Middle East Economy Watch

The regional economy remains robust, despite oil cuts and geopolitical turbulence

April 2024

Beyond the mounting social and humanitarian cost of the ongoing geopolitical crisis in the region, global trade has also been impacted. The current situation has resulted in severe disruptions in the Red Sea trade route and added to the interest in alternative land routes, including across the Arabian Peninsula and Levant or through Iraq and Turkey. These routes have economic and geographic logic but face their own geopolitical challenges, as we will examine in this report.

We are now seeing a stronger focus around sustainability and greening of the economy. 2023 saw a surge in green financing, especially in countries such as the UAE and Saudi Arabia. Some of this can be attributed to raised awareness in the run up to COP28 but overall, green finance remains an untapped opportunity for the region, in particular the Gulf Cooperation Council (GCC) countries, that have well-developed capital markets. In this report, we look at how green finance is accelerating economic diversification and job creation in the region, and its potential to attract foreign direct investment.

In this edition, we also examine the uncertainty around oil demand growth, with the OPEC+ deciding to keep production flat in the second quarter, maintaining the 2.2m barrels per day (b/d) in additional cuts, mainly by Middle Eastern producers. This uncertainty has also led to Saudi Arabia's decision to suspend its planned capacity expansion, as its buffers are adequate for the next few years. Conversely, gas demand growth looks promising in the medium term, prompting Qatar to upsize its giant North Field expansion project and Abu Dhabi is also considering new LNG capacity.

Finally, we look at non-oil trends in the region, with Gross Domestic Product (GDP) and Purchasing Manager Index (PMI) indicators showing significant growth in Saudi Arabia and the UAE, despite the decrease in oil production. Inflation has also cooled significantly in the region, although there is pressure on rents in Saudi Arabia and the UAE.

Oil cuts are extended but the non-oil sector remains robust

OPEC+ extends cuts into Q2

In the first few months of 2024, Brent crude traded around $80 per barrel, on par with its average price during 2023 (down from $101 per barrel in 2022). This is a fairly comfortable price for most of the region states, above the fiscal breakeven for all except Bahrain and Saudi Arabia.

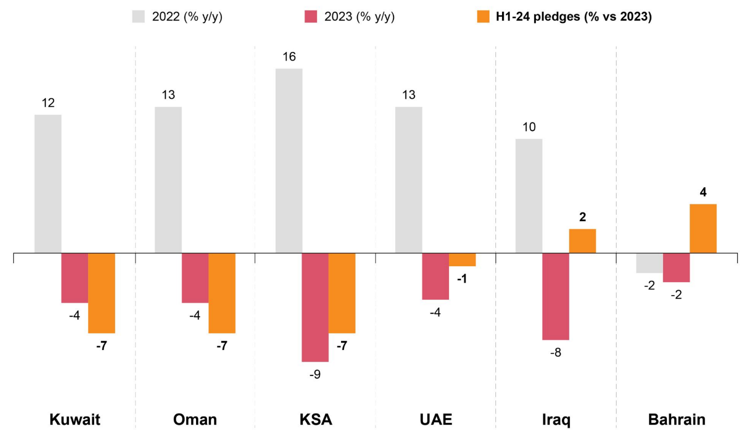
There are significant variations in forecasts for oil demand. Based on OPEC's February oil market reports, OPEC was anticipating 2.3m b/d in demand growth whereas the International Energy Agency (IEA) expected only 1.2m. The difference between them is greater than the combined crude production of Oman and Bahrain, or greater than the latest round of Saudi cuts. In addition, most forecasters expect that non-OPEC+ production, mainly from the US, Guyana and Brazil, will grow by at least 1.3m b/d.

