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Research Briefing | MENA

Key themes 2022: GCC starts the year on a firm footing

Economists

Maya Senussi
Senior Economist
+44(0)20 3910 8121

Scott Livermore
Chief Economist, M.East
+971 50 403 9455

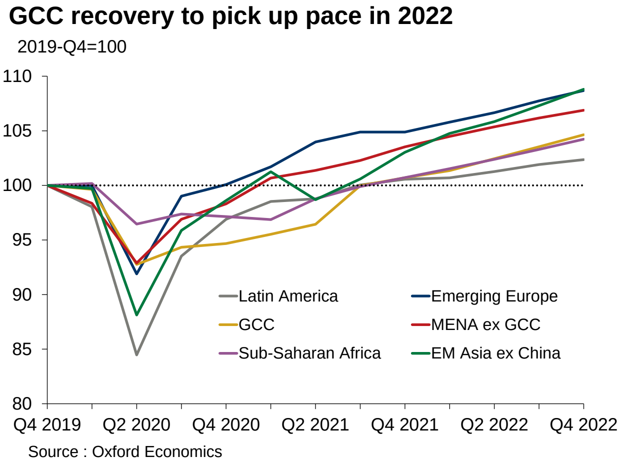
Amy McAlister
Lead Economist

Aoife Kealey
Senior Economist

John Payne
Economist

- **The Gulf Cooperation Council (GCC) will be one of only two major regions globally (the other being ASEAN) to grow faster – at above 5% – in 2022 relative to this year, provided the Omicron variant does not prove too disruptive. Although regional recovery has lagged its peers over the last 12 months, 2021 has been a decent year, with GCC GDP expected to surpass pre-crisis levels in Q1 2022.**
- **The expected increase will be driven by the oil sector, reversing the dynamics of the last three years when OPEC policy constrained output. We see output rising progressively unless Omicron hinders global demand.**
- **We expect non-oil activity to continue to recover in 2022 following the almost complete lifting of health restrictions. High vaccine coverage and roll-out of boosters should limit the need for tighter control measures, but we may downgrade our forecasts if the threat to key sectors such as travel and tourism lingers.**
- **The improvement in economic conditions will spur job creation after a year of limited employment gains. Coupled with domestic investment and measures to incentivise talent, this will fuel the return of expats (but not everywhere).**
- **The GCC has not escaped global inflation pressures, but inflation has been much less of a problem than in many Emerging Markets (EM). Like elsewhere, regional inflation rates will ease gradually during 2022, even as local rents unwind, stabilising below 2% in the medium-term.**
- **Rising economic activity will support regional stock markets despite the expected pullback in oil prices. Focus on fiscal repair should limit downside for bonds.**

Figure 1: The GCC economy has almost regained pre-pandemic level



The GCC recovery has been slower than elsewhere this year but is now picking up strongly.

Contact: Maya Senussi | msenussi@oxfordeconomics.com

Key themes 2022: GCC starts the year on a firm footing

Oil sector to drive growth in 2022…

We anticipate a strong recovery in economic output across the GCC in 2022, with GDP growing at 5.2%, almost twice the pace this year. It is challenging to forecast the impact of Omicron, given limited knowledge about the variant, but it is clear that downside risks stemming from the pandemic will linger for the foreseeable future.

Oil sector performance will lead the rebound next year, rising by almost 8%, following a modest 0.6% expansion in the last 12 months. The OPEC+ group has stuck to its plan to steadily increase production quotas and, despite adopting a flexible approach to policy, it is unlikely to adjust this unless the Omicron variant dents demand to the extent that leads to a marked decline in oil prices. We now see Brent averaging US$72.5pb in 2022, slightly above this year, but down to US$68pb by end-2022.

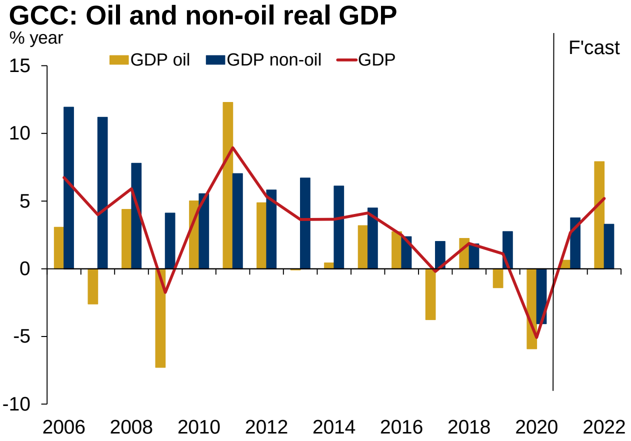
Notwithstanding higher expected investment in the oil sector and planned capacity increases in several countries, including Saudi Arabia and the UAE, energy transition will remain firmly on the regional agenda.

