July 2021

Middle East Economy Watch

The recovery is building momentum, but weaknesses remain

Over a year since the start of the COVID-19 pandemic, the “return to normal” always seems to be just a few months away, but keeps receding. There is good reason to think that, at least from an economic perspective in the GCC, that destination will soon be reached. Seasonally adjusted Saudi non-oil output hit a new high in Q1 and, although the Kingdom has had to cancel foreign Hajj pilgrims for a second year, residents are now visiting shops more frequently than in February 2020 before the full impact of the pandemic hit our region, according to Google mobility data.

There is no downplaying the pain of 2020, in human terms or economically, which amounted to the worst recession and public health crisis in most people’s lifetimes. The economic impact across our region was even worse than the global average because of the region’s dependence on oil and vulnerable sectors such as tourism. This also means that the recovery will be a little slower than elsewhere. However, leading indicators show that that recovery is already building momentum and IMF forecasts expect the Middle East economy as a whole to have returned to its previous level by mid-2022.

Real estate prices in Dubai, one of the benchmarks of regional confidence, are seeing the most sustained increases since before the oil crash in 2014. And with the postponed Expo coming up in October there is likely to be more to come.

Aside from vaccine rollouts and economic recovery, our region faces other challenges on the horizon. The move towards a global minimum corporate tax regime, driven by wealthy countries seeking to prevent multinationals from shifting profits to tax havens, presents challenges.

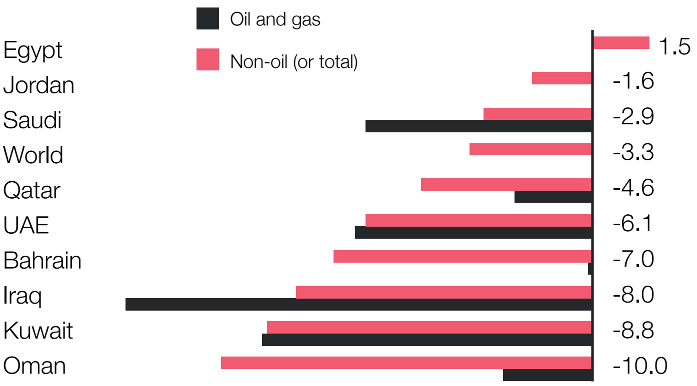
Although the GCC isn’t commonly used as a tax haven, we have traditionally had low-tax or no-tax environments, but if compelled to change in the future then this might dent our competitiveness.

2020 was painful, but the region is recovering relatively well

Sharp recession in 2020

The pandemic caused the worst global recession since the second world war, with an estimated -3.3% real contraction, nearly twice as bad as in 2009. Our region saw even sharper contractions, ranging from -3.7% (Qatar) to -8.9% (Kuwait). This was partly because of sharp cuts in oil production, as OPEC+ implemented the deepest production cuts in history when lockdowns caused demand to drop sharply (oil cuts in Bahrain and Oman were partially offset by higher gas production). However, even the non-oil sectors in oil-producing countries contracted by considerably more than the global average.

Real GDP growth by sector, 2020 (%)



Source: National statistical agencies; IMF estimates for World, Iraq and Oman; Total (non-oil) shown from World, Egypt and Jordan.

The non-oil contractions were especially severe due to the various lockdown measures across our region, and the exposure of certain sectors particularly vulnerable to the impact on movement and consumption. A detailed analysis of two of these vulnerable sectors—travel and tourism and real estate—follows. Another vulnerable sector is retail and wholesale trade, which saw contractions ranging from -7.2% in Bahrain to -13.1% in the UAE. Manufacturing, which is a vital focus of diversification in the region, was also hit by the decline in global demand, with the sector seeing contractions as large as -33% in Kuwait. In addition some states, such as Oman, were forced to intervene and implement austerity measures in response to weaker oil revenue, worsening the recession across some sectors.

By contrast, oil-importing countries in the region fared better, particularly Egypt which even achieved a small growth of 1.5%. However, this was still its slowest growth in 30 years and below its population growth rate of 2.0%.

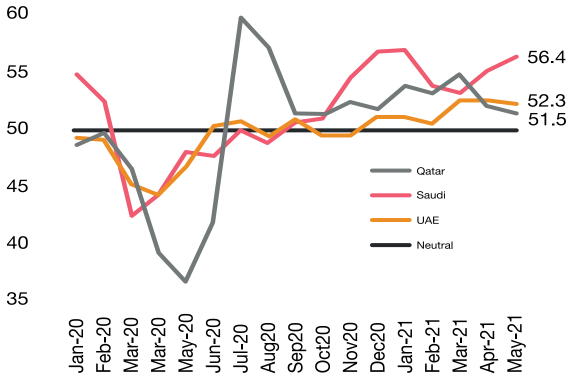
Signs of recovery despite a third COVID-19 wave

The region saw a renewed wave of COVID-19 this spring, which resulted in record rates of both cases and deaths. This happened even in those states—such as the UAE, Bahrain and Qatar—that have been world-leaders in vaccine rollouts.