This all means that if oil demand growth trends are in line with the lower IEA forecasts, non-OPEC supply could fully meet the additional demand. This would make it difficult for OPEC+ to increase its production without risking a decline in prices. Because much of the oil demand growth is expected in the second half of the year, OPEC+ decided on March 3, 2024 to extend through the second quarter, the 2.2m b/d of additional voluntary cuts that eight of its members have been implementing since January, led by the -1m b/d commitment from Saudi Arabia. In the second half of the year, the plan is to gradually taper these cuts "subject to market conditions", although some analysts anticipate that they could remain in place for most of the year.

The pledged output levels in H1 2024 are -7% below the average 2023 production levels of Kuwait, Oman and Saudi Arabia, bringing their output levels back to where they were in 2022, on average. These cuts mean that economic growth in these countries will be much lower than had been forecast with, for example, the International Monetary Fund's (IMF) October report projecting around 3% oil sector growth in each of these three countries. Now, even if cuts are tapered significantly in H2, all will likely see an average annual contraction in the sector.

The UAE's quota is only -1% lower than last year's average output because its base quota (before voluntary cuts) received a small uplift this year, as had been agreed in June. Meanwhile, although Iraq has pledged voluntary cuts, its output last year lagged behind its quota. Bahrain has made no additional pledges, but it suffered maintenance outages last year and, if it manages to produce at quota now, this will result in a small uplift.

Oil production trends



Source: OPEC; 2022-23 production based on official figures

Comparing the current pledged output levels with actual production capacities gives a very different picture of which countries are bearing the biggest burden. The UAE's current pledged level of 2.9m b/d is about a third below its capacity and Saudi Arabia's 9m is a quarter below. By contrast, Oman, Iraq and Kuwait are less than a sixth below their capacities and Bahrain is near to capacity.

The production cuts look likely to have a significant impact on revenue compared with what had been assumed last year when budgets were being developed. The IMF forecast an aggregate general government surplus for the GCC of 3% of GDP this year, with oil at $81 (in line with current trends) but production significantly higher (for example, it assumed 10.6m b/d for Saudi Arabia, compared with the current quota of just 9m). UAE, Oman and Qatar are likely to still post surpluses, but deficits will be several percentage points wider in other states as a result of the production cuts.

KSA pauses expansion while Qatar doubles down

Given supply/demand dynamics and the risk of increasing supply from non-OPEC+ countries, KSA has moderated its ambition to increase production capacity. In February, Saudi Aramco announced that it was suspending various projects, including a 700k b/d planned expansion of the Safaniya oil field. It also stated that it would no longer be targeting a +1m b/d increase in its "maximum sustainable capacity" to 13m b/d. No forecasters had anticipated Saudi Arabia producing close to its existing 12m b/d capacity in the coming years and therefore the change in investment plans will not impact output, but will free up capital to put into other projects, such as gas and renewables. In fact, Aramco recently announced a 15% increase in the proven reserves at the giant Jafurah gas field, which is a significant development.

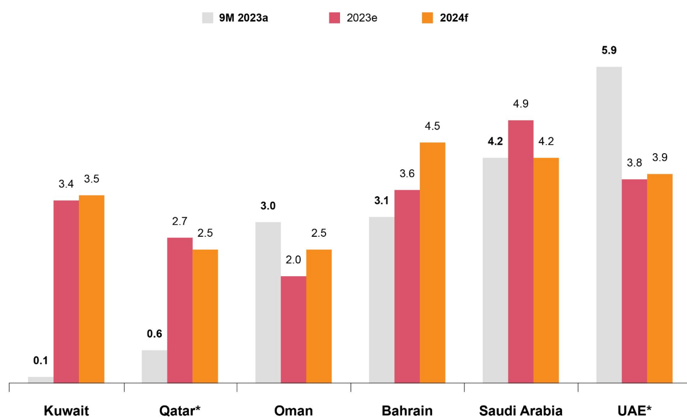
Meanwhile, Qatar made a significant announcement on gas, unveiling plans for North Field West, which will be the third phase of its ongoing LNG expansion. The project, due to be completed by 2030, will add 16m t/yr of LNG, equivalent to a fifth of current output, along with valuable byproducts such as condensates and LPG. This adds to the North Field East and South phases, which are due to add 48m t/yr during 2026-27. The expansion followed exploratory work that further extended the confirmed reserves of North Field, the world's largest gas field, and recent progress in signing long-term contracts, mainly with 27-year durations, for half of the gas from the existing expansion phases.