…as non-oil recovery continues

The non-oil sector recovery will continue in 2022, albeit at a slower pace of 3.3% (versus 3.8% seen this year), lagging the energy sector for the first time since 2018. Latest PMI surveys, the most-timely indicators of the health of the non-oil sector, point to sustained growth momentum, though firms' optimism has been hit by the emergence of Omicron. Pending a verdict on vaccine efficacy against the new variant, low infection rates, high vaccine uptake and booster shot campaigns will likely contain fresh outbreaks in the region and help countries avoid lockdowns. Less disruptive Covid measures have allowed mobility levels and domestic activity to return close to normal, helping to fuel the recovery, even though the relationship between GDP growth and changes in mobility has weakened over time.

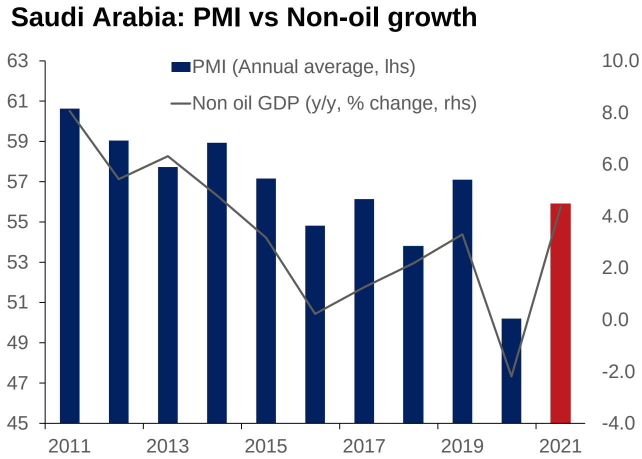
Our projections vary across economies given divergent growth strategies and different policy space. We are upbeat on the UAE and Qatar as they benefit from hosting international events (Expo and World Cup) and open the door to global investment and workforce, while the Saudi National Investment Strategy supports its growth prospects despite scaling back of spending. Kuwait and Oman will find it harder to boost recovery against the backdrop of workforce nationalisation policies and limited budget headroom.

Figure 2: The oil sector will be the main driver of regional recovery in 2021…



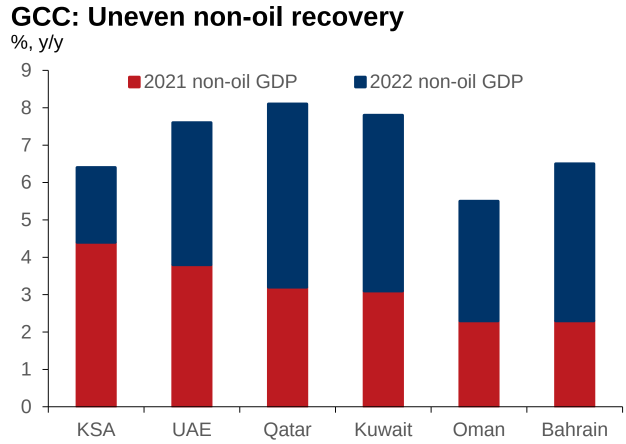
Source: Oxford Economics/Haver Analytics

Figure 3: …while non-oil recovery lags for the first time since 2018…



Source : Oxford Economics/Haver Analytics

Figure 4: …with mixed growth pattern across countries



Source : Oxford Economics/Haver Analytics

However, higher oil prices will facilitate some increase in spending, which, coupled with off-budget investment outlays in Oman, should help the non-oil sector recover from lengthy lockdowns.

The emergence of Omicron is a reminder that the pandemic is not over, and tightening border restrictions threaten the outlook for the key tourism and travel sector during the region's peak visiting season. This leaves some economies like the UAE (**Figure 5**), where travel and tourism accounts for about 16% of GDP overall, exposed. Tourists returned to the region after borders re-opened, with Dubai in particular witnessing a significant bounce due to the start of the delayed Expo 2020. However, domestic activity looks set to retain a key role in driving the rebound in the near term. The uncertainty due to Omicron and its global spread has already made international travellers more cautious and may impact bookings in early-2022, further delaying a full recovery in international arrivals into 2024.

