Middle East Economy Watch

The GCC looks set to weather the expected global recession in 2023

The IMF expects 2023 to be the weakest year for global growth since 2009, aside from 2020, with at least a third of the world's population experiencing recessions. However, while the outlook for most countries has been revised down, GDP growth forecasts have been slightly revised up for the GCC in 2023.

Continued strong oil revenue is expected to enable higher government spending, providing a buffer for the non-oil economy. Nonetheless, higher interest rates, which largely track the Federal Reserve rate, do present a potential barrier to access to credit.

More positively, inflation may have already peaked in the GCC, at less than half the level seen in the US, and is expected to rapidly ease towards a modest 2% annual rate - with the exception of the oil-importing countries in the region, such as Egypt, who are facing more challenging inflationary trends.

After a brief wave in the early summer, coronavirus levels are once again low across the GCC and some countries have recorded few or zero deaths for several months. This is one factor contributing to a rebound in the tourism sector, which in several GCC states is now above 2019 levels, even before the anticipated boom in November from the Qatar World Cup.

In this report, we also look in detail at developments in the hydrocarbons sector as OPEC+ implements its first new cuts since May 2020. The organisation has extended its cooperation agreement into 2023 to be able to respond if the global slowdown puts pressure on demand, although the current expectation is that there will still be solid growth in oil demand.

The OPEC+ cuts, entering their seventh year, cannot continue forever. The GCC and Iraq are bearing more than their fair share of the cuts due to production baselines that are low relative to their full production capacities. Most of them are investing heavily in expanding capacity which will further widen the gap between quota and capacity—for example by 2030 the UAE may have a capacity as high as 6 million barrels per day (b/d), twice its current OPEC+ allocated quota. This will add further pressure on OPEC+ to revise up the baselines.

Oil output is cut but capacity expands

OPEC+'s most recent cuts came after it had recovered to baselines

In October, OPEC+ cut production for the first time since May 2020, signalling the start of a new oil market strategy which has significant implications for exporters in the Middle East (all except for Qatar are members) as well as importers.

The October cut followed a period in which the market had largely been driven by the post-pandemic recovery in demand, and by the geopolitics of the war in Ukraine. Throughout this period OPEC+ steadily tapered its production cuts, with pauses and slight monthly variations (and deeper Saudi voluntary cuts in early 2021), but the destination was clear. In August, the organisation's production quota finally returned to the original baseline of 43.8m b/d, although actual production was only about 40.2m, given the serious production constraints that have developed for many of its members outside of the region.

The tapering was broadly in line with the plan agreed upon at the July 2021 OPEC+ meeting, although the organisation did quietly drop one clause that would have allocated higher baselines to the UAE, Saudi Arabia, Kuwait and Iraq from May 2022. The clause had been inserted after the UAE pointed out that the original baselines, derived from October 2018 production levels, did not adequately reflect its increased capacity of about 4m b/d, and therefore meant that it was bearing a larger burden from the cuts than other OPEC+ members.

High prices this year reduced the impetus to adjust the baselines (oil was under $75 when they were negotiated back in July 2021). However, this just delays the difficult but necessary resetting of baselines. The UAE's allocation is still 20% below its capacity, and Saudi Arabia's is about 10% below, whereas most other members of OPEC+, including Kuwait, have allocations that are at or above their current capacities (see graph).

OPEC+ is extended to 2023 in readiness for a demand shock

The initial cut in quotas for October was only by 100k b/d, reversing a similar increase in September, which were the smallest ever monthly adjustments since OPEC+ quotas were introduced in January 2017. The biggest change comes into effect this month, with allocations reducing by 2m b/d, about 5%. The true cut is expected to only be about half that amount because few OPEC+ members outside of the GCC were producing above these new quota levels.

The GCC has been willing to bear this burden partly because the immediate boost to price should largely offset the reduced volume (and market moves bear this out) and also because the agreement extended the OPEC+ pact for a seventh year, which would have expired at the end of 2022. OPEC's forecasts, as well as those of the IEA and others, still anticipate solid demand growth of over 2m b/d in 2023. However, there are concerns that the global economic slowdown could be even worse than the IMF's latest baseline forecast of 2.7% GDP growth, and therefore maintaining the agreement leaves exporters with options in the event of a demand shock. 2022 may bring back memories of 2008 when the global financial crisis also ran ahead of expectations and drove down prices sharply over the winter, after having hit record levels only a few months earlier.