Even with the new wave, which required temporary reimpositions of travel and movement restrictions, there were signs of solid recoveries underway. Saudi Arabia is the first to publish its Q1 GDP, which showed a very strong 4.9% q/q seasonally adjusted rebound in non-oil GDP, driven by private consumption (6.6%) and sectors such as non-oil manufacturing (13.6%) and transport and communications (8.5%).

A broader picture is visible from leading indicators. The purchasing managers indices in the GCC have all remained in expansion (above 50 points) this year and are higher than they were at the start of 2020.

PMI (% y/y)



Source: IHS Markit

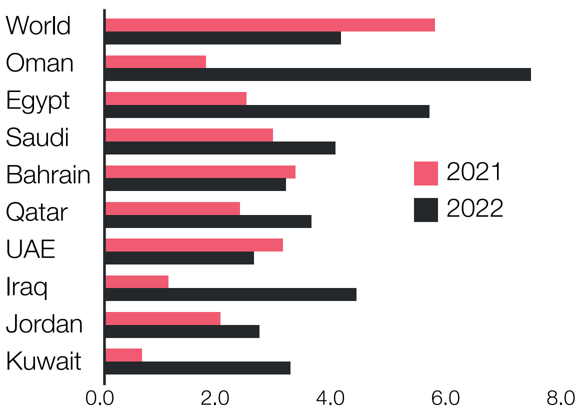
The recovery is visible in a host of other indicators such as point of sales data, showing a recovery in consumption. Google mobility data, which has become a familiar new indicator globally, also points to the recovery. In Saudi Arabia, this data shows that since late May people have been making more frequent visits to retail locations than before the pandemic. The trends suggest that most countries will also reach that threshold within a few months, except perhaps those that are most dependent on tourism, like Bahrain.

The recovery may be slower than the global average

Global recovery is shaping up to be even stronger than anticipated. The IMF sees world GDP rebounding by 5.8% this year, the most in nearly half a century, meaning that it should reach pre-Covid output levels by the autumn.

The IMF forecasts solid recoveries in the region, although at a slower pace than the global average. The IMF forecasts imply aggregate growth of 2.5% in 2021 across 11 countries in our region, not enough to fully offset their -3.2% contraction in 2020. This calculation excludes Libya, which is a special case because its peace process has restarted oil production which should result in GDP more than doubling this year. The region is not expected to return to pre-Covid levels of output until about mid-2022 and some states, such as Iraq and the UAE, won't get there until 2023.

Real GDP growth, 2021-2 (%)



Source: IMF World Economic Outlook, April 2021

The slower regional growth is partly because OPEC+ is only tapering its cuts gradually and so oil sector growth is seen as lagging the non-oil rebound, which the IMF puts at 3.1% regionally. However, since the IMF forecasts were published in April, oil demand has been beating expectations, causing a surge in prices, which is great news fiscally for Middle Eastern oil exporters. It also means that OPEC+ might speed up its tapering to meet demand, which is now expected to return to pre-Covid levels next year. Higher oil revenue usually translates into stronger non-oil growth, and so that too may well exceed the IMF's expectations.

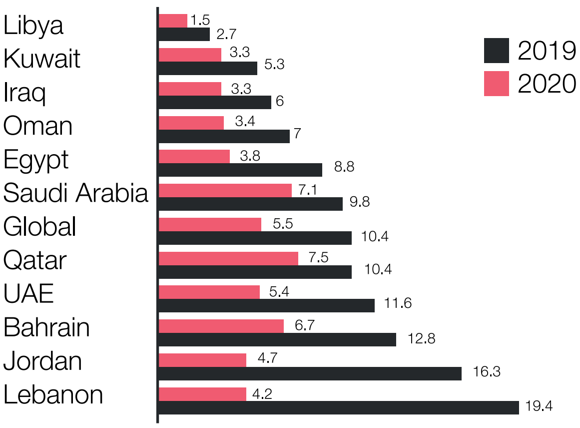
Hard hit sectors like tourism and aviation remain under strain

Impact on travel and tourism varied widely in 2020

The pandemic had a devastating effect on the travel and tourism sector globally by eliminating most international travel and, at least initially, limiting domestic tourism and travel. The World Travel and Tourism Council estimates that the sector's overall contribution to global GDP nearly halved in 2020 to about 5.5%. This is a broad measure that includes both spending by foreign visitors and residents and also the sector's indirect and induced impacts.