Non-oil growth looks robust
The region continues to focus on the next phase of diversification and development, driven by government investment and reforms to attract private investments. The picture is mixed, but overall non-oil trends look robust. The IMF's October 2023 forecasts see non-oil growth averaging 3.9% in the GCC this year, only slightly down from its estimate of 4.2% for 2023.

The available part-year outturn data for 2023 shows several states surpassing the IMF's estimates, notably the UAE, which clocked up 5.9% y/y growth in the first half of the year, driven by Abu Dhabi which was also up by 8.6% y/y in the first nine months (the federal level Q3 data is not yet available), while Dubai's diversified boom is continuing. Given this, it is no surprise that the UAE's PMI hit a four-year high of 57.7 in October. It has cooled a little since then to 56.6 in January, but this still indicates strong non-oil expansion, as does the 55.4 reading in Saudi Arabia.

Conversely, Kuwait and Qatar are not currently achieving the IMF's estimates for growth, largely because of slower growth in the manufacturing and construction sectors. This has also been reflected in Qatar's PMI, which has trended down to the breakeven level of 50.

Non-oil real GDP growth (% change y/y)



Source: National sources, IMF; *UAE and Qatar are only H1-24

Trade corridors

The Red Sea crisis highlights need for alternative transport routes
The attacks on shipping vessels in the Red Sea are a stark reminder of both the importance and the volatility of some of the trade routes in the region. Around 15% of global trade, worth over $1trn, including about 8m b/d of oil, previously passed through the Bab al-Mandab strait. Now most of that trade has been rerouted around Africa, adding about two weeks and significant costs. This includes much of the trade between the GCC and Europe.

The current Red Sea crisis has reduced Egypt's vital revenue from the Suez Canal by more than half at a time when it has been facing severe external financing challenges (although these eased after it secured investment from the UAE and additional IMF loans).

Aside from the Red Sea, there are other significant bottlenecks around the Arabian Peninsula including the Strait of Hormuz, which most of the region's hydrocarbon exports have to pass through, and the Suez Canal, which was obstructed when the EverGiven container ship ran aground in 2021.

New routes proposed
The risks, duration and costs of the existing maritime route have resulted in several proposals for alternatives. The two major ones proposed in recent years are the India-Middle East-Europe Economic Corridor (IMEC) and Iraq's Development Road. Both have challenges and advantages.

The plan for IMEC was announced at the G20 in Delhi in September 2023, signed by the US, EU, India, Saudi Arabia and the UAE. The formal document was light on details, including the precise rail route, which is assumed to run from Dubai to Haifa. It added a new component, a green hydrogen pipeline (potentially fed from facilities being developed at NEOM in Saudi Arabia, in the UAE and possibly Oman) and electrical and fibre optic cables along the route. Longstanding challenges with proposals for gas pipelines to both Europe and India suggest this could be difficult to commercialise. The overland portion would build on Saudi Arabia's existing North-South railway and plans to connect the Saudi network to the UAE's Etihad Rail. This leaves only a relatively short 300km route from al-Haditha to Haifa to build, which would only be possible in an integrated region.

Iraq's Development Road stems from the idea of a Berlin to Basra railroad, conceived at the dawn of the 20th century but never fully implemented because of the world wars. The 21st-century concept has its roots in the development of Iraq's Grand Faw Port, which is being built by Korea's Daewoo. The idea was floated in 2022 as the UAE and Turkey were negotiating a trade agreement and was expanded further at a conference in Basra in December 2022, under the earlier name of the "Dry Canal". The official project announcement came in May 2023 with an estimated cost of $17bn, for a corridor across Iraq with road, rail, pipelines and fibre optics, and a target completion date of 2029. It has been framed as a core element of economic diversification for Iraq, akin to Saudi Arabia's Vision 2030 giga projects.

