time.
  - Iraqi Finance Minister Ali Alawi said that he assumes electricity imports from Iran will be down significantly sometime in 2021.
    - Instead, we expect to see Iraq join its neighbours and connect to the Gulf electricity grid.
- There are challenges: al-Kadhimi has a bumpy road ahead because Iran is not going to disengage from Iraq quietly, and the economy is in poor shape.
  - Real GDP is expected to contract by 4.7% this year versus 3.9% growth in 2019, with state debt to exceed 80% of GDP.
  - Successful economic reforms could help the country receive international assistance; however, the impact of the reforms would not be felt until mid-2021 at the earliest
  - A-Kadhimi is shaking up Iraq's leadership to get economic reform under way. In September, Mustafa Ghaleb was appointed the new central bank governor, tested with tackling the country's monetary reforms.

[1] Improvised explosive device.
[2] Arabia Monitor; IMF.

# Jordan: Debt and discontent on the rise

**B1/B+**

- **Jordan's economy is projected to contract in 2020 after years of steady low growth. GDP will shrink by 3.7% before it rebounds by 3.7% next year. High public debt, the loss of foreign exchange flows from tourism and remittances and the recent resurgence in COVID-19 cases may stall this, however.**
  - ➢ Jordan's GDP contraction follows 2% growth last year. This, along with tax relief measures to mitigate the impact of the pandemic, means the kingdom's budget is squeezed.
    - With the government pledging last year not to increase taxes, revenue growth will be doubly limited this year. The budget deficit is expected to increase to USD 1.5B, or 3.2% of GDP, from 2.8% in 2019.
    - The slump in tourism revenue, which normally accounts for 10% of GDP, is also expected to expand the current account deficit to 5.8% of GDP from 2.8% in 2019.
  - ➢ The weak fiscal performance, together with lacklustre economic growth, is expected to increase public debt-to-GDP levels to 87.2% this year from 79.3% in 2019. This is much higher than the current median of 58% of GDP for similar BB-rated sovereigns.
    - Foreign aid and remittances constitute 10% of Jordan's national income.
      - o Data from the Central Bank of Jordan shows that expatriates' remittances declined by 5.4% YoY in Q1 2020 to USD 846M.
    - The budget shortfall is expected to be covered by a combination of domestic debt issuance, bilateral and multilateral assistance. But given the swelling debt ratios, we expect this will be difficult, and potentially expensive.
    - In July, the Ministry of Finance issued a 10-year USD 1.2B Eurobond and 5-year USD 500M Eurobond, which came after a USD 396M emergency loan was dispersed by the IMF in May.
    - Demand for the bonds was high -- 6.25 times oversubscribed -- and offered 5.85% and 4.95% coupon rates, respectively.
    - The USD 1.3B four-year programme approved by the IMF in March is focused on addressing Jordan's balance of payments needs, as a funding gap of around USD 1.5B is expected this year.
    - More recently, Jordan secured an over USD 800M soft loan from the European Union which is aimed at enhancing the country's public finances and supporting reform plans.

**Jordan Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 2.0 | 2.1 | 1.9 | 2.0 | -3.7 |
| CPI Inflation (%) | -0.8 | 3.3 | 4.5 | 0.3 | 0.2 |
| Fiscal Balance (% of GDP) | -3.6 | -3.3 | -4.4 | -6.1 | -6.7 |
| C/A Balance (% of GDP) | -9.4 | -10.8 | -7.0 | -2.8 | -5.8 |
| Total Gov't. Gross Debt (% of GDP) | 93.8 | 77.3 | 76.3 | 79.3 | 87.2 |
| Total Gross Extrn'l Debt (% of GDP) | 66.3 | 69.6 | 69.0 | 68.5 | 76.2 |
| Gross Official Reserves (Mos. of Imports) | 8.1 | 8.1 | 7.9 | 9.2 | 9.0 |
| Nominal GDP (USD B) | 39.3 | 40.8 | 42.3 | 43.8 | 42.7 |
| Population (Millions) | 9.1 | 9.4 | 9.7 | 10.1 | 10.2 |

      - o The loan will be disbursed in three tranches starting from October 2020, the loan will be repaid over 15 years.
    - At this stage, Jordan will need to allocate a large portion of its budget towards debt servicing, which will result in tapping into bond markets.
    - The high external debt is likely to put pressure on the government to push for austerity, including the reduction in social welfare programmes -- which we know is highly unpopular.
    - With COVID-19 cases on the rise again, the government may revert to a second lockdown, which would further delay economic recovery.

- **King Abdullah dissolved parliament and the senate ahead of elections on September 27. Parliamentary elections are set to take place on November 10.**
  - ➢ The recently-appointed senate, picked by Abdullah, will be headed once again by former premier Faisal Al Fayez.

[1] Arabia Monitor; IMF.

# Kuwait: When a rich state feels poor

## A1/AA-

- **Kuwait's GDP is forecast to contract by 1.1% this year, after only weak growth of 0.7% last year. With a deficit of more than USD 18B in FY 2019/2020[1] (18.3% of GDP), we expect the current fiscal year's budget deficit to mount, leaving parliament with no choice but to approve a much-delayed debt law.**
  - ➢ Kuwait is scrambling to boost its state coffers, particularly after racking up a 69% YoY increase in its past FY deficit. The deficit for the current fiscal year, has been recently revised and is projected to USD 46B, nearly 40% of GDP. It marks a 34% increase from the original budget deficit forecast.
    - This will be Kuwait's seventh straight year of deficit.
    - The amended budget bill projects revenues for the current fiscal year of just USD 23B, less than half of the original forecast of USD 48B.
    - This decline in revenue even includes newly passed legislation halting this year's 10% transfer of state revenue to the Future Generation Fund (FGF), managed by the Kuwait Investment Authority (KIA), and reversing last year's transfer.
  - ➢ Given the increase in Kuwait's liquidity risk and the depletion in the General Reserve Fund (GRF), another KIA holding, the state received its first credit downgrade from Moody's. Rated A1, it is now on par with Saudi Arabia and China. The absence of fiscal reforms, political disputes between government and parliament and a recent rejection of a debt law only worsen the outlook from here.
    - The GRF has around USD 7B remaining from its previous USD 14.3B balance. There is a risk it may all be drained away by the end of the year.
    - The reversal of the FGF transfer from last year will provide a temporary buffer. But much more is needed, which we expect to see by the end of the calendar year.
  - ➢ With parliament rejecting a bill to allow more borrowing from debt markets, we expect the government will eventually be forced to bypass the legislative process and pass the law by decree ahead of the parliamentary elections in November. It would not be the first time. In 1987 and 1998, the government issued public debt under an emergency decree.
  - ➢ But the deficit remains a problem. Until now, the government has not given any indication or request to parliament to access FGF assets (as opposed to transfers).If Kuwait does not tap into international debt markets soon, the FGF may become fair game.
    - But this remains politically contentious and will most certainly require multiple parliamentary sessions to secure legislative approval.

**Kuwait Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 2.9 | -4.7 | 1.2 | 0.7 | -1.1 |
| Crude Oil production (M Bpd) | 2.95 | 2.70 | 2.74 | 2.70 | 2.70 |
| Oil GDP Growth (%) | 3.9 | -9.0 | 0.2 | -1.0 | 0.0 |
| Non-oil GDP Growth (%) | 1.4 | 1.8 | 2.7 | 3.0 | -2.5 |
| CPI Inflation (%) | 3.5 | 1.5 | 0.6 | 1.1 | 0.5 |
| Fiscal Balance (% of GDP; After FGF Transfer) | -17.9 | -12.9 | -7.7 | -18.3 | -19.8 |
| C/A Balance (% of GDP) | -4.6 | 8.0 | 14.5 | 8.9 | -10.2 |
| Total Gov't. Gross Debt (% of GDP) | 10.0 | 20.5 | 14.8 | 11.6 | 21.0 |
| Total Gross Extrn'l Debt (% of GDP) | 38.4 | 44.9 | 43.8 | 48.2 | 63.7 |
| Gross Official Reserves (Mos. of Imports) | 6.5 | 6.4 | 6.8 | 8.1 | 7.0 |
| Nominal GDP (USD B) | 109.4 | 120.7 | 140.7 | 137.0 | 110.5 |
| Population (Millions) | 3.9 | 4.1 | 4.1 | 4.2 | 4.3 |

- **Emir Sabah al-Ahmed al-Sabah, dubbed the "dean of Arab diplomacy" died on 29 September, at the age of 91. He is succeeded by his half-brother Sheikh Nawaf al-Ahmad al-Sabah, who is expected to continue his legacy. But the new leadership will face immediate challenges as Kuwait is facing a liquidity crisis.**
  - ➢ Sheikh Nawaf, age 83, has been crown prince since 2006, and has served in several cabinet positions, including the ministries of social services, defence, and the interior.
    - ➢ He is no stranger to the country's foreign policy as he took over the late emir's responsibilities when he was hospitalised in the US for medical treatment earlier this year.
  - ➢ Nawaf's policies are not yet clear, but Kuwait's foreign policy is unlikely to change. We expect the new leadership will continue or even expand Sabah's efforts as the region's mediator, and will maintain friendly ties with Iran.