The importance of travel and tourism varies dramatically across our region. In countries like Kuwait and Libya, where there are very few foreign visitors and almost all the spending is domestic, the sectors are small so the decline in 2020 was proportionally smaller. In Lebanon, by contrast, the sector generated nearly a fifth of the total GDP in 2019, with 92% of the spending coming from visitors. As a result, GDP contracted by four-fifths when travel bans caused visitor numbers to fall to nearly zero after Q1. Some GCC states, such as Saudi Arabia and Qatar, saw more modest contractions, partly because residents who were unable to travel spent more on local leisure facilities after the initial lockdowns had ended.

Travel and tourism (% GDP contribution)



Source: World Travel and Tourism Council

Slow recovery

The emergence of more transmissible COVID-19 strains resulted in new waves of infection in several key tourism source markets during 2021, such as the UK and India, delaying the recovery of the sector. This was clearest in Dubai which saw a surge in monthly visitors to 1.1m in December 2020, as many as in the previous six months combined, falling back to an average of only 0.4m in January-April 2021.

Saudi Arabia reopened to foreign pilgrims in November 2020 and, until recently, a pilgrimage recovery looked likely by mid-2021. However, as the pandemic continues, a decision was made in June to limit the Hajj to just a small number of residents for a second year running. This is a significant blow to the economy in the Hejaz region, although some of the lost ground can be regained later in the year through a pickup in Umrah pilgrimages. The pandemic hit when the Kingdom was also beginning to develop its broader tourism sector, issuing the first tourism visa in late 2019 and investing heavily in new accommodation, leisure and cultural facilities in places such as AlUla. These investments should still bear fruit in the medium term.

Aside from tourism, the GCC, particularly the UAE and Qatar which have become major travel hubs, were hit hard by the collapse in global aviation. Emirates is the first major airline to publish results for its 2020/21 fiscal year which showed a -88% y/y decline in passenger numbers, resulting in a $5.5bn loss — its first in 33 years. However, it expects to have reopened 90% of its pre-COVID network by the end of July. Qatar Airways retained the largest network of any airline during the pandemic, only reducing its weekly flight numbers by just over a half, albeit at lower capacities. It soon expects to be operating more flights and routes than before the pandemic.

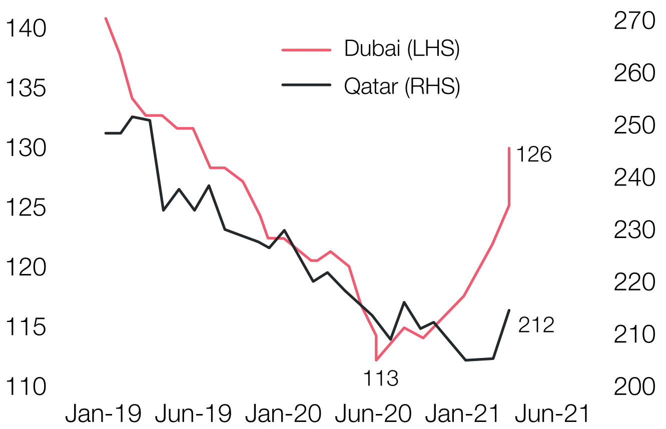
Signs of real estate recovery in some states

Real estate in the Middle East, particularly in the GCC, is extremely cyclical because of the trends in expat population growth and pulses of building that tends to result in an overshoot in supply. These pulses have historically been driven by oil prices, with busts in 2009 and again, more gradually, since 2016.

The pandemic compounded oversupply with weaker demand, as expats left the region because of redundancies or health concerns. Most of the GCC has infrequent population data, with just Oman publishing monthly data on the expat population, which showed a -8.3% y/y decline in May 2021. Lockdowns also made the process of trading property more difficult. Qatar's total population series showed a record decline of -4.3% y/y in May—meaning the decline in expats, 85% of the population, will have been even higher.

Dubai and Qatar, as examples, both saw peaks in their property markets in 2015 and have since been in decline. However, Dubai has been posting a steady rebound this year, its first period of sustained growth in seven years, reaching the highest levels since 2019 in May. Qatar saw an uptick in March but data is not yet available for Q2, although there are anecdotal indications of improvement. Both states have major events coming up that could boost real estate – Expo in Dubai and the World Cup a year later in Qatar. Listed real estate developers are seeing a strong recovery in their share prices. Emaar Properties, for example, had nearly doubled by mid-June from its March 2020 low when HSBC announced a buy recommendation on the stock, in the expectation of a sustained upswing in real estate. In Qatar, Ezdan Real Estate's stock has tripled from its low and is trading at levels not seen for five years.

Property price indices (100=July 2008)



Source: PropertyMonitor.ae and Qatar Central Bank

In Saudi Arabia, real estate was one of the strongest sectors in Q1 2021, posting a seasonally adjusted growth of 5.1% q/q. There is still considerable pent-up demand for housing for Saudi nationals which will continue to support the sector. It is a similar story in Kuwait, where in May the cabinet approved a draft law for residential mortgages, which should provide a significant boost.