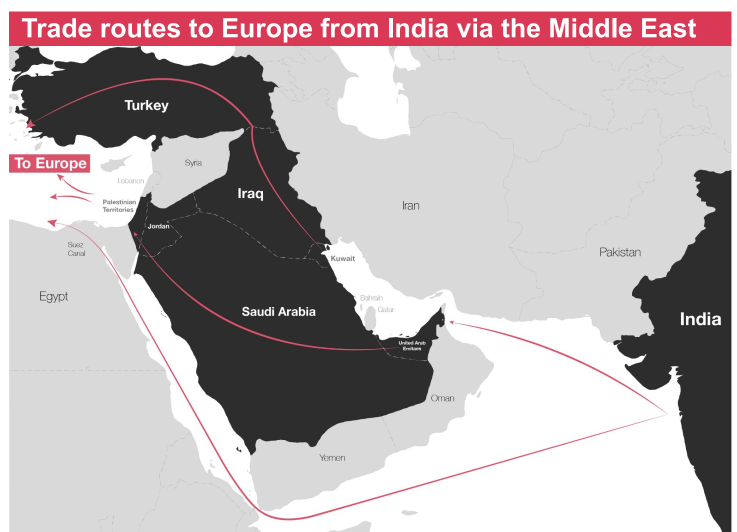
The future of trade
As trade flows within and through the Middle East continue to increase, the impetus is to develop quicker, cheaper, greener and more secure trade corridors.

Progress on either initiative is unlikely until there is a political breakthrough on the ongoing Gaza conflict, something which may also be required to end the Red Sea disruptions. As trade continues to grow, there could be scope for both of these routes to develop and also for an expansion in the Suez Canal, with Egypt currently conducting a feasibility study to convert the single-lane sections into double lanes capable of hosting ships moving in both directions.

Meanwhile, there is scope to develop the eastward section of the trade route from the Gulf. IMEC has been seen in part as a challenge to China's Belt and Road Initiative (BRI). However, Chinese trade with the region and Europe would also benefit from it, or from the Development Road, particularly as China completes its trade corridor through Pakistan. China is a major trade partner directly with most Middle Eastern countries, and they are already involved in the BRI in various ways, including through participation in the Asian Infrastructure Investment Bank, a major source of capital for the BRI.

Concurrently, the region's trade with India continues to expand. The UAE signed a free-trade agreement in 2022, while Oman is reported to be on the cusp of agreeing one. As well as these regulatory measures to facilitate trade, there is also cross-border investment and agreement on trade infrastructure, including Abu Dhabi Ports signing MoUs in February with Gujarat Maritime Board and Indian transport company RITES, and DP World signing MoUs in January to develop new container terminals in the India state.

Trade routes to Europe from India via the Middle East



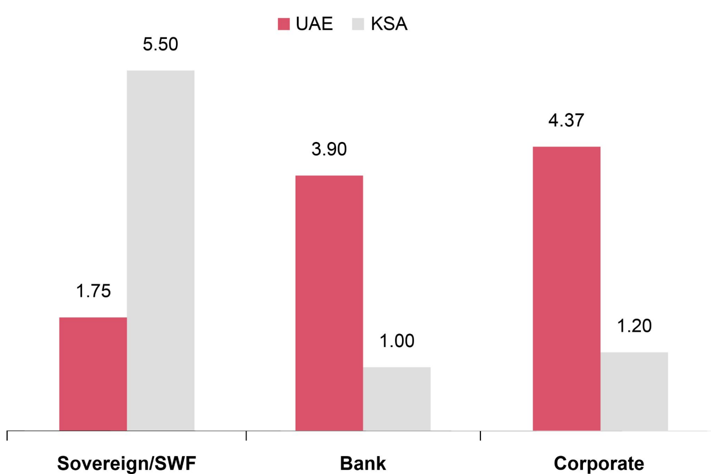
Source: Middle East Eye

Green financing gathers pace

At the start of 2023, we identified green financing as one of the key economic themes to watch during the year. The sector did indeed build momentum, including a more than doubling in the issuance of green bonds and sukuk in the Middle East to $24bn, the majority coming from the UAE and Saudi Arabia (see graph).

