October 2019

Middle East Economy Watch

Investment reforms and 2020 events offer growth prospects for the GCC

The attacks on Saudi oil facilities took place as this report was going to press - we continue to monitor the situation and any wider implications closely. Prior to this incident, 2019 had been a relatively slow year economically for the Middle East. This was partly a result of muted oil prices (which were hovering around $60 in mid-September) and continued limits on oil production, requiring fiscal restraint in several countries. In addition, various cyclical factors and a supply overhand in the real estate sector have contributed to continued deflation in much of the region. Real growth rates in Q1 2019, where they are available, have been broadly in line with 2018 performance, showing about 2% growth in the GCC and slightly higher in the rest of MENA.

However, looking beyond the current indicators, significant groundwork is being laid down in markets and legislation that should drive future growth. In this issue, we have focused on the key changes that have been underway in the landscape for foreign investment and public-private partnerships (PPP). There is a broad trend of reforms across the region, in both the oil exporting and importing countries, to modernise legislation and enhance the business environment.

We also look at the growing interest in the Gulf by emerging market equity and bond investors, made possible by capital market reforms. Inflows of portfolio investment should increase the scope of financing for both the public and private sectors. This should help the region grow and develop despite turbulence in the oil market.

As we look ahead, it is notable that the region will be hosting two major global events in 2020: the Expo in Dubai and the G20 summit in Saudi Arabia. Expo is expected to have a significant economic impact for Dubai, and we forecast that it is likely to result in it becoming the second most visited city in the world in 2020 (see article below). The challenge will be to ensure the temporary uptick in activity driven by the event can be translated into longer term growth. There is good reason to think that Dubai will be able to do this.

Although the G20 is a much smaller scale event, and will have little direct economic impact, it will play a similar role in terms of profile, showcasing some of the social and economic reform changes that have been underway in recent years, and potentially catalysing future investment.

Expo and G20 will attract global focus on the Gulf

Next year, the GCC region will be in focus because of several major global events, including Expo in Dubai, which opens on 20 October 2020 and runs for nearly six months, and the G20 summit in Riyadh on 21-22 November 2020. In different ways, the two events will showcase the region's economic development and potential and could contribute to ongoing efforts to attract investments and diversify economies. The GCC's location in a geopolitically sensitive region means it is often in the news, but these events could allow it to present a different side to key audiences.

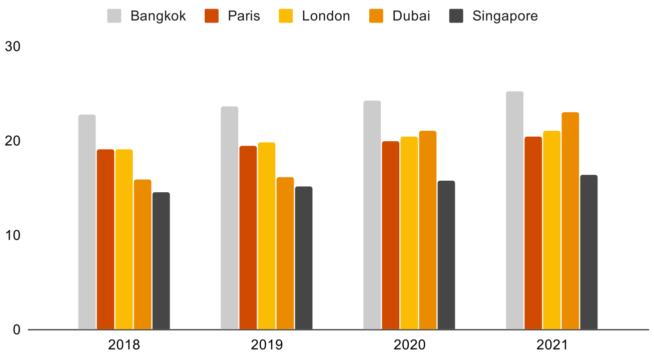
Expo will make Dubai the second most-visited global city

The Expo in Dubai will be the first time that the Middle East region has hosted a World Expo, part of a series of exhibitions showcasing national cultures and human progress that began back in 1851 and are now scheduled every five years. Ongoing preparations include the government's spending on infrastructure for the Expo site itself and private sector investments to expand accommodation capacity. This has been providing a boost to the construction sector, although about 80% of the work has already been completed.

During the event itself, the economic impact will come largely from spending by the influx of visitors. Dubai already hosted 15.9m tourists in 2018, making it the fourth most-visited city globally according to Mastercard's Destination Cities Index. We forecast that the surge of visitors for Expo should result in it advancing to become the second most-visited city during 2020-21, reaching 23 million visitors in 2021.