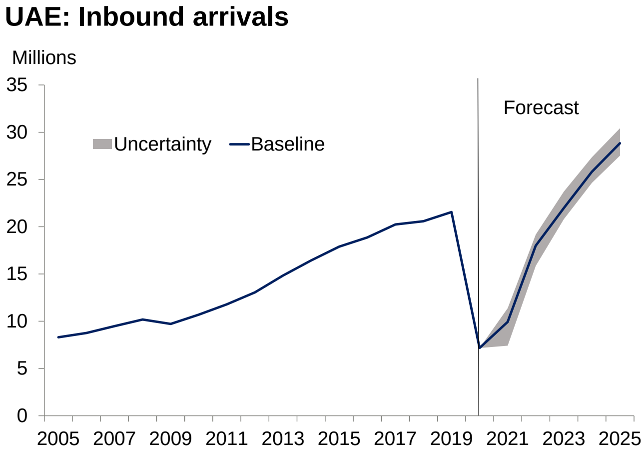
Job creation set to pick up after muted 2021

The region should create more jobs in 2022 after limited gains (or outright decline in employment in Oman and Qatar) this year so far (**Figure 6**). The employment gauges in PMI surveys have hovered around the neutral 50-threshold, contrary to a rise in other sub-components, indicative of a jobless recovery. We ascribe the weak hiring activity to continued adjustment to the pandemic as well as firms' quest to safeguard profit margins in the face of rising input costs and the need to discount selling prices amid strong competition.

However, monthly employment data from Oman demonstrate labour markets have stabilised (**Figure 7**). Oman's job market has been hit the hardest in the region, with the expat workforce, the group most affected by job cuts, declining by almost 22% since end-2019. This extended the trend since mid-2017 when authorities doubled down on Omanisation efforts. Some of Oman's demographic transition will prove permanent given tight rules on foreign employment, though we take the fact that some expats are again finding jobs as a good omen.

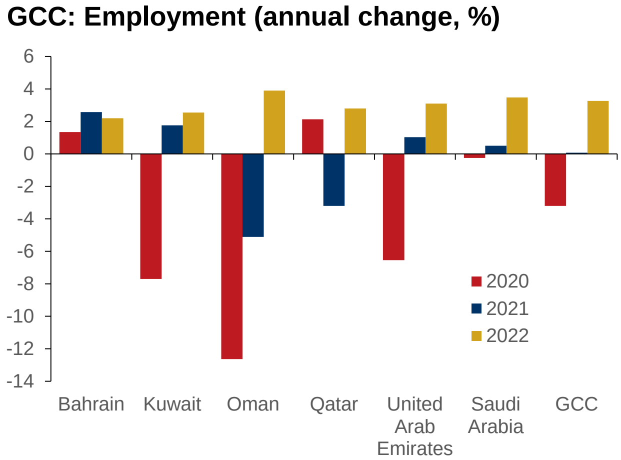
Moreover, various regional surveys also point to hiring picking up heading into 2022. Indeed, leaving Oman and Kuwait aside, we expect economic recovery and the string of legal, social and visa reforms (spearheaded by the UAE) to gradually bring expats back.

Figure 5: Omicron threatens to weigh on the bounce-back in tourism



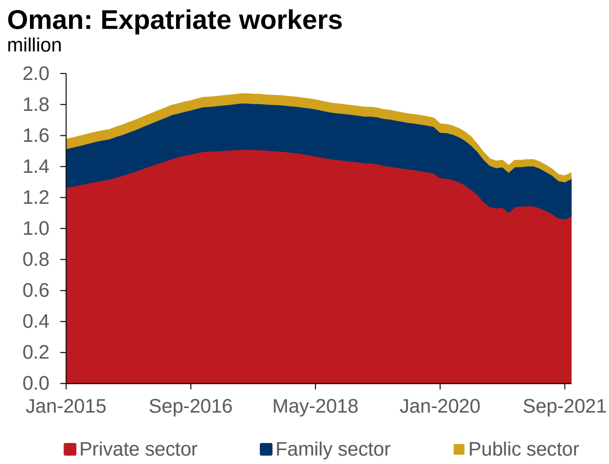
Source: Tourism Economics

Figure 6: Employment has been relatively stagnant this year…



Source : Oxford Economics/Haver Analytics

Figure 7: …but the worst is behind with a stronger rebound seen in 2022



Source : Oxford Economics/Haver Analytics

Inflation nearing its peak

As in much of the world, households in the Gulf have faced a rise in the cost of living, with first food and more recently transport prices leading the increases (**Figure 8**). However, as expected, inflation has remained more contained than in most EMs, not least because the dollar-pegged currencies curbed prices of imported goods. Moreover, the energy and food prices (which have the highest share in regional CPI baskets) have likely peaked, which implies regional inflation will gradually subside in the coming months, even as the powerful disinflationary impetus from housing wanes. We see GCC inflation averaging 2.6% next year, just above the estimated 2.5% this year, before falling back below 2% in 2023. Against this backdrop, regional central banks can afford to remain patient, keeping interest rates at current levels, with low financing costs supporting recovery momentum.

