Steady as she goes

KHATIJA HAQUE CONSIDERS THE ECONOMIC OUTLOOK FOR THE GCC.

The GCC has been relatively resilient in the face of a deteriorating global economic environment over the last couple of months. We acknowledge that the risks to our GCC growth forecasts are on the downside, particularly for 2012 as oil production is likely to decline in the face of slower global growth and a return to "normal" oil production in Libya. However, we have held off revising our growth forecasts for now, as many of our non-oil sector indicators and data series are released with a substantial time lag.

OIL PRODUCTION DRIVES GCC GROWTH IN 2011 Oil production continues to underpin GDP growth, with oil output from OPEC's GCC members 8.7% higher in the year to September, compared with average 2010 production. Although Libyan oil production rose to 100,000 bpd (barrels per day) in September, the first increase in oil production since the start of this year, Libya's production is well below the 1.6 million bpd prewar levels and OPEC does not expect a return to normal production levels until the end of Q1 2012.

FISCAL POLICY IS ALSO SUPPORTING THE REGIONAL ECONOMY Notwithstanding some weakness in recent weeks, oil prices are still almost 40% higher than the 2010 average and have provided a substantial boost to the region's coffers. Consequently, fiscal policy continues to underpin the private sector, particularly in Saudi Arabia and Qatar.

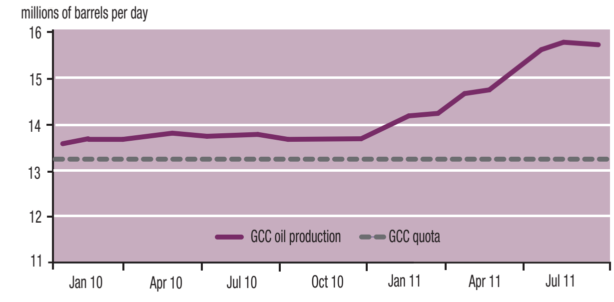
The Saudi king announced a surprise $120bn spending package in the first quarter of this year, and we estimate around 30% of this will be disbursed this year, mainly in the form of increased social security benefits, public sector bonuses and increased minimum wages, public sector job creation, and increased education spend. We estimate that around SAR 340bn ($90bn) is allocated for infrastructure spending, mainly on housing, and this is likely to be disbursed over the next five to 10 years. Despite the increased spending this year, we still expect the budget to post a surplus in excess of 13% of GDP in 2011.

In Qatar, the government has outlined an ambitious programme of infrastructure development ahead of the 2022 FIFA World Cup. In addition, last month it announced a series of public sector wages and pensions increases, ranging from 50% (for lower ranks of the military) to 120% (for military officers). Civilian public sector employees will receive a 60% increase in wages and pensions. The wage increase will cost the budget QAR 30bn ($8.2bn) this year, and an additional QAR 10bn per year thereafter, according to Qatar News Agency. Quasi-government workers are also pushing for wage increases and some private sector firms have already followed suit with wage hikes. As a result of the substantial public sector wage increases, we have revised down our forecast for Qatar's 2011/12 budget surplus to 7.0% of GDP, from 8.4% previously.

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.

Figure 1: Oil production by GCC OPEC members



Source: Bloomberg Emirates NED Research

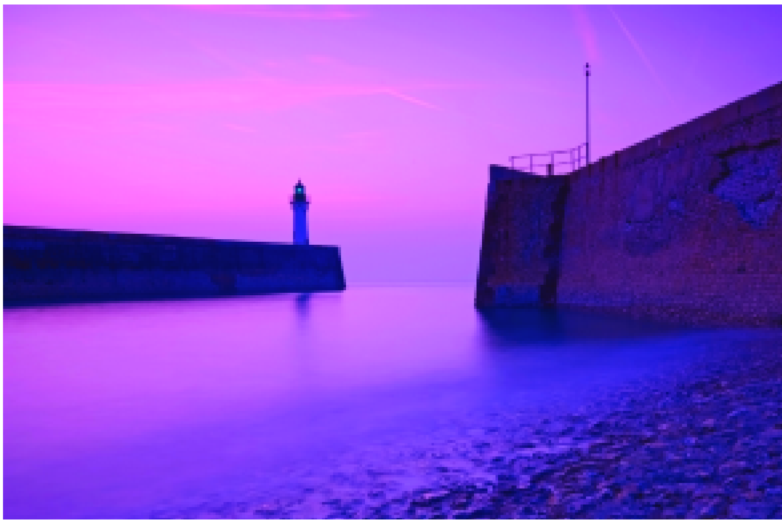
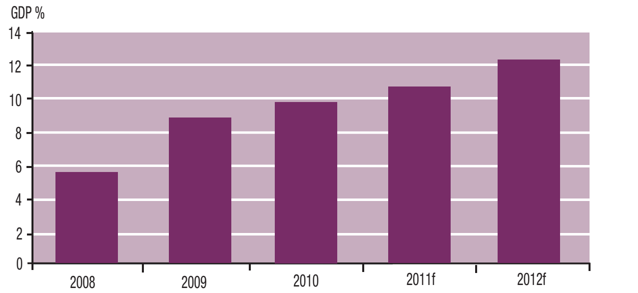


Figure 2: GCC governments' average capital spending*



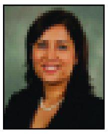
*GDP weighted regional average

Source: Haver Analytics, Emirates NBD Research

PRIVATE SECTOR SHOWING SOME SIGNS OF WEAKNESS The private sector is showing some signs of weakness, particularly in the UAE, where the Purchasing Managers' Index (PMI) data for August showed the private sector at close to neutral levels. However, this could reflect seasonal factors, as Ramadan coincided with the peak summer month this year. In Saudi Arabia, the PMI dropped sharply again in September, although the private sector is still expanding.

Liquidity conditions in the region have also tightened a little over the summer, as deposits across the biggest three economies declined. However, money supply growth on an annual basis is still positive, even where government deposits are excluded from the measure. Private sector credit continues to surge in Qatar (18.9% year on year (y/y) in August) and to a lesser extent Saudi Arabia (9.2% y/y in August). The UAE continues to lag behind the rest of the region, with private sector credit (including non-bank financial institutions) at under 1% y/y in H1 2011.

INFLATION LOWER THAN EXPECTED YEAR-TO-DATE Inflation has beaten our expectations across the region so far this year, despite rising global food prices, and we have revised down our 2011 inflation forecasts for all the GCC countries, except Kuwait. In the UAE, Qatar, and Bahrain, housing costs have declined, keeping headline inflation contained. In Saudi Arabia, housing costs have risen by less than we had anticipated at the start of this year. Demand-driven inflationary pressures are becoming evident, however, and we expect this to continue to build in Saudi Arabia and Qatar, particularly as the authorities have substantially increased public sector wages and other social benefits.



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