This is based on official forecasts for about 11m additional tourists coming for Expo, which we assume are distributed evenly across the six months of the event, and underlying growth trends for the remainder of each year. If numbers exceed expectations, or if tourism growth is slower in Bangkok, which currently is the most-visited, then Dubai might even move into first place.

International visitors (million)



Source: Mastercard, Dubai Tourism, PwC forecasts

Long-term impacts

The key challenge for Dubai will be to convert the enthusiasm generated by Expo into longer-term gains. There will be an inevitable lull after the event, as visitor numbers decrease and tens of thousands of temporary expatriate staff hired for the event depart. However, the investment in the Expo site will continue to have an impact as it converts into a mixed-used development anchored by the Dubai Exhibition Centre, which will continue to host major events and is forecast to attract 1.1m foreign visitors a year.

The hope is that many of the newcomers who attend Expo will like what they see and become regular visitors to Dubai. Its central hub location on intercontinental transit routes, and the very high satisfaction results found in the Dubai International Visitors Survey, support that outcome. Dubai's economic model also harnesses tourists as investors, particularly in real estate, and most Expo visitors are expected to be relatively affluent and in turn, potential investors who might be attracted by the current cyclical downturn in real estate prices, resulting from significant new supply.

Saudi Arabia will help frame the G20 agenda

When the annual G20 meeting arrives in Riyadh in November 2020, it will be the first time the Middle East has hosted such a large gathering of global leaders. While Expo focuses on global culture and technology, the G20 is the leading forum for global economic policy. Its membership includes countries accounting for 90% of the world's GDP and two-thirds of global population. It was founded in 1999 in an effort to expand the G7 club of large developed economies to include broader representation by adding 12 other large economies and the European Union. Saudi Arabia has an important role as the only Arab state and the only OPEC member in the group. Since the global financial crisis in 2008, the G20 has taken over the baton from the G7 as the most important annual gathering.

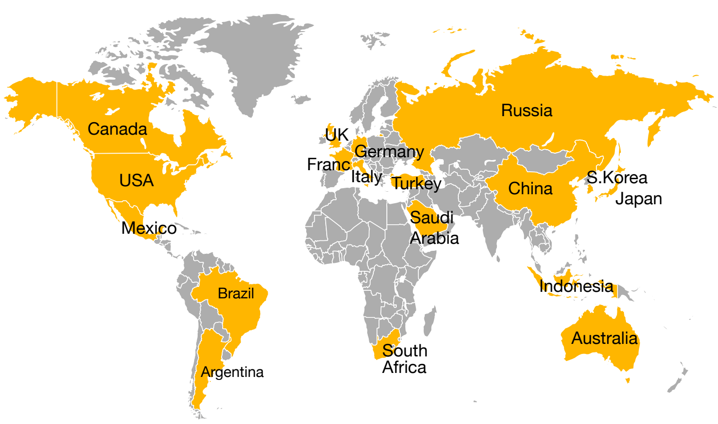
In hosting the 15th G20 summit, Saudi Arabia will be able to frame some of the topics discussed by the world leaders and work to mediate agreements, and its secretariat is currently preparing an agenda. This will also be shaped by whatever key economic and political events are underway at the time, which are difficult to predict. However, we can expect that trade and climate change, both issues on which Saudi Arabia has an important perspective, will continue to be prominent. The summit will also happen two weeks after the US presidential election, the result of which could have a significant impact on the G20 discussions. In any case, Donald Trump, a close ally of Saudi Arabia, will represent the US at the G20, as the US presidential inauguration won't take place until January 2021.

The summit will highlight Vision 2030 developments

The summit could also be happening at a time when OPEC and its partners (including G20 member Russia) may be debating whether to extend oil production cuts into 2021. In June, the Russian president and the Saudi crown prince met on the sidelines of this year's G20 in Japan, agreeing to continue oil cooperation, and a few days later the OPEC+ group formally agreed to extend cuts to March 2020. Many oil sector analysts expect that they will be extended for a further nine month period to end-2020, depending on trends in the global economy and oil market, in which case a decision to end the cuts, after four years, or continue in some form into 2021 could be pending when the G20 meets in Riyadh.