Data and projections: June 2021

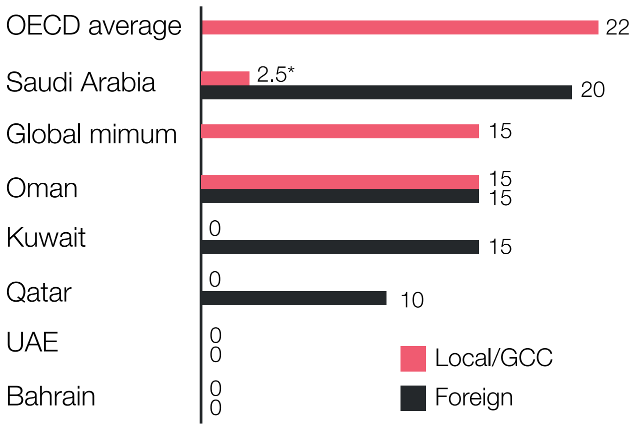
	GDP share (2020)		Real GDP growth (% y/y)			Inflation (% y/y)			Fiscal bal. (% GDP)	
	PPP	MER	Q1-21	2020	2021p	Apr-21	2020	2021p	2020	2021p
Middle East	**100%**	**100%**	**-**	**-3.8**	**3.9**	**4.1**	**2.8**	**3.8**	**-6.2**	**-11.0**
GCC	**60.4%**	**69.0%**	**-**	**-3.7**	**2.7**	**2.5**	**1.0**	**2.7**	-5.0	**-9.4**
Saudi Arabia	33.3%	34.4%	-3.0	-4.1	2.9	5.3	3.4	2.7	-11.1	-3.8
UAE	13.3%	17.4%	-	-6.2	3.1	-2.0	-2.1	2.9	-7.4	-1.3
Qatar	5.4%	7.2%	-	-3.7	2.4	1.0	-2.7	2.4	-2.1	1.4
Kuwait	4.2%	5.3%	-	-8.9	0.7	3.1	2.1	2.3	-9.4	-6.8
Oman	2.7%	3.1%	-	-6.4	1.8	1.6	-0.9	3.8	-17.5	-4.4
Bahrain	1.5%	1.7%	-	-5.8	3.3	-2.0	-2.3	1.5	**-13.1**	-9.1
Non-GCC	**39.6%**	**31.0%**	**-**	**-4.1**	**6.5**	**7.8**	**6.9**	**6.1**	**-14.6**	**-7.4**
Egypt	26.4%	17.8%	2.9	3.6	2.5	4.1	5.7	4.8	-9.0	-7.3
Iraq	8.2%	8.4%	-	-10.9	1.1	5.5	0.6	9.4	-17.5	-9.2
Jordan	2.2%	2.1%	-	-2.0	2.0	3.1	0.4	2.3	-7.0	-7.7
Lebanon	1.6%	0.9%	-	-25.0	-	122.0	88.2	-	-16.5	-
Libya	0.8%	1.1%	-	-59.7	131.0	2.8	22.3	18.2	-103.9	0.3
Palest. Terr.	0.5%	0.7%	-	-11.0	5.7	1.3	-0.7	0.3	-7.7	-7.5

Sources: PwC analysis, National statistical authorities, IMF estimates and forecasts (WEO, April 2021). *Older inflation series: Mar: Bahrain, Feb: UAE, Dec: Libya.
Notes: The Middle East region is defined here by PwC's business coverage (which excludes non-Arab countries, Syria and Yemen).

Chart of the quarter

Efforts by the OECD's BEPS working group to reform global corporate tax policy, to discourage avoidance, finally seem to be making progress. The G7 has backed a global minimum rate of 15% on the largest 100 multinationals, permitting home countries to make up any shortfalls. The G20, which includes Saudi Arabia, is expected to endorse a modified version of this proposal.
This could have implications for the GCC states, which have among the lowest corporate tax rates globally. UAE, Bahrain and Qatar tax foreign companies at below the proposed global minimum and only Oman taxes local companies at this rate. In addition, the GCC has tax-free zones and sometimes offers tax holidays (as Saudi Arabia has recently done for multinationals relocating their regional hubs). The impact of new rules on the GCC will depend very much on the details agreed. If they remain limited to the largest multinationals, few changes may be needed (Aramco is on this list, but the oil sector may be excluded). If the scope is broader, including covering untaxed payments from subsidiaries to parents in the GCC, then rates may have to rise. That could fit with efforts to boost non-oil revenue but would reduce one key aspect of the GCC's competitiveness at a time when the region is trying to attract investment to help with diversification.

Non-oil corporate tax rate, by company type (%)



Source: Tax Foundation, OECD; *Zakat not income tax

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