The issuance spanned a wide range of entities including banks (Dubai Islamic Bank, Abu Dhabi Commercial Bank, Al Rajhi), corporates (Saudi Electricity Company, DP World, Masdar, RAQA, Aldar), sovereign wealth funds (Mubadala and PIF) and the GCC's first sovereign sustainable bond from Sharjah. There was a broader range of issuers in the UAE, but Saudi Arabia is catching up.

Green bonds and sukuk in GCC in 2023 ($bn)



Source: market and media reports

The most notable regional issuance was Egypt's Green Panda Bond, the first from the region issued in China, which raised RMB3.5bn (US$479m) to finance public transit projects. In another first, this bond received a partial guarantee from the Asian Infrastructure Investment Bank, helping to reduce the cost of borrowing after Egypt complained that its debut green bond in 2020 was more expensive than a conventional one. This raises questions about whether green debt offers a cheaper financing option. Masdar's CEO stated in September that he is "not convinced that people are paying that greenium right now". Despite this, the UAE renewables firm still plans to issue a second green bond next year. Elsewhere, Jordan Kuwait Bank issued Jordan's first green bond, which included blended financing through the IFC.

Milestones

A significant development was NEOM's green hydrogen plant achieving its US$8bn financial close, making it the largest-ever green project funded in the region and the first of this type. During the year, significant progress was also made towards other green hydrogen projects in the region, particularly in Oman, and some of them may move into the financing phase during 2024.

There were also important regulatory developments, including Abu Dhabi Global Market issuing its sustainable finance regulatory framework, similar to those released by others such as Qatar Financial Centre. The importance of green financing was highlighted by multilaterals. The IMF published a paper on the topic as part of its UAE Article IV mission, in which it praised the UAE's framework as the most advanced in the region but also noted that there was much to be done including improving disclosure, corporate governance and the taxonomy of eligible green projects to help unlock the estimated $163bn in financing it estimates that the UAE requires. The Arab Monetary Fund and its partners also published a guidance note on sovereign green issuance.

COP28 and beyond

There were some notable outcomes for green financing at COP28. The most substantial one was the announcement of ALTÉRRA, a new climate investment fund to which the UAE has committed $30bn. The fund is located in Abu Dhabi Global Market and aims to mobilise $250bn in private financing by 2030, particularly into emerging markets, including in the Middle East. The fund made substantial initial commitments in partnership with BlackRock, RPG and Brookfield, with plans to roll out more financing during 2024.

The green financing trend in the Middle East is continuing in 2024, with Sharjah issuing its second sustainable bond in February. In addition, Oman published a Sustainable Finance Framework, and Qatar's finance minister said at Davos that its debut green bond would be coming soon.

Saudi Arabia is also thought to be contemplating a sovereign green issuance, on top of the large sums raised by PIF, and it has just launched its Green Financing Framework, which sets out its approach to financing climate commitments. The massive investment underway across the GCC in renewable energy, green hydrogen and other sustainable projects requires substantial amounts of financing, both debt and equity, which suggests that the sector will continue to grow in the coming years.