Aside from the core discussion, the summit will also provide a spotlight on Saudi Arabia itself. It comes as the Kingdom nears the end of its National Transformation Program, the first medium-term plan to set quantitative and ambitious goals for economic reform and diversification, as part of the broader Vision 2030. Significantly, it will also be happening around the time that Saudi officials have indicated the Aramco IPO is likely to take place and also when the first phase of NEOM city should be complete. Two key elements of the Kingdom's broader diversification strategy. The attention resulting from the G20 could be harnessed to attract interest in both portfolio and direct investment in Saudi, which will be vital if it is to achieve its objectives.

G20 Members



Note: The European Union is also a member

Foreign and private investment drive picks up pace

Oman's legal trio

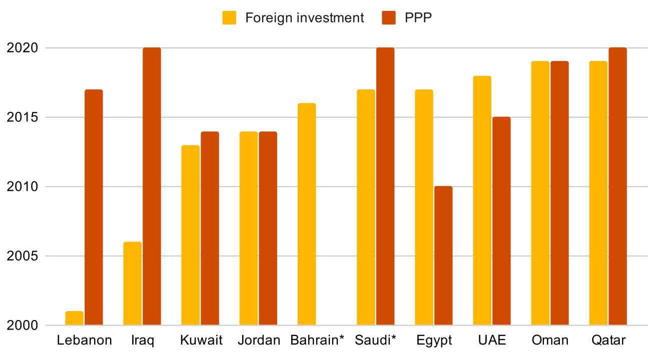
In July, Oman passed three critical laws in quick succession, covering foreign direct investment, privatisation and public-private partnerships (PPP). The laws had been in development for several years, and together comprise a central component of the country's strategy to mitigate its fiscal deficit and diversify the economy.

The privatisation law will facilitate asset sales, following on from the ongoing divestment of stakes in two electricity distribution firms, which were auctioned in March, and the sale of a 10% stake in the Khazzan gas field last year. Additional sales will help finance the structure budget deficit, alongside debt (such as the tightly priced $3bn bond in July), during a transitional period when the country implements fiscal reforms and seeks to encourage non-oil growth. The PPP law will also help in this by shifting some capital expenditure from the budget to the private sector, such as the development of infrastructure for Khazaen Economic City. Finally, the new foreign investment law is part of efforts to create a more robust business environment to support growth, alongside other efforts such as a pending bankruptcy law.

PPP - a regional trend

Oman stands out as the latest country to update these key laws, and for doing all three at once. However, it is following in the footsteps of a trend that has been underway in the region and has picked up pace considerably in the past few years.

New investment and PPP laws (year of enactment)



Source: PwC analysis; *Amended investment laws/regulations

We last focused on foreign investment in the June 2018 MEEW which mentioned that as well as Oman, there were also pending laws in the UAE and Qatar. Both have now passed and are significant steps for both countries who previously had substantial limitations, particularly on 100% foreign ownership. In the UAE, the new law has already enabled US confectionary giant Mars to buy full ownership of its local subsidiary, and we expect other multinationals to follow suit. Bahrain and Saudi Arabia have expanded the scope of their existing laws in recent years, while Egypt passed a law back in 2017.

Harnessing the private sector

Increased scope for participation and improved protections make it more likely that foreign investors might participate in PPP projects, which are also being facilitated by a raft of dedicated laws. Egypt, Jordan and Kuwait started the trend, with PPP laws since being passed in Dubai and Lebanon and expected by 2020 in Saudi Arabia, Qatar and Iraq. A combination of tighter budgets with ambitious infrastructure development plans has driven the regional shift towards PPP.

There are already a very wide range of PPP projects out to tender, moving well beyond the power sector where the model has already become the region's standard method for procurement. These range from hospital radiology in Saudi Arabia to a labour city in Kuwait. Some very large projects are planned in the next few years such as the Khaldeh-Nahr Ibrahim Expressway in Lebanon, the King Hamad Causeway between Bahrain and Saudi Arabia, and multiple transport projects such as the Mecca Metro and the Saudi Landbridge railway. The financing costs for all of the planned PPPs will be many tens of billions of dollars.