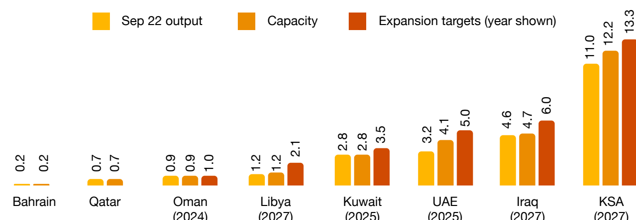
Expansion plans vary in scale and feasibility

Even as the GCC cuts production and contemplates another year of quotas, they continue to invest heavily in expanding their capacity. This strongly suggests that they do not expect OPEC+ controls to remain in place indefinitely and, while they remain in place, they could motivate a reassessment of burden sharing in 2023, for example through an adjustment of baselines.

The UAE is making the most progress on ambitious expansion plans. ADNOC had originally planned to boost its capacity from 4 to 5m b/d by 2030 but has been making rapid progress in key fields such as Upper Zakum, where it awarded $3.4bn in drilling contracts in August. Recent media reports suggest that the target data had been moved up five years to 2025. Moreover, a new target of 6m b/d is reportedly being contemplated for 2030—about half its current capacity and double its OPEC+ quota. Saudi Arabia plans to boost capacity by 1m b/d by 2027 - a 9% increase. There are more ambitious targets from other countries with Kuwait aiming at 3.5m (+25%) by 2025, Libya at 2.1m (+75%) by 2027 and Iraq at 6m (+28%) also by 2027 (and potentially up to 8m by 2028). These three countries all have the reserves required to support their planned expansions but have also frequently missed previous targets. For example, Libya's 2.1m target was originally set for 2021 but has repeatedly slipped as conflict has hindered investment. This makes the possibility of expansions elsewhere more uncertain than for UAE and Saudi Arabia.

Oman does not have a formal national target, but PDO, which is responsible for 80% of its crude production, is aiming to lift its output to 0.7m b/d by 2024, from about 0.65m currently. Qatar is mainly focused on LNG expansion but aims to plateau its crude output at around 0.7m b/d, after a long period of steady decline. Finally, Bahrain doesn't have specific published national targets and is currently focused on maintaining current output levels from its two conventional fields. The wildcard here is the Khaleej al-Bahrain shale oil reserves discovered in 2018, which, if developed, has the potential to increase Bahrain's capacity sharply - perhaps more than doubling it. Production was slated to start in 2023, but so far no announcements have been made.

Crude oil production (m barrels/day)



Source: OPEC, IEA, National oil companies

Oil reserves can be monetised during the energy transition

It may seem strange that Middle Eastern oil exporters are so focused on growing capacity after producing well below their existing capacities for the last six years and at a time when they are taking the energy transition increasingly seriously, investing in renewables and hydrogen (see our **July report**) and announcing net-zero emissions targets.

The rationale is that even if global oil demand is nearing a peak and may begin to decline in the second half of the decade, the region is highly competitive on both production costs and the carbon intensity of emissions. Therefore as global demand declines there is scope for increased output from the region, building market share. Most states in the region have production-to-reserve ratios of many decades so it makes sense to monetise these during the energy transition. The revenues from oil production can then be reinvested in renewables, which also means they can reduce domestic consumption of hydrocarbons and export a larger share of production. This is likely to make it increasingly difficult for OPEC+ to maintain a consensus into 2023, as producers in our region seek a way to maintain tools to manage the global oil balance while creating space to increase their output in line with their current and future capacities.

The Middle East is not immune to the global squeeze

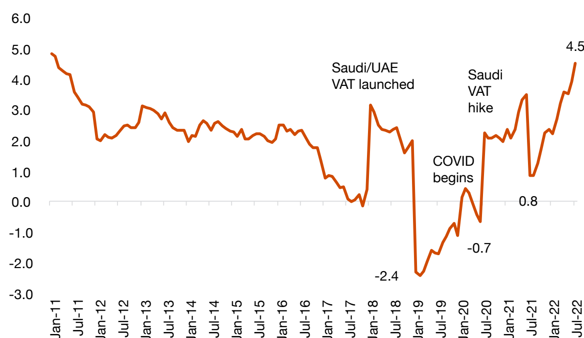
Aside from the potential impact on the oil market, the global slowdown due to high inflation and rising interest rates is being felt in the Middle East. The most severe impact is clearly being felt by the oil importers in the region such as Egypt, Lebanon and Jordan which are facing severe twin deficits and looking to the IMF, the GCC and other donors for financing support.

The oil exporters are buoyed by export earnings, which means that their current accounts are very strong, and most are also running sizable fiscal surpluses. The IMF forecasts that the GCC's aggregated current surplus will be 17% of GDP this year and the fiscal balance will be 7% of GDP, with all the GCC maintaining current surpluses through to 2027 and all, except Bahrain, expect to maintain fiscal surplus. However, our region is still experiencing heightened inflation, and hiking interest rates would constrain credit and non-oil growth.