[1] Fiscal Year runs from April 1 to March 31
[2] Arabia Monitor; IMF.

# Lebanon: Beyond resilience

C/SD

- **Lebanon's economy is going from bad to worse on a regular basis -- slowing down since 2011, battered by political ineptitude and now with parts of Beirut flattened by an explosion. With no government in sight, the outlook is dire.**
  - GDP is forecast to contract by at least 12% this year, following a 6.5% contraction in 2019. This would mark the country's worst performance since the civil war ended 20 years ago.
    - Deteriorating economic conditions, subdued productivity, the currency collapse in the black market, and the port blast on August 4 have all left the economy in tatters.
  - Inflation in August surged to 120% YoY, from 112.4% in July. The latest increase is the highest inflation since the aftermath of Lebanon's civil war.
    - The average inflation rate in the first eight months climbed to 58%, up from lows of 2.78% recorded in August 2019.
    - Lebanon over the past 20 years has been able to maintain average annual inflation at around 3%. But with the Lebanese lira losing over 80% of its value and reaching 8,225 LBP per USD on 27 September (a further drop following the resignation of Prime Minister-designate Mustapha Adib), the fixed exchange rate is now under pressure.
    - Lebanon's currency depreciation made imports more expensive. With 80% of food coming from abroad, around half of the population has been driven into poverty as people struggle to provide for their basic needs.
      - Poverty over the year tripled, reaching 23% from 8%. Of the 6 million population, 2.7 million are now estimated to be living below the poverty line, surviving on less than USD 14 per day.
  - While the government has been subsidising basic necessities, this will be halted in three months; Banque du Liban (BDL) has said foreign currency reserves are running too low to sustain the cost.
    - Year-to-date, subsidies have contributed to a 27% (USD 8B) decline in BDL reserves. The end to the subsidies programme is likely to push people back on the streets again.
  - We expect an end to the dollar peg is coming. External funding will be needed -- from the IMF, for example -- but without economic and fiscal reform, it is unlikely to come.
    - Foreign currency assets in mid-September stood at USD 28.1B, reflecting a 24.4% decline so far this year.

**Lebanon Macroeconomic Indicators[2]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 1.6 | 0.9 | -1.9 | -6.5 | -12.0 |
| CPI Inflation (%) | -0.8 | 4.5 | 4.6 | 2.9 | 17.0 |
| Fiscal Balance (% of GDP) | -8.9 | -8.6 | -11.3 | -10.7 | -15.3 |
| C/A Balance (% of GDP) | -23.1 | -26.5 | -26.7 | -20.6 | -12.6 |
| Total Gov't. Gross Debt (% of GDP) | 146.1 | 149.7 | 154.9 | 172.2 | 183.6 |
| Total Gross Extrn'l Debt (% of GDP) | 182.0 | 190.3 | 192.8 | 196.3 | 186.6 |
| Gross Official Reserves Ex. Gold (Mos. of Imports) | 14.9 | 14.6 | 14.4 | 20.5 | 16.0 |
| Nominal GDP (USD B) | 51.2 | 53.1 | 55.0 | 52.7 | 53.9 |
| Population (Millions) | 6.7 | 6.8 | 6.8 | 6.8 | 6.8 |

    - Of the total assets, USD 5B are in Lebanese Eurobonds, along with credit-linked loans. This suggests the liquid portion of total reserves is at USD 19.5B.
  - While forensic audits of the BDL have already begun, as called for by the IMF and French President Emmanuel Macron as a prerequisite for aid, we doubt Lebanon will be in financial order for a bailout soon. There needs to be a complete economic overhaul.
    - The challenge is compounded by Lebanon receiving Moody's lowest grade in July. This suggests little chance of investors recovering principal or interest.
- **Forming a government and coming up with comprehensive reforms is likely to take longer than it has in the past, unless there is a serious and cohesive international effort, buttressing Macron's call for a government made up of independent technocrats.**
  - Adib failed to form the non-political government he promised because of an impasse between different political groups over the next cabinet.
  - Hezbollah and the Amal movement pushed back against Adib for control over the Finance Ministry as well as having a say in ministerial picks.
  - Government formation could well take another quarter, perhaps more.

[1] Arabia Monitor; IMF.

# Libya: Much ado, but no real change

NR/NR

- **The Libyan economy has been hit with a series of overlapping shocks: the escalating conflict has stifled economic activity with revenue unstable and inconsistent due to the recurring oil blockade, while the pandemic threatens to make things even worse. Libya will be unable to turn its economy around until a formal government is established with a lasting ceasefire in place - neither of which are likely in the foreseeable future.**
  - ➢ The conflict has disrupted oil production and exports, hindering what could otherwise be a relatively strong economic performance. The closure of oil facilities from January has led to almost USD 9.5B of losses in revenue.
  - ➢ While rebel military commander General Khalifa Haftar's Libyan National Army (LNA) has lifted the oil blockade, which has ended the nine-month stalemate that crippled Libyan oil production, production could halt as quickly as it resumed, obstructing the potential for oil to be a stable revenue source.
    - The promise was part of an agreement reached on 18 September between Haftar's son, Khalid, and Ahmed Maiteeg, deputy prime minister of the internationally recognised Government of National Accord (GNA).
    - However, members of the GNA are reported to be contesting the agreement because it includes agreeing to Haftar's timeframe for resuming production and sharing the revenue between the rival governments.
      - o The GNA and its backers want to ensure oil revenues go through the Central Bank of Libya so that Haftar is unable to access them.
      - o Instead, the signed deal agrees the establishment of a joint commission that would oversee revenue distribution, going against the international community's preference.
  - ➢ Although production has resumed, militias on the ground can disrupt production on a whim.
    - The deal fails to address the number of militias and mercenaries who have frequently attacked facilities, disrupting production. These include Russian-backed Wagner Group paramilitaries, Syrian mercenaries and Sudanese Janjaweed militia.
  - ➢ Ultimately the deal is still quite tentative, and we do not see full production resuming in the near future.
  - ➢ Libya's public wage bill continues to increase, standing at the USD 20B which is 86% of GDP and represents 57.4% of total budget expenditures.

**Libya Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | -7.4 | 64.0 | 17.9 | 9.9 | -58.7 |
| Crude Oil Production (M Bpd) | 0.3 | 0.8 | 1.0 | 1.1 | 0.4 |
| Oil GDP Growth (%)* | ... | ... | ... | ... | ... |
| Non-oil GDP Growth (%)* | ... | ... | ... | ... | ... |
| CPI Inflation (%) | 25.9 | 28.0 | -1.2 | 4.6 | 22.3 |
| Fiscal Balance (% of GDP) | -113.3 | -43.5 | -0.2 | 8.8 | -7.2 |
| C/A Balance (% of GDP) | -24.7 | 8.0 | 1.8 | -0.3 | -6.6 |
| Total Gov't. Gross Debt (% of GDP) | ... | ... | ... | ... | ... |
| Total Gross Extrn'l Debt (% of GDP) | 20.6 | ... | ... | ... | ... |
| Gross Official Reserves (Months of Imports) | 19.8 | ... | ... | ... | ... |
| Nominal GDP (USD B) | 18.5 | 30.2 | 41.4 | 39.8 | 23.0 |
| Population (Millions) | 6.4 | 6.5 | 6.6 | 6.7 | 6.8 |

    - Regressive and inefficient subsidies, particularly those concerning the cost of fuel, constitute 19% of GDP and are estimated at USD 4.5B.
    - Such high and fixed recurrent expenditures have resulted in fewer investments, which have been at their lowest since 2010. They are estimated to be USD 2.5B, or 10.8% of GDP.
  - ➢ Adding to the political instability, GNA Presidential Council Chairman and Prime Minister Fayez al-Saraj has resigned from office with the intention of leaving his post in October. A prolonged search for a replacement would make the GNA even more fragile.
    - Al-Saraj resigned after infighting in his administration threatened his authority leading to a government reshuffle.
    - Al-Saraj removed Fathi Bashagha, the GNA minister of interior, but he was quickly reinstated after an uproar from Turkey and supporting protesters.
  - ➢ Any replacement for al-Saraj would have to be endorsed by Turkey and the international community. One possibility is Speaker of the House of Representatives Aguila Saleh.

[1] Arabia Monitor; IMF.