Privatisation push

The pending Private Sector Participation law in Saudi Arabia will cover both PPP and privatisation, which is overseen by the National Centre for Privatisation. There has been some slippage in the ambitious timeframes for privatisation mapped out when oil prices were near their bottom in 2016, because of complexity and perhaps a reduced sense of urgency. Nonetheless, good progress is being made and bidders were recently qualified for the flour mills privatisation, with bids due in January 2020. The biggest planned offering is of course the IPO of a small stake in Aramco, intended to raise up to $100bn, which has regained momentum over the summer. Meanwhile, 50% of Boursa Kuwait was sold privately in February and most of the remaining public stake is due to be IPOed in Q4 2019. Egypt is also planning to IPO several public firms in the final months of the year and the recent formation of the Egypt Fund, its first sovereign wealth fund, is expected to provide an impetus for further public divestments.

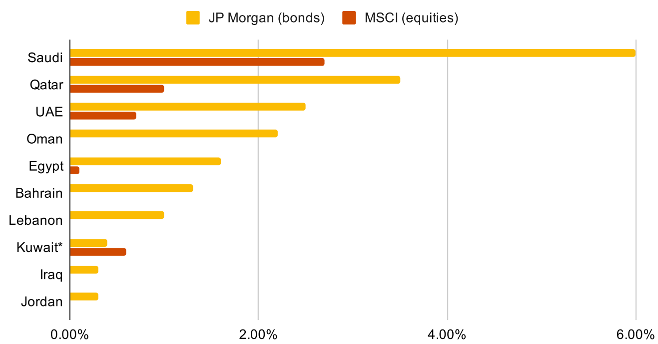
Gulf weights increase in emerging market indices

Gulf states have also been making progress in attracting portfolio investments. This year has seen two landmark developments. Firstly, the other five Gulf states joined Oman (and other Middle Eastern states) as members of the JP Morgan Emerging Markets Bond Index Global, a process completed in September. This is the benchmark used by bond investors and, following a raft of FX debt issuance, including $22bn in the year to August 2019 and $105bn in 2016-18, the region's weighting has reached over 19%, more than double that of China.

Meanwhile, this year Saudi Arabia joined the equivalent benchmark for equities, the MSCI Emerging Market Index, following the UAE and Qatar, both of which entered in 2014. Kuwait is expected to join the index in 2020. Collectively the four GCC states will comprise about 5% of the index. Egypt is already a member, but with a very small weighting (0.1%), and it is unlikely that any more Middle Eastern countries will be added to either index in the near term, largely because of their smaller sizes. The GCC upgrades are partly due to their size, but also because of deliberate reforms that have improved liquidity, settlement and clearance processes and enhanced the rights of investors.

Inclusion in benchmark indices has been driving an influx of foreign capital into the region, boosting prices and improving liquidity. This will help states finance their deficits and also help companies secure financing, both on equity markets and through bonds, which can be better priced relative to their sovereign's yield curve. For more see our quarterly GCC Capital Markets Watch.

Weights in major emerging market indices (%)