Inflation hits 11-year high

Inflation in the GCC has been rising steadily since mid-2021, hitting an 11-year high of 4.5% in July 2022. Excluding the impact of VAT changes (particularly its introduction in Saudi Arabia and the UAE in January 2018 and then tripling in Saudi Arabia in July 2020) this upwards trend has been underway since early 2019, when regional deflation hit a low of -2.4% y/y, barring a brief decline at the start of the pandemic.

GCC inflation (% y/y)



Source: National statistical agencies; PwC analysis weighting countries by GDP, and estimating the UAE by applying the Dubai trends to the federal basket

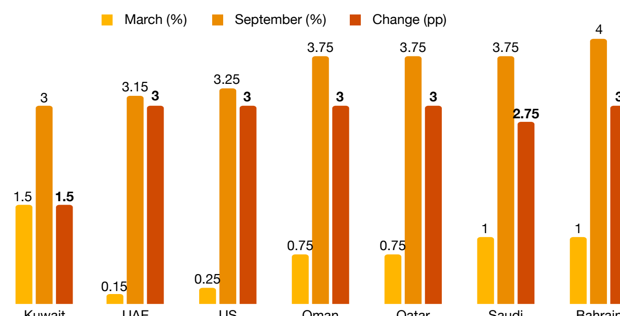
There was a slight easing in GCC inflation to 4.3% in August, less than half the level of many Western countries. Qatar is, however, undergoing a short-term surge, particularly in rents, in the run up to the World Cup, and inflation saw a spike in September to 6.0%. The expectation, however, is that inflation will ease soon. The IMF forecasts that inflation will average about 3.7% in 2022 and ease to 2.7% in 2023, then hold steady near 2% across the GCC in 2024-27.

As discussed in our **March report**, the factors driving inflation vary between countries, and this divergence has remained the case so far this year. All countries have seen a significant contribution from food prices (up by between 4% in KSA and 10.4% in Bahrain in August) but local factors and widely different weightings in the CPI basket have had a major impact. Transport prices were up sharply only in the UAE, as other states have capped fuel prices. Recreation, which includes the cost of holiday flights, was only an issue for Qatar and Dubai. Hospitality inflation was mainly an issue in Bahrain, a welcome consequence of recovering tourism. The impact of rents varied widely from a small decline in Bahrain to an 11% y/y increase in Qatar in September, due largely to the temporary surge in demand for housing and holiday rentals for the World Cup. Meanwhile, the strengthening US dollar has helped mitigate imported inflation for the GCC.

Interest rate hikes mirror the US

The GCC's pegged currencies mean they are largely compelled to mirror US interest rate hikes. So far in 2022, they have followed in lockstep with the Fed across its four hikes totalling 300 basis points. The main exception is Kuwait, which has a little more flexibility due to its peg to a basket of currencies and started the cycle with substantially higher rates, so although it has only hiked by half as much as the Fed, its base rate of 3% is just 25bp behind. There will likely be a further 75bp hike from the Fed at the start of November, which the GCC will once again mirror.

Main policy interest rates



Source: Central banks

The rate hikes are unlikely to do much to mitigate inflation in the region, which is far lower than in the US and would moderate without monetary intervention. However, there is a concern that the higher rates might not be appropriate for this particular moment in the GCC's business cycles and could constrict borrowing and hence growth at a time when they are looking to drive investment to diversify their non-oil economies. Although the economic boom in 2005-8 showed that the combination of both high rates and strong non-oil growth is at least possible in the GCC.

Leading indicators suggest strong non-oil growth

There have been indications of strong growth so far in 2022, even as rates have risen. Real non-oil growth picked up in Q2 in three of the four GCC states that have reported Q2 data, including to 9.0% y/y in Bahrain and 9.7% in Qatar. Leading indicators such as purchasing managers indices have also been strong, including Dubai's hitting a three-year high of 57.7 points in August, although all the PMIs eased back in September.

The region's banks are in a strong position, with limited signs of non-performing loans and higher rates improving their net-interest margins. They are therefore well placed to continue lending. GCC governments also have significant fiscal space, thanks to (surging) oil revenues, which they can use to support their economies through subsidies and spending. Saudi Arabia, notably, is budgeting 2023 spending that is 18% higher than it was previously projecting. Government initiatives include promoting SMEs, which can be engines for growth and job creation. Saudi Arabia's SME Bank is gearing up its concessional lending, and the UAE's Ministry of Economy just launched the second phase of its Entrepreneurial Nation programme to develop start-ups.

There are likely to be some hiccups along the road. Qatar's construction sector and other parts of the non-oil economy may see a decline after the World Cup, and in Dubai the hot property market will eventually peak . Nonetheless, the broad outlook for the region is much more positive than that for western economies and others that will be on the edge of recession going into 2023. The IMF's GDP growth forecasts in the October WEO report actually saw a net increase of 0.2pp for the GCC overall to 3.7%, at a time when it has been revising down most countries globally.

