Beyond oil

KHATIJA HAQUE ASSESSES THE 2012 ECONOMIC OUTLOOK FOR THE GCC.

The GCC emerged relatively unscathed from the global and regional turmoil in 2011, at least from a macroeconomic perspective. Growth is likely to have reached 7% on average for the bloc, and inflation is low thanks to a strong dollar and a weak housing market in several of the Gulf states. The GCC fiscal surplus rose to an estimated 11% of GDP last year, up from 6% of GDP in 2010, despite substantially higher public spending.

The main reason for this enviable state of affairs is oil. Oil prices were almost 40% higher than in 2010 while oil production rose 10% year on year. However, such a boost to growth is unlikely to be repeated in 2012: global growth forecasts have been downgraded, suggesting weaker demand for oil; output from Libya is likely to rise sharply as the country recovers from its civil war; and oil exports from Iraq are also likely to rise as its production capacity improves.

NEGATIVE IMPACTS Non-oil sectors are likely to be affected by slow global growth and the consequences of the euro zone debt crisis. Of the larger Gulf economies, the UAE is probably more exposed to global developments than Saudi Arabia and Qatar because of its openness, diversified economy, relatively high debt levels and reliance on global capital markets for financing. Almost 10% of the UAE's GDP comes from transport, storage and communication, compared with 4% in Saudi Arabia and Qatar, so lower global trade volumes will hit UAE growth in 2012. Given the importance of non-oil trade between the UAE and Asia, a sharp slowdown in China and India would be particularly worrying.

GLOBAL CAPITAL MARKETS The UAE's reliance on global capital markets and European banks for financing, and the high level of public sector debt maturing in 2012, also make it more vulnerable to tighter global liquidity conditions than, say, Saudi Arabia, which has no public sector external debt. The IMF estimates that $30bn of UAE public sector debt will mature next year, at a time when European banks are less willing or able to extend credit because of issues within the euro zone. Consequently, public sector domestic borrowing is likely to remain high, continuing to crowd out the private sector and potentially constraining non-oil growth. To the extent that the maturing external debt is paid down, this deleveraging could also prove a headwind to growth in 2012.

The GCC

The Gulf Cooperation Council, or GCC, is a political and economic union of the Arab states bordering the Persian Gulf. Formed in 1981, it currently consists of its founding members: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE.

It is, however, not all bad news. GCC governments are in a much stronger financial position than their Western counterparts. Substantial accumulated oil surpluses – conservatively estimated at over $1 trillion in the GCC – have provided a level of comfort that has allowed the GCC to boost spending without having to worry about financing budget deficits for several years to come.

Saudi Arabia has been the most aggressive with its spending since the financial crisis, boosting capital expenditure by 50% between 2008 and 2010. Another $120bn of spending was announced in Q1 2011, most of which will be disbursed over the next five to 10 years. Qatar also has an ambitious programme of infrastructure investment anchored by its hosting of the 2022 FIFA World Cup. Meanwhile the UAE should push ahead with essential infrastructure programmes even as flashier projects have been delayed. Current spending will also be given a boost in 2012, thanks to public sector wage increases and higher social spending across the region.

Government spending is therefore likely to be the main driver of our forecasted 3.9% average GDP growth in the GCC this year. While this is probably the appropriate policy stance in an environment of slower global growth, high uncertainty and risk aversion, fiscal vulnerability to oil prices is much higher than it was even five years ago. Structural reform and economic diversification away from oil are thus even more important for sustainable long-term growth.

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