Source: JP Morgan, MSCI; *Kuwait's MSCI weight is for 2020

Data and projections: September 2019

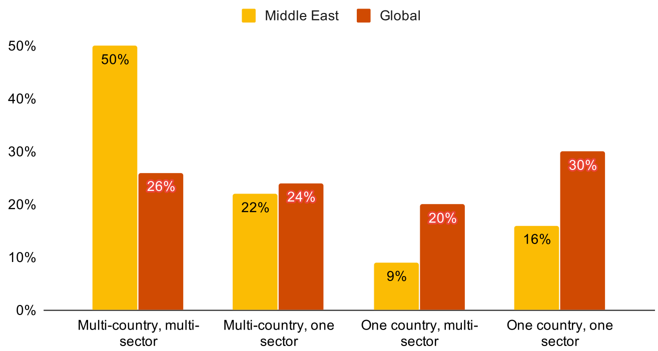
	GDP share (2018)		Real GDP growth (% y/y)			Inflation (% y/y)			Fiscal bal. (% GDP)	
	PPP	MER	Q1-19	2018	2019p	Jul-19	2018	2019p	2018	2019p
Middle East	**100%**	**100%**	**-**	**2.3**	**2.6**	**0.1**	**3.6**	**2.6**	**-2.7**	**-4.3**
GCC	**61.0%**	**72.5%**	**-**	**2.0**	**2.2**	**-1.0**	**2.1**	**0.6**	**-2.8**	**-3.1**
Saudi Arabia	32.2%	34.1%	1.7	2.4	1.8	-1.3	2.5	-0.7	-5.9	-7.9
UAE	12.6%	18.5%	2.2	1.7	2.8	-1.5	3.1	2.1	-1.8	-0.8
Qatar	6.2%	8.4%	0.9	1.4	2.6	-0.6	0.2	0.1	1.8	6.1
Kuwait	5.3%	6.2%	2.6	1.2	2.5	1.2	0.6	2.5	11.4	9.5
Oman	3.4%	3.6%	-	2.4	1.1	0.3	0.9	1.5	-8.7	-9.9
Bahrain	1.3%	1.7%	2.7	2.5	1.8	-0.4	2.1	3.3	-11.7	-8.4
Non-GCC	**39.0%**	**27.5%**	**-**	**3.0**	**3.8**	**2.8**	**7.3**	**7.8**	**-2.6**	**-7.6**
Egypt	22.5%	10.9%	5.6	5.3	5.5	8.7	14.4	14.5	-9.5	-8.6
Iraq	11.7%	9.9%	-	0.6	2.8	-0.8	0.4	2.0	6.2	-5.2
Jordan	1.6%	1.8%	2.0	1.9	2.2	0.2	4.5	2.0	-2.4	-4.0
Lebanon	1.6%	2.5%	-	0.2	1.3	1.5	6.1	2.0	-11.2	-11.7
Libya	1.3%	1.9%	-	7.4	4.3	-7.1	9.3	15.0	3.9	-10.9
Palest. Terr.	0.4%	0.6%	3.8	0.8	1.4	1.5	-0.2	1.5	-8.3	-10.4

Sources: PwC analysis, National statistical authorities and IMF (WEO, April 2019). *Older inflation series: June (Libya), May (Iraq).
Notes: The Middle East region is defined here based on PwC's business coverage (which excludes non-Arab countries, Syria and Yemen).

Oman's legal trio

Family businesses are the core of the private sector economy in the Middle East. Our 2019 global survey of family businesses highlighted some significant differences in the composition and outlook of firms in the Middle East. For one thing, they are unusually diversified compared with peers elsewhere, with 72% spanning multiple countries and 59% in multiple sectors. They are also more forward looking in their planning. 84% plan to bring expertise from outside the family to boost management (compared with only 53% globally) and more are open to M&A (34% vs 24%) and changing their business model (34% vs 20%). This willingness to adapt should help ensure that they continue to flourish in a world of rapidly changing technology and shifting economic power. However, in the short term they slightly underperformed, with a net of 34% reporting growth in 2018 vs 64% in 2016 and 60% of family firms globally in 2018.

Family business diversification (% share)



Source: PwC Family Business Survey 2019

Contact Details

Hani Ashkar
Middle East Senior Partner
E: hani.ashkar@pwc.com

Stephen Anderson
Middle East Clients & Markets Leader
E: stephen.x.anderson@pwc.com

Richard Boxshall
Middle East Senior Economist
E: boxshall.richard@pwc.com

We partner with our region's governments and businesses, to help solve the region's most important problems and build trust in our society. We are investing in the very best talent, over 5,600 people, providing an unparalleled range of expert capabilities from Strategy, through Advisory and Consulting to Tax and Assurance Services, underpinned by the standout digital platform in the region.