# Mauritania: Mining itself out of the pandemic slump

NR/NR

- **GDP in Mauritania is expected to contract by 2% this year due to the impact of COVID-19 and low oil prices. Prior to the pandemic, the economy was forecast to expand by around 5.7%. Recovery is not expected to begin until 2021, although an expansion in mining and the development of a large offshore gas field should accelerate the pace.**
  - Fiscal consolidation efforts encouraged by IMF recommendations helped Mauritania's GDP to increase by 5.9% last year, before the on-going pandemic put a halt to it all.
  - The performance of the economy going forward will depend on how the country approaches its reforms in the sectors of agriculture, infrastructure and -- perhaps most importantly -- the extractive sector.
  - Projects in the mining sector have picked up now that the pandemic is under some control. This will be crucial for future growth.
    - Mauritania's economy is highly dependent on the extractive sector, with mines and oil making up around three-quarters of total exports.
    - The sector represents 25.9% of GDP and employs more than 55% of the workforce. But it was not as impacted as other areas of the economy by COVID-19, allowing for some optimism in a rebound.
      - In summer, Canada's Chilean Metals signed a CAD 4.5M (USD 3.4M) funding agreement to create a joint venture with Australia's Aura Energy for its mining tenements (licences and leases) in Mauritania.
      - Canada's Kinross Gold also came to an agreement with the government on a 30-year exploration license after solving a dispute over taxes. Mauritania will get a 15% free carried interest in the profits.
  - Such expansion in the sector, with boosted production and output, will feed upon itself in terms of attracting more interest from foreign players.

| Mauritania Macroeconomic Indicators[1] | | | | | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020f |
| Real GDP Growth (%) | 1.8 | 3.5 | 2.1 | 5.9 | -2.0 |
| CPI Inflation (%) | 1.5 | 2.3 | 3.1 | 2.3 | 3.9 |
| Fiscal Balance (% of GDP) | -0.5 | 0.0 | 2.5 | 2.1 | -3.3 |
| C/A Balance (% of GDP) | -15.1 | -10.0 | -13.8 | -10.6 | -17.3 |
| Total Gov't. Gross Debt (% of GDP) | 78.5 | 55.1 | 61.4 | 58.5 | 67.8 |
| Total Gross Extrn'l Debt (% of GDP) | 87.8 | 63.0 | 61.5 | 58.1 | 66.5 |
| Gross Official Reserves (Mos. of Imports) | 3.5 | 3.1 | 3.0 | 3.7 | 3.4 |
| Nominal GDP (USD B) | 4.7 | 6.8 | 7.0 | 7.6 | 7.4 |
| Population (Millions) | 4.2 | 4.3 | 4.4 | 4.5 | 4.6 |

- **The corruption trial of former President Mohamed Ould Abdel Aziz has prompted a government reshuffle, including the resignation of the prime minister, Ismail Ould Bedde Pulde Cheikh Sidya. His replacement, Mohamed Ould Bilal, is a government veteran who served under former President Sidi Ould Cheikh Abdallahi, who was deposed by Aziz in a 2008 coup.**
  - The line-up of new government officials includes some familiar faces, including Abdallahi and some of Aziz's old ministers, but it has also brought in some fresh-faced technocrats.
  - Sidiya stepped down after he was implicated in investigation into Aziz. He was one of several former ministers to appear in a formal report into Aziz's financial deals.
  - The new government is similar to Aziz's old cabinet with 18 new ministers re-elected. We expect another reshuffle will come as further details from the Aziz trial come to light.
  - As the new guard tries to push the old guard out of power, this could create unrest in the country from Aziz's sympathisers but also stall the execution of fiscal and social reforms if composition remains unstable.

[1] Arabia Monitor; IMF.

# Morocco: Risking a recession

**Ba1/BBB-**

- **Even prior to COVID-19, Morocco was set for sluggish growth this year: GDP was forecast to expand by a modest 2%. The IMF has revised this down to a 3.7% contraction -- which would mark the first recession since 1995. Despite the rollout of government initiatives, the key sectors of tourism and agriculture, which together contribute 25% of GDP, are not expected to recover until mid-2021.**
  - ➢ Drought-stricken agricultural output is translating into sizeable declines in exports, while the pandemic is taking a toll on tourism, remittance revenues and auto exports
  - ➢ The combined shock of the COVID-19 pandemic and a drought took a toll.
    - The economy contracted by 4.1% in Q3, following a 13.8% GDP decline in Q2. Morocco's High Commission for Planning forecasts GDP to contract 5% this year, worse than the IMF predicts.
    - We believe the IMF may be too optimistic, given that lower oil prices and efforts from international funding organisations will not be enough to offset the negative impacts of the pandemic and drought.
    - The contraction has been particularly compounded by lower revenues in the agriculture sector, which contributes 14% of GDP.
      - o Revenue declined by 5.9% in Q3, following a 6.1% decrease in Q2. The prospects are unfavourable: the target for the winter cereal harvest is 3.8M hectares -- 20% below the average.
  - ➢ Though lower oil prices may benefit Morocco as a net importer, we expect the balance-of-payments deficit to widen further, mainly on the back of weak FDI inflows.
    - The current account deficit is expected to widen to 8.4% in 2020, reflecting the sharp dip in exports, tourism revenue and remittances.
    - The revised budget projects a deficit of 7.5% this year, around a USD 627M increase from 2019 and 4 percentage points higher than the early forecast.
      - The revision is due to a combination of a fall in tax revenues by 18.6% (around 4% of GDP) and a 5% (2% of GDP) increase in spending.
      - To finance its balance of payments, the government raised USD 4B in foreign debt. This is expected to increase government debt to 75.3% of GDP -- an increase of 15% YoY.

| Morocco Macroeconomic Indicators[1] | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 1.1 | 4.2 | 3.0 | 2.2 | -3.7 |
| CPI Inflation (%) | 1.8 | 0.8 | 1.9 | 0.0 | 0.3 |
| Fiscal Balance (% of GDP) | -4.5 | -3.5 | -3.7 | -4.1 | -7.1 |
| C/A Balance (% of GDP) | -5.0 | -3.4 | -5.3 | -4.1 | -7.8 |
| Total Gov't. Gross Debt (% of GDP) | 64.9 | 65.1 | 65.3 | 65.8 | 73.7 |
| Total Gross Extrn'l Debt (% of GDP) | 33.7 | 33.7 | 32.7 | 33.0 | 35.1 |
| Gross Official Reserves (Mos. of Imports) | 6.1 | 5.7 | 5.3 | 6.4 | 4.1 |
| Nominal GDP (USD B) | 103.3 | 109.7 | 117.9 | 118.6 | 114.6 |
| Population (Millions) | 35.2 | 35.7 | 36.0 | 36.4 | 36.9 |

- ➢ Tourism, which accounted for 11% of GDP and generated USD 8B in foreign currency in 2019, is among the sectors hardest hit this year.
  - Despite borders reopening in September, allowing for the entry of international travellers from 67 countries, we do not expect this to offset the losses incurred so far.
  - Revenue losses for 2020-2022 in tourism are expected to reach USD 34B, based on a forecast for a decline of 30% in arrivals. So far, this year, the kingdom has had a drop of 69% in tourist arrivals and 60% in revenues. This will be hard to recover from anytime soon.
    - o These numbers are particularly sharp because they compare with a landmark year in 2019, when arrivals crossed the 13 million mark for the first time, a 5.2% increase from 2018.
  - Domestic tourism accounts for 22% of total tourism expenditure but has grown less than 0.5% per year in the last 10 years and will not fill the vacuum.
- ➢ There have been some signs of overall economic recovery, although a second lockdown would put an end to this. In H1, 45 investment projects were announced. These projects are set to create over 8,500 jobs in the short to medium term. Looking forward, we expect more government support and an acceleration of public-private partnerships.

[1] Arabia Monitor; IMF.

# Oman: Cash-strapped and borrowing

**Ba3/BB-**

- **The IMF forecasts Oman's GDP will shrink by 2.7% this year, the worst GDP hit since 2003. As elsewhere, it is mainly the result of the pandemic and lower oil prices. But Oman has weak finances and only had minimal growth of 0.5% in 2019. Accordingly, given the sultanate's swelling fiscal imbalance, the speed of recovery is uncertain. To fill the void, Oman is expected to tap the debt market. It will be expensive.**
  - ➢ Oman entered the pandemic in a weaker fiscal position than its neighbours, with a budget deficit forecast at nearly 17% of GDP, compared with 7.6% in 2019.
    - Urgent action is needed to mitigate the economic blow of the pandemic.
    - The 2020 budget also assumed an average oil price of USD 58 pb to balance its budget this year, the highest among the GCC. The current price is around USD 41 pb.
    - We believe the downside risk will remain high until fiscal reforms take effect and oil prices improve. In the meantime, there is pressure on Oman's reserves that threatens its ability to defend its dollar peg.
  - ➢ The large deficit is expected to hasten the deterioration of the already weakened sovereign and external balance sheets. Fiscal deficits and external debt maturities will amount to USD 12B through 2022, about 20% of GDP.
    - We expect government debt to increase beyond the IMF's forecast of 78.3% of GDP this year (vs 60% in 2019) as a result of the contraction in GDP.
      - This is because Oman's sovereign net foreign assets (SNFA)[1], which in the past have been crucial to supporting financing flexibility, are set to shrink to -17% of GDP, from 2019's -2% of GDP, reflecting its high net borrowing. In 2018, SFNA stood at 3.5% of GDP.
    - The current account deficit will also widen to over 12% of GDP from 5% of GDP last year. For now, though, a decline in imports and outbound remittances may lessen the pressure on reserves.