Data and projections:

	GDP share 2023		Real GDP growth (% y/y)			Inflation (% y/y)			Fiscal bal. (% GDP)	
	PPP	MER	Q3-23*	2023e	2024p	Jan-24*	2023	2024p	2023e*	2024p
Middle East	**100%**	**100%**	**-**	**1.7**	**3.6**	**7.6**	**5.7**	**6.5**	**0.4**	**0.2**
GCC	**59.7%**	**73.1%**	**-**	**1.5**	**3.7**	**2.2**	**2.6**	**2.3**	**2.4**	**3.2**
Saudi Arabia	33.3%	36.8%	-4.4	0.8	4.0	1.6	2.5	2.2	-2.0	0.3
UAE	13.3%	17.5%	3.8	3.4	4.0	3.2	3.1	2.3	5.1	4.4
Qatar	4.9%	8.1%	1.0	2.4	2.2	3.0	2.8	2.3	10.4	10.1
Kuwait	3.8%	5.5%	-3.7	-0.6	3.6	3.3	3.4	3.1	14.0	9.5
Oman	3.0%	3.7%	2.2	1.2	2.7	-0.1	1.1	1.7	2.2	5.9
Bahrain	1.4%	1.5%	2.5	2.7	3.6	0.8	1.0	1.4	-5.1	-3.2
Non-GCC	**40.3%**	**26.9%**	**-**	**2.1**	**3.4**	**22.6**	**14.1**	**17.9**	**-5.0**	**-8.0**
Egypt	26.8%	13.7%	2.7	4.2	3.6	29.8	23.5	32.2	-4.6	-10.7
Iraq	7.6%	8.8%	-	-2.7	2.9	4.0	5.3	3.6	-7.7	-7.8
Jordan	2.5%	1.4%	-	12.5	7.5	1.8	3.4	2.9	6.1	9.3
Lebanon	2.0%	1.7%	2.7	2.6	2.7	2.0	2.7	2.6	-7.0	-6.6
Libya	1.2%	0.8%	-	-	-	177.0	-	-	-	-
Palestinian Territories	0.3%	0.5%	3.0	3.0	2.7	19.0	3.4	2.7	-1.3	-2.2

Sources: PwC analysis, National statistical authorities, IMF estimates and forecasts (WEO, Oct 2023). *Inflation: Nov - Libya, Dec - Iraq, UAE estimated from Dubai; GDP growth: Qatar and UAE Q2; Lebanon GDP shares from 2021; Fiscal: preliminary figures of KSA, Qatar, Oman & Bahrain.
Notes: The Middle East region is defined here based on PwC's business coverage (which excludes non-Arab countries, Syria and Yemen).

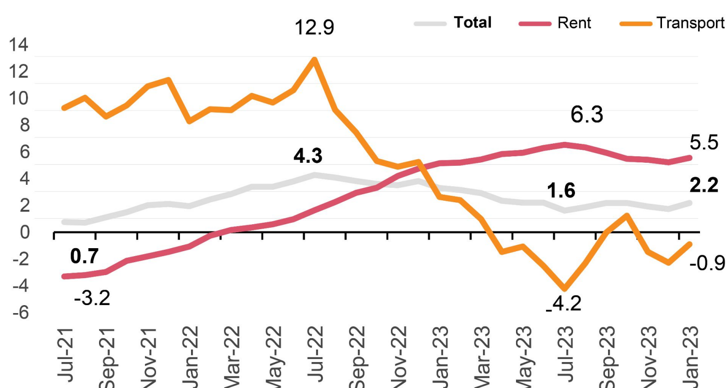
Chart of the quarter: Inflation cools in the GCC

Inflation cooled in the GCC during 2023, with our composite for the region averaging 2.6% and ending the year at 1.7% y/y, down from a post-Covid high of 4.3% in July 2022. (The uptick to 2.2% in January was mainly due to a base effect for Qatar.) Subsidies are one of the reasons why inflation in the GCC did not spike to the same heights seen in some other major economies.