Regional assets to stay resilient

Rising economic activity and planned IPOs will support regional stock markets. However, we see gains moderating in 2022 as the oil price gradually pulls back, after the steep oil price-driven ascent this year (**Figure 9**).

Meanwhile, regional bonds have outperformed EM peers this year, as the surge in oil prices boosted fiscal revenues. Conservative budget assumptions should limit downside in the near term.

Figure 8: GCC inflation has marched upward due to food and transport costs

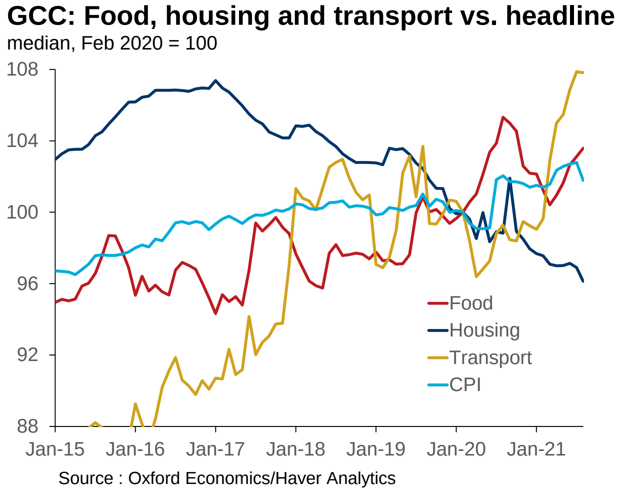
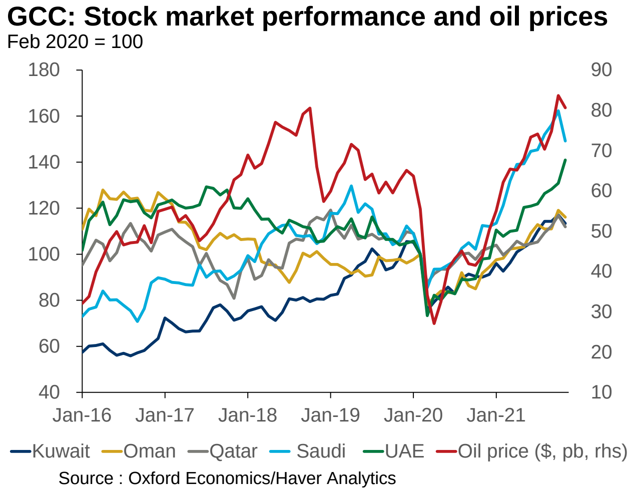


Figure 9: Stronger outlook for demand and oil prices has lifted local equity markets



GCC Forecasts												
	Real GDP (%y/y)			Inflation (%y/y)			Current Acc. (%GDP)			Fiscal Balance (%GDP)		
	2020	2021	2022	2020	2021	2022	2020	2021	2022	2020	2021	2022
World	-3.5	5.8	4.3	2.8	4.3	4.1	-	-	-	-	-	-
MENA*	-4.2	4.6	4.3	20.6	62.7	26.4	-	-	-	-	-	-
GCC	-5.1	2.7	5.2	1.4	2.5	2.6	1.3	10.3	12.1	-9.7	-1.8	2.2
Bahrain	-5.1	2.2	3.6	-2.3	-0.3	2.7	-9.3	-14.3	-14.6	-13.9	-8.5	-7.7
Kuwait	-8.9	2.5	6.7	2.1	3.4	2.5	31.9	45.7	47.3	-33.2	-15.3	-10.5
Oman	-5.8	2.1	3.5	-0.9	1.6	2.0	-11.9	-3.8	-5.4	-16.4	-4.5	-5.1
Qatar	-3.6	2.5	3.7	-2.6	2.1	2.6	-2.5	9.5	9.8	-2.1	4.3	6.0
Saudi Arabia	-4.1	3.3	5.0	3.4	3.6	2.9	-3.1	6.3	9.8	-11.2	-2.8	3.0
UAE	-6.1	1.8	6.2	-2.1	0.0	2.0	5.9	11.5	11.0	-0.2	4.0	3.9