**Oman Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 4.9 | 0.3 | 1.8 | 0.5 | -2.8 |
| Crude Oil Production (M Bpd) | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| Oil GDP Growth (%) | 3.4 | -2.1 | 4.7 | 1.0 | -0.4 |
| Non-Oil GDP Growth (%) | 6.2 | 2.4 | -0.7 | 0.0 | -5.0 |
| CPI Inflation (%) | 1.1 | 1.6 | 0.9 | 0.1 | 1.0 |
| Fiscal Balance (% of GDP) | -21.3 | -14.0 | -7.9 | -7.0 | -16.9 |
| C/A Balance (% of GDP) | -19.1 | -15.6 | -5.5 | -5.2 | -14.2 |
| Total Gov't. Gross Debt (% of GDP) | 32.7 | 46.4 | 53.5 | 62.6 | 78.3 |
| Total Gross Extrn'l Debt (% of GDP) | 67.8 | 78.6 | 80.6 | 91.7 | 116.7 |
| Gross Official Reserves (Mos. of Imports) | 7.0 | 5.5 | 6.3 | 7.1 | 6.0 |
| Nominal GDP (USD B) | 65.5 | 70.6 | 79.3 | 76.9 | 64.9 |
| Population (Millions) | 4.4 | 4.6 | 4.8 | 4.9 | 5.1 |

- ➢ We see the government's funding needs coming through external debt, including bank loans and non-market funding. But given the downbeat views of credit ratings, Oman will face higher funding costs.
  - The Ministry of Finance is working on an approved new financing plan this year. After already issuing USD 1.4B in development bonds and securing a one-year USD 2B bridge loan this year, Oman has issued USD 520M in a local sovereign sukuk, the country's third.
    - The sukuk issue is targeting small investors and will carry an annual "profit rate" of 5.25% for six years.
  - To fund the remainder of the year, Oman plans to issue a 3B-4B USD-denominated bond. It would be Oman's first return to the international bond market this year.
  - Yields on Oman's bonds -- rated as "junk" -- have been rising, however, meaning that the issue will probably be expensive.
- ➢ Oman may end up having to ask for support from the GCC, again, particularly if the dollar peg becomes too hard to maintain. The GCC would not want to risk contagion.

[1] The net foreign asset position of a country reflects the indebtedness of that country. It is the value of the assets that country owns abroad, minus the value of the domestic assets owned by foreigners.

[2] Arabia Monitor; IMF.

# Palestine: Deserted and declining

**NR/NR**

- **Prior to the pandemic, Palestine's economy was already projected to slip into a recession in both 2020 and 2021. With a quarter of Palestinians already living below the poverty line in 2019, the situation will be much worse by year-end due to the impact of COVID-19 lockdowns and dwindling humanitarian aid. There is a potential humanitarian catastrophe on hand.**
  - ➢ Palestine's GDP is forecast to contract anywhere from 7.6% to 11% this year.
    - With the rate of COVID-19 infection increasing, bringing with it stricter lockdowns, the 11% looks more likely.
  - ➢ A 40% decrease in government revenues of around USD 2.5B is expected due to reduced earnings and increased health care costs. This limits the ability of the government to maintain public services and pay public sector employees
    - The Palestinian authorities were unable to pay the salaries of more than 100,000 government employees in May.
    - More civil servants could be made redundant or forgo their salaries again as public funds continue to be squeezed.
  - ➢ Palestinian workers in Israel and Israeli settlements are a major source of income for the Palestinian economy. But they have been amongst the worst hit by the pandemic and its accompanying border closures.
    - In 2019, 133K Palestinian workers in Israel generated around 15% of the de jure state's GDP, amounting to USD 2.6B.
    - Because of the pandemic, however, only 25,000 Palestinians are still working in Israel.
    - This is set to lower Palestine's gross national income by around 25%, an economic body blow to an economy that was on the ropes anyway.
      - o Tens of thousands of families have been left without a source of income further deteriorating their living conditions.
      - o The increasing number of infections in Palestine also suggests that normal conditions will not return in the near future.
  - ➢ Additionally, international donor support is expected to decline by USD 266M as Palestine drifts to the wayside of global concern because the pandemic has focused support elsewhere.
    - Palestine could face a humanitarian disaster, without foreign aid, which pays for essential goods and services including healthcare and food.

**Palestine Macroeconomic Indicators[2]**

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 4.1 | 1.4 | 1.2 | 0.9 | -5.0 |
| CPI Inflation (%) | -0.2 | 0.2 | -0.2 | 1.6 | 0.1 |
| Fiscal Balance (Ex-support, % of GDP) | 35.2 | 37.5 | 39.5 | … | … |
| Recurrent Budget Support (% of GDP) | -8.0 | -7.3 | -6.6 | -7.4 | -10.7 |
| C/A Balance (% of GDP) | -10.1 | -13.2 | -13.1 | -10.7 | -11.7 |
| Nominal GDP (USD B) | 13.4 | 16.1 | 16.3 | 17.1 | 16.5 |
| Population (Millions) | 4.7 | 4.9 | 5.0 | 5.1 | 5.1 |

- **Palestinians are also dealing with the blow from the UAE-Bahrain-Israel deal; the pact has provoked public uproar in the country. However, while there may be civil unrest on the ground, the deal could accelerate reconciliation of the administrations of the Palestinian Authority and the Gaza strip.**
  - ➢ Although Israeli Prime Minister Benjamin Netanyahu has said the normalisation deal can end the Israel-Palestine conflict once-and-for-all, it is more likely that it will prompt an uptick in violence on the ground.
  - ➢ The deal, however, could potentially be the catalyst that unifies the administrations of the Gaza strip, and the Palestinian Authority as leadership on both sides stand united against the deal.
    - The Palestinian Authority was split in 2007 after a failed Hamas and Fatah coalition government resulted in violence between the two parties, leading to Hamas' takeover of the Gaza strip.
    - In September, Abbas, announced a new dialogue for a unity agreement with Hamas leaders.
    - At the least, we expect the deal will certainly strengthen cooperation between the increasingly side-lined rival leaderships.

[1] Fiscal year beginning 1 July.
[2] Arabia Monitor; IMF.

# Qatar: Trading regional peace for neighbourly peace

**Aa3/AA-**

- **GDP is set to decline by 4.3% this year, but it should pick up strongly in 2021 by 5% growth as the country gears up to host the 2022 FIFA World Cup. Doha is already showing signs of recovery -- the private sector began rebounding in Q3, and the government passed a new labour law that should boost labour productivity.**
  - Qatar is a regional outlier, the only country in the GCC that the IMF believes will have a budget surplus.
    - Despite the impact of various headwinds -- lower global energy demand, the pandemic, the boycott by neighbours -- the IMF remains firm in its assessment that Qatar is on track for another year of fiscal surplus, which it projects will reach more than 5% of economic output.
    - The Qatari government itself is not so optimistic. In August it forecast that the budget will be in deficit by 9.3% this year, followed by a 6.5% shortfall in 2021, only to stabilise in 2022 with a 0.1% surplus.
    - We believe that the result simply depends on liquefied natural gas production (LNG), of which the country is the world's largest exporter.
  - The state relies heavily on natural gas, holding 16% of the world's reserves. It has been hit hard by the global decline in demand, which is estimated to decrease by 4% this year.
    - 80% of Qatar's export earnings are from the gas industry, but prices are bumping along near historic lows.
    - Doha continues to set ambitious targets for the sector, however. It has steamrolled through the pandemic with the largest LNG expansion in the industry.
      - Qatar Petroleum reserved new-build berths for more than 100 LNG carriers by 2027, which would represent 60% of global LNG carrier shipbuilding capacity.
  - It is attempting to improve labour productivity, with a new law setting the monthly minimum wage at USD 275, a 25% increase from USD 206.
    - It is also doing away with the controversial Kafala system, which gave sponsors control over their employees.
    - As the first GCC state to implement a reform of this scale, Qatar is aiming to build a stable worker base by attracting expatriate workers, just as others in the GCC are cutting back.
      - Expats constitute 90% of its workforce.

| Qatar Macroeconomic Indicators[1] | | | | | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020f |
| Real GDP Growth (%) | 2.1 | 1.6 | 1.5 | 0.1 | -4.3 |
| Crude Oil Production (Mb/d) | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Oil GDP Growth (%) | -0.9 | -0.7 | -0.3 | -1.5 | -2.5 |
| Non-oil GDP Growth (%) | 5.3 | 3.8 | 3.2 | 1.5 | -5.9 |
| CPI Inflation (%) | 2.7 | 0.5 | 0.2 | -0.6 | -1.2 |
| Fiscal Balance (% of GDP) | -5.4 | -2.9 | 5.2 | 4.1 | 5.2 |
| C/A Balance (% of GDP) | -5.5 | 3.8 | 8.7 | 2.4 | -1.9 |
| Total Gov't. Gross Debt (% of GDP) | 46.7 | 49.8 | 44.6 | 52.3 | 57.4 |
| Total Gross Extrn'l Debt (% of GDP) | 127.2 | 99.6 | 101.6 | 122.3 | 145.9 |
| Gross Official Reserves (Mos. of Imports) | 6.1 | 2.7 | 5.8 | 9.6 | 7.9 |
| Nominal GDP (USD B) | 151.7 | 166.9 | 191.4 | 188.9 | 156.6 |
| Population (Millions) | 2.5 | 2.6 | 2.7 | 2.8 | 2.8 |

- **Qatar is essential to the US strategy of "maximum pressure" on Iran. This has prompted Washington to encourage talks between Qatar and other GCC states, after three years of boycotts. We believe a GCC reunion is possible in the near-future.**
  - Kuwait is hosting discussions between the parties in conflict.
    - The aim of the US administration is to build on the prospect of ending the blockade to prompt Qatar to be the next state to formally recognise Israel.
    - The US is set to name Qatar as a "non-NATO ally", a formal designation that would give Doha preferential access to US military equipment.
  - Doha remains firm on on the Palestinian issue, however, and has ruled out normalising relations with Israel, at least for now. But talks continue with other GCC states, and progress has been made in the past couple of months. Qatar could playball on normalisation, in return for GCC peace.