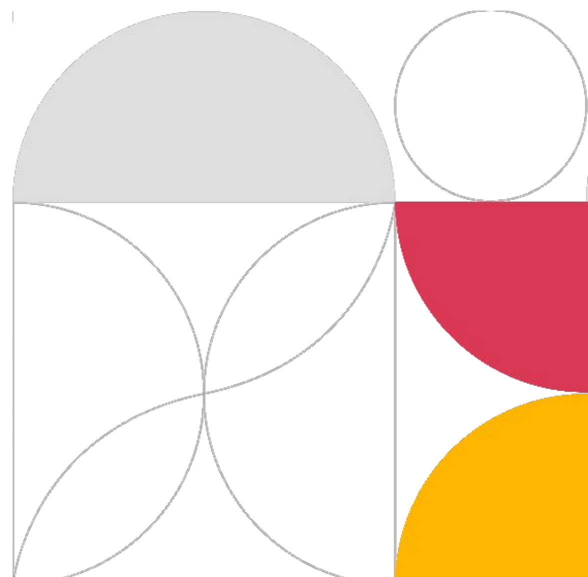
However, the UAE has liberalised fuel prices which indirectly impacted even the countries with fuel subsidies. This caused transport to be a significant contributor to inflation in 2022, but turned deflationary for most of 2023. On the other hand, rents were deflationary in 2021 and weak in 2022, but they have steadily risen in several states over the last year. As of January 2024, rents have increased to 7.8% in Saudi Arabia and 6.2% in Dubai, making them the major driver of inflation in the region. This has partially offset the deflation in transport.

Aside from food, which averaged about 2.5% across the GCC in January, other components are all registering only modest inflation under 2%. Higher interest rates in the region during 2023 may have been a disinflationary factor, dampening demand for local goods and services, combined with the impact of easing global prices on imports.

GCC inflation eases but rents remain high



Source: National sources, PwC analysis; UAE estimated from Dubai components from July 2023; composite series weighed by non-oil GDP.



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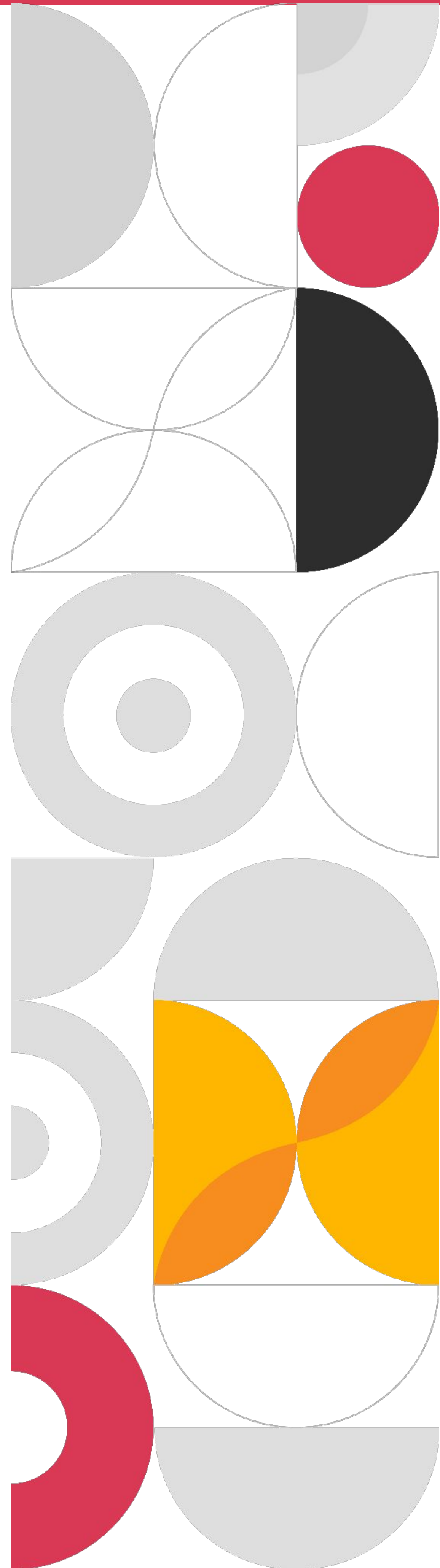

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