Data and projections: November 2022

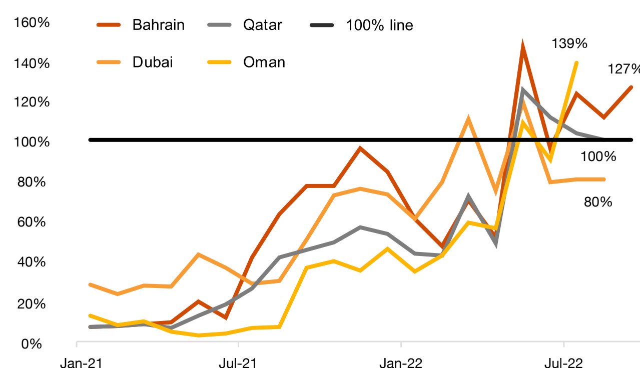
	GDP share (2022)		Real GDP growth (% y/y)			Inflation (% y/y)			Fiscal bal. (% GDP)	
	PPP	MER	Q2-22	2022p	2023p	Aug-22	2022p	2023p	2022p	2023p
Middle East	**100%**	**100%**	**-**	**6.2**	**3.9**	**7.1**	**4.7**	**4.4**	**5.3**	**4.1**
GCC	**59.1%**	**70.3%**	**-**	**6.4**	**3.6**	**4.3**	**3.7**	**2.7**	**7.3**	**6.0**
Saudi Arabia	32.5%	34.3%	12.2	7.6	3.7	3.0	2.7	2.2	5.5	3.9
UAE	13.1%	17.1%	-	5.1	4.2	7.0*	5.2	3.6	7.7	4.9
Qatar	4.9%	7.5%	6.3	3.4	2.4	5.0	4.5	3.3	12.5	16.0
Kuwait	4.0%	6.2%	-	8.7	2.6	4.2	4.3	2.4	14.1	14.1
Oman	3.1%	3.7%	5.8	4.4	4.1	2.6	3.1	1.9	5.5	2.3
Bahrain	1.4%	1.5%	6.9	3.4	3.0	3.9	3.5	3.4	-4.7	-6.0
Non-GCC	**40.9%**	**29.7%**	**-**	**5.9**	**4.7**	**13.7**	**7.2**	**8.3**	**0.6**	**-0.4**
Egypt	26.8%	15.9%	3.3	6.6	4.4	14.6	8.5	12.0	-6.2	-7.4
Iraq	8.5%	9.6%	-	9.3	4.0	5.4*	6.5	4.5	11.1	9.2
Jordan	2.0%	1.6%	2.9	2.4	2.7	5.4	3.8	3.0	-5.9	-6.6
Libya	2.1%	1.4%	-	-18.5	17.9	5.0*	5.5	4.0	15.8	22.1
Lebanon	1.3%	0.6%	-	-	-	162.0	-	-	-	-
Palest. Terr.	0.4%	0.5%	3.0	4.0	3.5	3.2	4.9	3.4	-3.5	-3.1

Sources: PwC analysis, National statistical authorities, IMF forecasts (WEO, Oct 2022). *UAE inflation is estimated from Dubai's trends and the national basket weights, because no monthly national data has been published yet for 2022. Iraq's is for July and Libya's is for June.
Notes: The Middle East region is defined here based on PwC's business coverage (which excludes non-Arab countries, Syria and Yemen).

Chart of the quarter

In May 2022, Bahrain, Qatar, Dubai and Oman all recorded more visitor arrivals than in the same month in 2019 for the first time since the start of the pandemic (Dubai had briefly surpassed this level in March during the Expo finale). However, May numbers were inflated by Eid al Fitr, which saw large numbers of Saudis visiting neighbouring countries, followed by a pullback in June. Although, during Q3 most of these countries again received more visitors than in 2019. The exception was Dubai, which averaged only 80% of its 2019 visitor numbers in June-August, less than its average in the first part of the year. A contributing factor to this may have been a coronavirus wave of Omicron variants which peaked in the UAE but has now declined. However, other indicators, such as the tourism component of Dubai's PMI, point to strong momentum in the sector. The World Cup, which begins on 20 November, will provide impetus not only in Qatar, which will receive over six months of tourists in just a month and with high levels of pre-visitor spending, but also for Dubai, Oman and Saudi Arabia, which will host some fans. As there are still no direct flights between Bahrain and Qatar, Bahrain is unlikely to receive a significant benefit.

Tourist arrivals (% of same month in 2019)



Source: National statistical agencies, PwC analysis; N.B. monthly data for 2022 is not yet available for KSA and Kuwait.

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