[1] Arabia Monitor; IMF.

# Saudi Arabia: Turning austere

**A1/A-**

- **Faced with a wider budget deficit, the Saudi government is taking unprecedented measures to tighten up fiscally, but the recovery outlook remains bleak and some measures are unpopular. The forecast for Saudi Arabia was revised by the IMF to a 6.8% contraction from a 4.5% decline estimated in April. It compared with 0.3% growth in 2019.**
  - ➢ Saudi Arabia's budget deficit in H1 exceeded the entire yearly deficit of 2019, hitting USD 38.2B (most of it coming in Q2). The H2 deficit looks like it might exceed the entire initial 2020 budget deficit projection for USD 50B (around 6.4% of GDP).
    - Minister of Finance Mohammed Al-Jadaan has said the deficit could now widen to up to 9% of GDP this year from the 4.5% deficit in 2019. We expect it could be even higher and surge up to USD 100B, or around 13% of GDP (vs 4.5% of GDP in 2019).
    - Oil revenue in Q2 declined by 45% YoY to USD 25.5B. This is expected to spiral down further by the end of the year.
    - Non-oil revenue also declined by 55% YoY in the same period. It resulted from the pandemic-induced economic downturn and the deferral in various tax payments.
      - o Looking ahead, we believe non-oil revenue will continue to decline. The tripling of VAT to 15%, however, should mitigate some of the losses to the budget.
    - The mounting imbalance should be temporary. We remain optimistic that the deficit will narrow in coming years as oil prices will gradually recover and the government pushes ahead with more measures to curb spending.
  - ➢ We expect the government to finance its deficit primarily through debt, with a focus on domestic debt. Debt issuance will also be complemented by drawdowns from the government reserve account. Government reserves are forecast to decline to 12% of GDP by 2021, from 18% of GDP in 2019.
    - Debt is expected to rise this year, particularly after the easing of the debt ceiling to 50% of GDP from 30%. Saudi Arabia's pandemic stimulus package, which makes up 4% of GDP and is equivalent to 13% of this year's budget, has also reinforced debt-issuance plans.
    - By 2022, we expect debt to reach around 40% of GDP versus the low of 2% of GDP in 2014. This is still manageable -- and nowhere near extreme levels of 20 years ago, when the ratio peaked over 103% of GDP.

**Saudi Arabia Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 1.7 | -0.7 | 2.4 | 0.3 | -6.8 |
| Crude Oil Production (M Bpd) | 10.4 | 9.9 | 10.3 | 9.8 | 9.8 |
| Oil GDP Growth (%) | 3.6 | -3.1 | 3.1 | -3.6 | 0.0 |
| Non-oil GDP Growth (%) | 0.2 | 1.3 | 2.2 | 3.3 | -4.0 |
| CPI Inflation (%) | 2.0 | -0.9 | 2.5 | -1.2 | 0.9 |
| Fiscal Balance (% of GDP) | -17.2 | -9.2 | -5.9 | -4.5 | -11.4 |
| C/A Balance (% of GDP) | -3.7 | 1.5 | 9.0 | 6.3 | -3.1 |
| Total Gov't. Gross Debt (% of GDP) | 13.1 | 17.2 | 19.0 | 22.8 | 34.0 |
| Total Gross Extrn'l Debt (% of GDP) | 24.6 | 18.2 | 19.2 | 23.2 | 28.9 |
| Gross Official Reserves (Mos. of Imports) | 31.7 | 28.3 | 28.6 | 33.2 | 28.0 |
| Nominal GDP (USD B) | 644.9 | 688.6 | 786.5 | 793.0 | 668.4 |
| Population (Millions) | 32.4 | 33.1 | 33.7 | 34.2 | 34.2 |

- ➢ So far this year, Saudi Arabia has raised USD 12B from international markets and USD 11B from the domestic market. Taking into account the USD 26M in sukuk issuance and USD 9B in refinancing obligations, year-to-date debt issuance stands at around USD 58B. We expect to see more by the end of the year.
  - We see sovereign foreign assets declining sharply, to around 68% of GDP by 2021, from 72% in 2019. This will be mainly on the back of the increase in government external debt and drawdown in reserves. For now, this is not worrisome as the kingdom remains stronger in its sovereign net foreign asset position than the average 'A' category sovereigns.
- ➢ The recent, bold austerity measures and the drawdown of reserves reflect a new Saudi Arabia. The challenge is that the moves are likely to stall economic recovery next year and, with the debt mounting, this may be painful to endure.
  - A key issue we will be following for the next quarters is whether the inflation will start to put pressure on the USD-SAR currency peg. We do not expect Saudi Arabia to devalue its currency, at least for now.
  - But if efforts to boost the private sector and diversification plans do not soon start to outweigh Saudi's dependency on oil revenue, things may be changing for the decades-old peg.

[1] Arabia Monitor; IMF.

# Somalia: Disasters decimate economy

B2/NR

- **Somalia continues to reel from the impact of the pandemic, locust infestation, flooding, and terrorist attacks. Its GDP is forecast to contract by 11% this year as a result, with any recovery only expected in 2021 at the earliest.**
  - Livestock production, which makes up around 75% of the country's total exports and provides income for 60% of the population, has fallen by around 50% due to the pandemic.
    - The livestock industry is particularly dependent on the export of cattle, camels and goats to Saudi Arabia during the Hajj period. The cancellation of the pilgrimage due to COVID-19 left Somalia with a loss of around USD 250M.
    - The resulting surplus of stock in Somalia led to a price slump on the domestic market, further draining millions of Somalis of their livings.
  - Somalia is also suffering from the worst locust infestation in 25 years, declaring a national emergency as large swarms spread across East Africa affecting over 360,000 hectares of land and threatening agriculture and food security.
    - Somali officials have sent helicopters to spray new swarms of desert locusts but there are limits to their ability to do so in areas controlled by the jihadist terrorist group Al Shabaab, further exacerbating the spread.
  - The locust infestation has been compounded by flooding which has displaced more than 412,000 people, forcing them to seek shelter in other districts, thereby increasing the risk of COVID-19 transmission as people are forced to congregate together.
  - Solving these problems requires stability, something Somalia lacks both politically and economically.
- **Political infighting and fractured rule have hindered the UN-backed government from establishing a clear offensive against Al Shabaab and otherwise stabilising the country. Elections, which were set to take place this autumn, have been delayed until next year because of the pandemic.**

**Somalia Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 4.9 | 1.4 | 2.8 | 2.9 | -2.5 |
| CPI Inflation (%)* | 1.2 | 6.1 | 3.2 | 3.0 | 2.7 |
| Fiscal Balance (% of GDP)* | 0.0 | -0.6 | 0.0 | 0.1 | 0.2 |
| C/A Balance (% of GDP) | -6.0 | -9.7 | -10.3 | -13.7 | -11.4 |
| Total Gov't. Gross Debt (% of GDP) | ... | ... | ... | ... | ... |
| Total Gross Extrn'l Debt (% of GDP) | 105.3 | 115.1 | 111.3 | 106.4 | 76.9 |
| Gross Official Reserves (Mos. of Imports) | ... | ... | ... | ... | ... |
| Nominal GDP (USD B) | 3.9 | 4.5 | 4.7 | 4.9 | 5.0 |
| Population (Millions) | 14.2 | 14.6 | 15.1 | 15.6 | 16.0 |

- In 2011, Al Shabaab was pushed out of Mogadishu with the help of African Union soldiers, but the militants still control some rural areas and conduct frequent attacks in urban areas.
  - In September, a suicide bombing in the port city of Kismayo outside a mosque killed six people. It followed the killing of three people in a suicide bombing in Mogadishu the same week.
  - In August, Al Shabaab attacked Mogadishu's central prison and an upscale hotel in the city -- the latter frequented by the country's politicians.
- Holding elections is critical for the country's stabilisation, particularly given that Somalia's current government has been characterised by infighting and reshuffling of positions.
  - In July, Somalia's parliament removed Prime Minister Hassan Ali Khaire with a no confidence vote. He was replaced as acting PM by his former deputy Mahdi Mohammed Gulaid.
  - Khaire has decided to run for president.

[1] Arabia Monitor; IMF.

# Sudan: Pandemic threatens the transition to democracy

**B2/NR**

- **Sudan's economy is set for its third year of recession. Before the pandemic, it was already suffering from decades of conflict, a structural trade deficit, inflation and poverty. A bright spot, however, is Khartoum's increased dialogue with long-time critic Washington, raising at least the prospect of a road to recovery.**
  - Sudan's economy has been in a downward spiral since 2011; GDP almost halved between then and 2019, falling from USD 66B to around USD 34B.
  - COVID-19, natural disasters and the drop in oil prices will add 2020 to the decline because of their impact on Sudan's trade.
    - The UAE, China, Saudi Arabia and Egypt account for 67% of Sudan's exports which include oil, livestock, sesame oilseed and gold.
      - If Saudi Arabia, in particular, does not lift its lockdown measures in the near future, Sudan will suffer. The kingdom consumes nearly 60% of Sudan's livestock exports.
    - The drop in oil prices has already reduced Sudan's oil export earnings by 80%, accounting for a USD 400M loss.
  - It all adds up to a revised GDP forecast for a 7.2% contraction this year (from a previous 1.2%). The IMF expects GDP to partially recover but continue to contract by 3% in 2021.
    - Due to lockdown measures, unemployment levels are expected to rise to 25% in 2020 from 22% in 2019.
  - The damage to Sudan's economy has been compounded by Nile flooding, which has led to rising food prices and job losses.
    - Consumer price inflation is predicted to increase from 51% last year to around 81% this year.
    - Floods resulted in the Sudanese pound losing over 40% of its value in a matter of days, leading the government to call a state of emergency.
      - The Sudanese pound is officially trading at SDG 57 to USD 1, but reports suggest that the black market rate is closer to SDG 250 to USD 1, a significant devaluation.
      - In response to the flooding the US has pledged to offer aid, which comes at a pivotal point in US-Sudanese relations and offers a lifeline to the distressed country.

**Sudan Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 2.9 | 0.7 | -2.3 | -2.5 | -7.2 |
| CPI Inflation (%) | 17.8 | 32.4 | 63.3 | 51.0 | 81.3 |
| Fiscal Balance (% of GDP) | -4.4 | -6.5 | -7.9 | -10.8 | -16.9 |
| C/A Balance (% of GDP) | -7.6 | -10.1 | -13.0 | -14.9 | -15.2 |
| Total Gov't. Gross Debt (% of GDP) | 128.4 | 159.6 | 185.6 | 200.3 | 295.2 |
| Total Gross Extrn'l Debt (% of GDP) | 123.3 | 155.9 | 181.9 | 198.9 | 299.2 |
| Gross Official Reserves (Mos. of Imports) | 0.9 | 1.1 | 2.8 | 4.9 | 2.0 |
| Nominal GDP (USD B) | 55.6 | 45.8 | 35.9 | 33.6 | 25.3 |
| Population (Millions) | 39.8 | 40.8 | 41.8 | 42.8 | 43.8 |

- **Sudan desperately needs to be re-integrated onto the global stage in order to begin to repair its damaged economy and resist domestic unrest. Recent negotiations with the US to normalise relations with Israel could provide Sudan with necessary access to global partnerships.**
  - Authorities from Sudan, the US, and the UAE met in Abu Dhabi to discuss Sudan's addition to the growing list of Arab countries normalising relations with Israel.
  - Cooperating in normalisation talks could push the US to remove Sudan from the US State Sponsors of Terrorism list -- a designation held by Sudan since 1993.
  - Furthermore, Sudan's decision to normalise relations with Israel is expected to result in the write-off of debts owed to the US, in addition to a desperately needed aid package of USD 3B.
    - These discussions are the first step in Sudan shifting its foreign standing towards the US and the West, something previously difficult under the rule of Omar al-Bashir.

[1] Arabia Monitor; IMF.

# Syria: Russia to the rescue, again

NR/NR

- **Economic indicators from Syria are limited, but the country has undoubtedly taken yet another hit after years of civil war. This time it is from the Caesar sanctions and the crisis in neighbouring Lebanon. Russian investment in key sectors of the economy may cushion some of the blow, but it may already be too late to reverse the humanitarian damage.**
  - ➢ The US Caesar Syria Civilian Protection Act took effect in June, sanctioning any individual, company or state doing business with the regime of President Bashar al-Assad.
    - The intent of the sanctions are to debilitate the regime and paralyse the economy. It is more likely, however, that these sanctions have hurt Syrian civilians more than affecting the regime itself.
  - ➢ Additionally, the crisis in Lebanon, which has served as the gateway for Syrians to global markets, is now shutting down Syrian business.
    - Many Syrians have been locked out of their supposedly safe-haven Lebanese deposit accounts because of the imposition of strict capital controls.
  - ➢ This leaves Syria at high risk of famine, with food inflation rapidly escalating. Sanctions have played a role in this by accelerating the collapse of Syria's currency.
    - On the black market, the Syrian pound depreciated from 915 LS per USD to 2,300 LS per USD between January and August, compared with 512 LS per USD at the official rate. So far, the pound has lost over 55% of its value.
  - ➢ The plummeting currency means a sharp decline in purchasing power. Buying household goods has become inaccessible for many Syrians prompting concerns over a greater humanitarian crisis in the already ailing country.
    - Currently, more than 80% of Syrians live in poverty.
  - ➢ Moscow is offering a lifeline to Damascus to help cope with the downturn.
    - Russian Deputy Prime Minister Yuri Borisov and Minister of Foreign Affairs Sergey Lavrov met with Assad in September to discuss investment in key sectors of the economy – namely in energy and mining sectors. A deal is set to be formalised in December.
    - We expect that the ties between the two countries will remain resilient for the foreseeable future, especially as the US attempts to squeeze the Syrian regime.

**Syria Macroeconomic Indicators[1]**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2020f |
|---|---|---|---|---|---|---|
| Real GDP Growth (%) | -18.9 | -18.7 | 1.8 | -15.0 | -4.0 | 3.0* |
| CPI Inflation (%) | 36.7 | 91.7 | 36.4 | 15.2 | 40.0 | ... |
| Fiscal Balance (% of GDP) | -16.9 | -12.3 | -8.6 | -7.3 | ... | ... |
| C/A Balance (% of GDP) | -15.3 | -12.2 | -10.5 | -10.8 | ... | ... |
| Total Gov't. Net Debt (%of GDP) | 54.1 | 52.5 | 53.2 | 58.7 | ... | ... |
| Total Gross Extrn'l Debt (% of GDP) | 19.2 | 23.1 | 26.9 | 31.1 | ... | ... |
| Gross Official Reserves (USD B) | 4.8 | 1.8 | 1.8 | 1.7 | ... | ... |
| Nominal GDP (USD B) | 44.0 | 42.8 | 43.4 | 20.0 | 15.0 | ... |
| Population (Millions) | 19.2 | 18.7 | 18.4 | 18.2 | 18.2 | ... |

- **UN-backed talks on a new Syrian constitution are under way. But following the US withdrawal from the country and general international disengagement, Russia is likely to continue to expand its sphere of influence as Assad solidifies his control.**
  - ➢ Geir Pederson, the UN Special Envoy to Syria, was in Moscow to discuss the constitution, as well as to assist in the implementation of a ceasefire and facilitate a Syrian-led transition under the UN Security Council's Resolution 2254.
    - If the Security Council's Resolution is reached -- which entails ceasing attacks on civilians -- Caesar sanctions could be lifted.
    - However, this largely depends on the US president in office. President Donald Trump is very unlikely to align himself with a regime backed by Iran, meaning that sanctions are likely to be sustained for the foreseeable future.
  - ➢ A long-awaited UN meeting on Syria was set to take place in March but was delayed because of the COVID-19 pandemic.
    - Pederson's Russia meeting came after an abrupt end to UN talks in Geneva because of a positive coronavirus diagnosis among the delegation.
  - ➢ Efforts from international organisations have fallen by the wayside as the coronavirus delays dialogue to address the crisis.

[1] Arabia Monitor; IMF.

# Tunisia: Technocrats face a bumpy road

B2/NR

- **Tunisia continues to be impacted by the pandemic, with GDP forecast to shrink 4.3%, the largest contraction since 2010's 1.9%. Economic recovery will take time, particularly on the back of the lacklustre 1% growth last year. This will also be compounded by the widened twin deficits, high levels of external debt and loss of revenue from key sectors. The newly formed technocratic government, however, may provide some needed stability, if it can last.**
  - ➢ The economic contraction this year will put Tunisia in the deepest recession since 1956. There is an urgent need to finance the country's large fiscal and balance-of-payments gaps, estimated at 4.3% and 4.7% of GDP, respectively.
  - ➢ We do not expect the deficit to narrow yet because there has been a temporary halt in fiscal consolidation. This will increase the already high debt ratios.
    - The current account deficit is expected to stabilise at 9% of GDP on the back of a decline in external receipts, domestic investment and subdued demand. Lower energy imports, however, will provide some offset.
    - In the past, the wide persistent deficit was financed mostly through borrowing, which pushed external debt to around 77% of GDP in 2019 -- one of the highest levels among emerging market sovereigns. We expect the debt ratio to reach 90% of GDP next year.
  - ➢ External liquidity risks will be mitigated by strong backing from multilateral creditors and the IMF. This, in turn, is expected to allow Tunisia to meet its financing needs over the next two years.
    - So far, it has secured loans of around 6.4% of GDP which will cover around 40% of the external funding and 56% of fiscal financing requirements needed for this year.
    - After receiving a four-year USD 3B loan from the IMF in 2016, Tunisia was optimistic it could secure a successor deal. But further payment negotiations were suspended in July due to Tunisia's political turmoil.
    - We do not expect the new technocratic government to lock in any new IMF funding in the coming months. But this could change if it were able to implement economic reforms.
    - Recovery is partly dependent on the government and the Central Bank of Tunisia preventing further declines in creditability; debt has been rated as "highly speculative" by major agencies.

**Tunisia Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 1.1 | 1.9 | 2.7 | 1.0 | -4.3 |
| CPI Inflation (%) | 3.6 | 5.3 | 7.3 | 6.7 | 6.2 |
| Fiscal Balance (% of GDP) | -6.2 | -5.9 | -4.6 | -3.9 | -4.3 |
| C/A Balance (% of GDP) | -9.3 | -10.2 | -11.2 | -8.8 | -7.5 |
| Total Gov't. Gross Debt (% of GDP) | 62.3 | 70.6 | 78.2 | 72.3 | 88.5 |
| Total Gross Extrn'l Debt (% of GDP) | 66.9 | 84.3 | 97.3 | 90.3 | 109.9 |
| Gross Official Reserves (Mos. of Imports) | 3.1 | 2.6 | 2.5 | 5.2 | 3.6 |
| Nominal GDP (USD B) | 41.8 | 39.8 | 39.8 | 38.8 | 36.7 |
| Population (Millions) | 11.4 | 11.5 | 11.7 | 11.8 | 11.9 |

- **Tunisia's former interior minister, Hichem Mechichi has replaced Elyes Fakhfakh as prime minister. Mechichi received a majority of votes needed to take office and push through his technocratic government. However, with 67 dissenting votes and political infighting challenging the new PM's legitimacy, a bumpy road lies ahead.**
  - ➢ Prior to Mechichi's nomination, it emerged that President Kais Said had asked party leaders to vote against the PM, who he had just nominated.
    - It was reported that this decision was based on Said's opposition to some of Mechichi's cabinet appointments, including Ali Kooli, the head of Bank ABC-Tunisie who has now been tasked with overseeing the newly combined ministries of finance, economy and investment.
  - ➢ Mechichi also faces challenges in parliament, which is led by the moderate Islamist party Ennahda with 54 of the 217 seats.
    - Parliament initially refused to support Mechichi's cabinet because it does not have a single party-affiliated member.
    - It eventually endorsed the government, however, because there is no appetite for early elections that would have resulted from a rejection and could cost many incumbents their seats.

[1] Arabia Monitor; IMF.

# UAE: Testing a new regional paradigm

**Aa2/NR**

- **The UAE, like its GCC neighbours, saw its growth forecast cut sharply following the double blow of low oil prices and the COVID-19 pandemic. From an initial projection of 2.5% growth, the IMF revised its forecast to a GDP contraction of 3.5%. Despite the dip, we believe an economic rebound is coming: private sector activity and foreign investor interest are showing signs of recovery.**
  - ➢ The UAE economy was hit by the global economic downturn because of its dependence on oil and tourism revenues, both of which declined sharply in 2020.
    - The central bank projects GDP will shrink by 5.2% this year, a bleaker forecast than that of the IMF, which for now has not revised down its 3.5% contraction assessment.
    - We believe the extent of the economic contraction largely depends on the ability of the hospitality industry to recover, as all seven emirates have reopened for international tourists.
    - The economic downturn was compounded by the decline in foreign currency reserves, which shrank by 4% YoY in July. Foreign exchange reserves fell to USD 96.4B in July, from an all-time high of USD 109B in February.
  - ➢ To boost their finances, Dubai and Abu Dhabi returned to bond markets for the first time in years.
    - Abu Dhabi successfully completed a USD 5B multi-tranche bond, with historically low coupons. The bonds includes a 50-year tranche, the longest ever issued by a GCC country, banking on trust in Abu Dhabi's ability to deliver long-term growth.
      - International investors accounted for 95% of the geographical allocation, a positive sign for the emirate's global appeal.
    - The Dubai government sold USD 2B in dual-tranche bonds in September, its first public debt market sale in six years.
  - ➢ The UAE economy is beginning to show signs of recovery. The private sector grew for three consecutive months until July 2020, when the PMI reached 50.8.
    - The index fell below the 50.0 mark in August to 49.4, a 4% YoY decline, due to the employment PMI declining to its lowest level in 11 years (41.5). Firms are shedding jobs to control on costs. We expect the economy to recover further by mid-2021, especially as the country gears up for the delayed Dubai Expo in October 2021.

**UAE Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | 3.0 | 0.5 | 1.7 | 1.3 | -3.5 |
| Crude Oil Production (M Bpd) | 3.0 | 2.9 | 3.0 | 3.1 | 3.1 |
| Oil GDP Growth (%) | 2.6 | -2.8 | 2.8 | 2.0 | 0.0 |
| Non-oil GDP Growth (%) | 3.2 | 1.9 | 1.3 | 1.0 | -5.0 |
| CPI Inflation (%) | 1.6 | 2.0 | 3.1 | -1.9 | -1.0 |
| Fiscal Balance (% of GDP) | -2.0 | -2.0 | 2.0 | -0.8 | -11.1 |
| C/A Balance (% of GDP) | 3.7 | 7.3 | 10.0 | 7.4 | 1.5 |
| Total Gov't. Gross Debt (% of GDP) | 20.2 | 22.1 | 21.8 | 26.6 | 33.6 |
| Total Gross Extrn'l Debt (% of GDP) | 69.6 | 73.5 | 69.7 | 77.7 | 94.0 |
| Gross Official Reserves (Mos. of Imports) | 3.3 | 3.7 | 3.8 | 4.7 | 3.1 |
| Nominal GDP (USD B) | 357.0 | 377.7 | 414.2 | 402.5 | 343.0 |
| Population (Millions) | 9.2 | 9.4 | 9.5 | 9.7 | 9.8 |

- **The UAE-Israel normalisation deal could bring renewed opportunities for growth. In just over a month, several bilateral business deals were signed between the two nations.**
  - ➢ Following years of covert trade, estimated at USD 1B per year, official commerce between the UAE and Israel is projected to reach USD 500M in its first year and to grow to USD 4B within three to five years.
    - The first month of normalisation saw multiple breakthroughs in trade relations between the two countries, far exceeding expectations.
    - We project economic opportunities to increase between the two nations in the coming years, as they emerge from the global economic downturn, particularly in the defence, technology and financial sectors.[2]
  - ➢ The agreement also signals that the UAE will take on a more important position on the geopolitical front, which may alter the region's power balance. The potential to side-line Iran further could either lower regional volatility, or increase it dramatically, depending partly on the US stance in the next administration.

[1] Arabia Monitor; IMF.
[2] Deals include: signed agreement between DP World and Tel Aviv-based DoverTower; Jebel Ali Free Zone agreement with Israeli Chambers of Commerce; Diamond exchange pact agreed between Dubai and Israel, among others.

# Yemen: Perilous plight

**NR/NR**

- **Yemen's war-torn economy is expected to contract by 4.8% this year after growth of 2.1% in 2019. Unfortunately, international donor bandwidth is stretched by the pandemic, and Yemen could further suffer the consequences.**
  - ➢ The civil war has destroyed medical infrastructure and new development for more than five years, leaving Yemen ill-equipped to battle COVID-19. The cost of physical damage is estimated to be more than USD 14B.
    - Deteriorating healthcare systems have resulted in a 15% decrease in Yemen's Human Development Index, now ranking it 177th out of 189 countries.
  - ➢ With the Yemeni rial devalued by 70% and reduced financial support from Saudi Arabia, the stability of Yemen's economy is threatened further.
    - The USD 2B central bank deposit from Saudi Arabia in 2018 is almost used up, with less than USD 200M remaining at last count in May.
      - o This is likely to weaken purchasing power and place pressure on household expenditure
    - Saudi financial support of USD 1.35B, promised in June, has yet to be received.
  - ➢ The UN also reduced its humanitarian activity in Yemen by 75%, including cuts in food rations, during the pandemic outbreak. This is likely to cause food prices to almost double again, increasing food insecurity and pushing Yemenis into even a stronger reliance on humanitarian aid and dependence.
- **Geopolitical instability continues to linger within the country; prospects for a ceasefire are slim and violence is likely to increase. However, an agreement between the EU and the United Nations Development Programme which aims to improve economic and social conditions provides a glimmer of hope for improved living conditions.**
  - ➢ While the international community has now rallied to provide emergency support for Yemen, given the prolonged funding gap and the lack of dialogue during the COVID-19 crisis, it could be too late to remedy the damage already done.

**Yemen Macroeconomic Indicators[1]**

| | 2016 | 2017 | 2018 | 2019 | 2020f |
|---|---|---|---|---|---|
| Real GDP Growth (%) | -13.6 | -5.1 | 0.8 | 2.1 | -3.0 |
| Crude Oil Production (M bpd) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0.4 |
| CPI Inflation (%) | 21.3 | 30.4 | 27.6 | 10.0 | 26.7 |
| Fiscal Balance (% of GDP) | -9.3 | -5.3 | -6.7 | -3.8 | -8.0 |
| C/A Balance (% of GDP) | -3.2 | -0.2 | -1.4 | -7.4 | -2.8 |
| Total Gov't. Gross Debt (% of GDP) | 79.6 | 84.3 | 63.5 | 56.3 | 68.8 |
| Total Gross Extrn'l Debt (% of GDP) | 22.4 | 28.2 | 21.5 | 18.9 | 24.4 |
| Gross Official Reserves (Mos. of Imports) | 1.2 | 0.9 | 0.5 | 1.4 | 2.1 |
| Nominal GDP (USD B) | 28.1 | 24.6 | 27.6 | 29.9 | 24.2 |
| Population (Millions) | 27.5 | 28.2 | 28.9 | 29.5 | 29.8 |

- ➢ Despite a ceasefire in June, the forces associated with the Yemeni government in the governorate of Abyan committed over 350 documented violations.
- ➢ This contributed to the decision of the Southern Transitional Council to suspend participation in ongoing consultations on a peace deal.
- ➢ While formal peace negotiations drift, on 1 September, the EU and the United Nations Development Programme (UNDP) signed a partnership agreement worth USD 82.4M to support local governance and foster economic growth in Yemen.
  - Although the agreement may take some time to come into effect, it could enable Yemen to develop long-term economic growth in the health, water, food and education sectors.
- ➢ However, support from the international community must be sustained to see through any change. A second wave of the pandemic jeopardises efforts from being carried out.
- ➢ Ultimately, while the UNDP deal is promising for lasting growth, the fighting continues to jeopardise the safety of Yemenis, unless international organisations and foreign players move quickly to mediate peace -- conciliation is unlikely to occur this year.

[1] Arabia Monitor; IMF.

# GCC Sovereign Ratings Update

| | Moody's | | Last Moody's action | | S&P | | Last S&P action | | Rating Change Considerations |
|---|---|---|---|---|---|---|---|---|---|
| | Rating | O/L* | Action | Date | Rating | O/L | Action | Date | |
| **Bahrain** | B2 | | Affirmed O/L Stable | 17-Dec-18 | B+ | | Affirmed O/L Stable | 29-May-20 | If Bahrain materially outperforms fiscal and external forecasts, upward pressure on ratings would continue. Conversely, if these constraints intensify, downward pressure will re-emerge. |
| **Kuwait** | A1 | | Downgraded O/L Stable | 22-Sep-20 | AA- | | Downgraded O/L Negative | 17-Jul-20 | Ratings could be lowered further if a renewed fall in oil prices or slow growth were to undermine Kuwait's revenue and fiscal profile or if parliamentary resistance blocks or reverses planned reforms. |
| **Oman** | Ba3 | (-) | Affirmed Negative | 23-Jun-20 | BB- | | Downgraded O/L Negative | 17-Apr-20 | Ratings could dip if debt as a share of GDP remains on an upward trend or if the net external asset position were to weaken at a faster pace. We expect pressure on Oman's credit ratings to continue until the agencies see dynamism from the new Sultan. |
| **Qatar** | Aa3 | | Affirmed O/L Stable | 24-Sep-20 | AA- | | Affirmed O/L Stable | 08-May-20 | Ratings could come under pressure if developments in oil production and prices, or in the banking sector, were to significantly weaken the country's external or fiscal positions; for example, if the government's gross liquid assets fall significantly below 100% of GDP. |
| **Saudi Arabia** | A1 | (-) | Affirmed Negative | 01-May-20 | A- | | Affirmed O/L Stable | 25-Sep-20 | Ratings could be lowered again if sizable and sustained reductions in the deficit are not achieved, or if liquid fiscal financial assets fell below 100% of GDP. Ratings could also come under pressure if domestic or regional events compromised political and economic stability. |
| **UAE** | Aa2 | | Affirmed O/L Stable | 26-Mar-19 | AA | | Affirmed O/L Stable | 02-Jul-07 | Reducing the debt of government-related enterprises of Abu Dhabi banks and of the government of Dubai could support upgrade considerations in the medium term. |

Bloomberg; Moody's; S&P; JPMorgan.
*O/L stands for outlook.
Note: Political & institutional factors, rather than just fiscal & economic performances, constrain GCC ratings starting from Moody's Aa & S&P's A categories.

# MENA exc. GCC Sovereign Ratings Update

| | Moody's | | Last Moody's action | | S&P | | Last S&P action | | |
|---|---|---|---|---|---|---|---|---|---|
| | Rating | O/L* | Action | Date | Rating | O/L | Action | Date | Rating change considerations |
| **Algeria** | N/R | | | | N/R | | | | Sovereign rating on hold due to domestic and energy market conditions. |
| **Egypt** | B2 | | Affirmed O/L Stable | 11-May-20 | B | | Affirmed, O/L Stable | 08-May-20 | A delay or reversal in implementing fiscal and economic reforms agreed upon under the IMF programme and renewed intensification of political turmoil and instability would be credit-negative. |
| **Jordan** | B1 | | Affirmed O/L Stable | 08-Nov-18 | B+ | | Affirmed O/L Stable | 11-Sep-20 | Successful implementation of key political and structural economic reforms, favouring more sustainable growth and further easing fiscal and external vulnerabilities would support an improvement in the ratings outlook. |
| **Lebanon** | C | | On Watch | 27-Jul-20 | SD | (-) | Affirmed O/L SD | 21-Aug-20 | Ratings could be affirmed or raised, if the country receives significant donor funding that would allow the government to implement immediate reforms. Meanwhile, although we feel this can be rapidly unblocked if a restructuring program is put in place, it is conditional on policy reform. |
| **Morocco** | Ba1 | | Affirmed, O/L Stable | 20-Nov-18 | BBB- | | Affirmed O/L Stable | 04-Oct-19 | If higher economic growth were to exceed forecasts, and exchange rate flexibility were to increase markedly, this would be supportive of a ratings upgrade. |
| **Tunisia** | B2 | (-) | On Watch | 17-Apr-20 | N/R | | | | Implementing structural reforms agreed under the extended IMF programme, including public bank recapitalisation and governance reform would be credit positive. However, a downgrade is likely if there are delays in the availability of external funding, fiscal overruns or major contingent liabilities that would weaken Tunisia's fiscal strength and the adequacy of its foreign exchange reserves. |

Bloomberg; Moody's; S&P.
*O/L stands for outlook.

# About Arabia Monitor

**Arabia Monitor** is an independent research firm specialised in economic and market analysis, and strategy advisory on the Middle East and North African region, which it views as the new emerging market. Arabia Monitor’s in-depth, locally informed analysis by Arab, Persian and Chinese speakers has placed it consistently ahead of the curve in identifying new trends within and around the region and understanding its geopolitics.

**Arabia Advisors** specialises in portfolio strategy and private placements. It works with firms, family offices and government related organisations that are looking to streamline, re-balance or diversify their asset portfolios. Based in the UAE as an off-shore company, Arabia Advisors services a regional and international client base with interest in the Arab countries.


**Arabia Monitor**
**Aston House| Cornwall Avenue| London L3 1LF**
**Tel +44 203 239 4518**
***info@arabiamonitor.com***
***www.arabiamonitor.com***



© Arabia Monitor 2020
This is a publication of Arabia Monitor Limited (AM Ltd) and is protected by international copyright laws and is for the subscriber's use only. This publication may not be distributed or reproduced in any form without written permission.
The information contained herein does not constitute an offer or solicitation to sell any security or fund to or by anyone in any jurisdictions, nor should it be regarded as a contractual document. Under no circumstances should the information provided on this publication be considered as investment advice, or as a sufficient basis on which to make investment decisions. The information contained herein has been gathered by AM Ltd from sources deemed reliable as of the date of publication, but no warranty of accuracy or completeness is given. AM Ltd is not responsible for and provides no guarantee with respect to any of the information provided herein or through the use of any hypertext link.