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Managing risk, enabling trade

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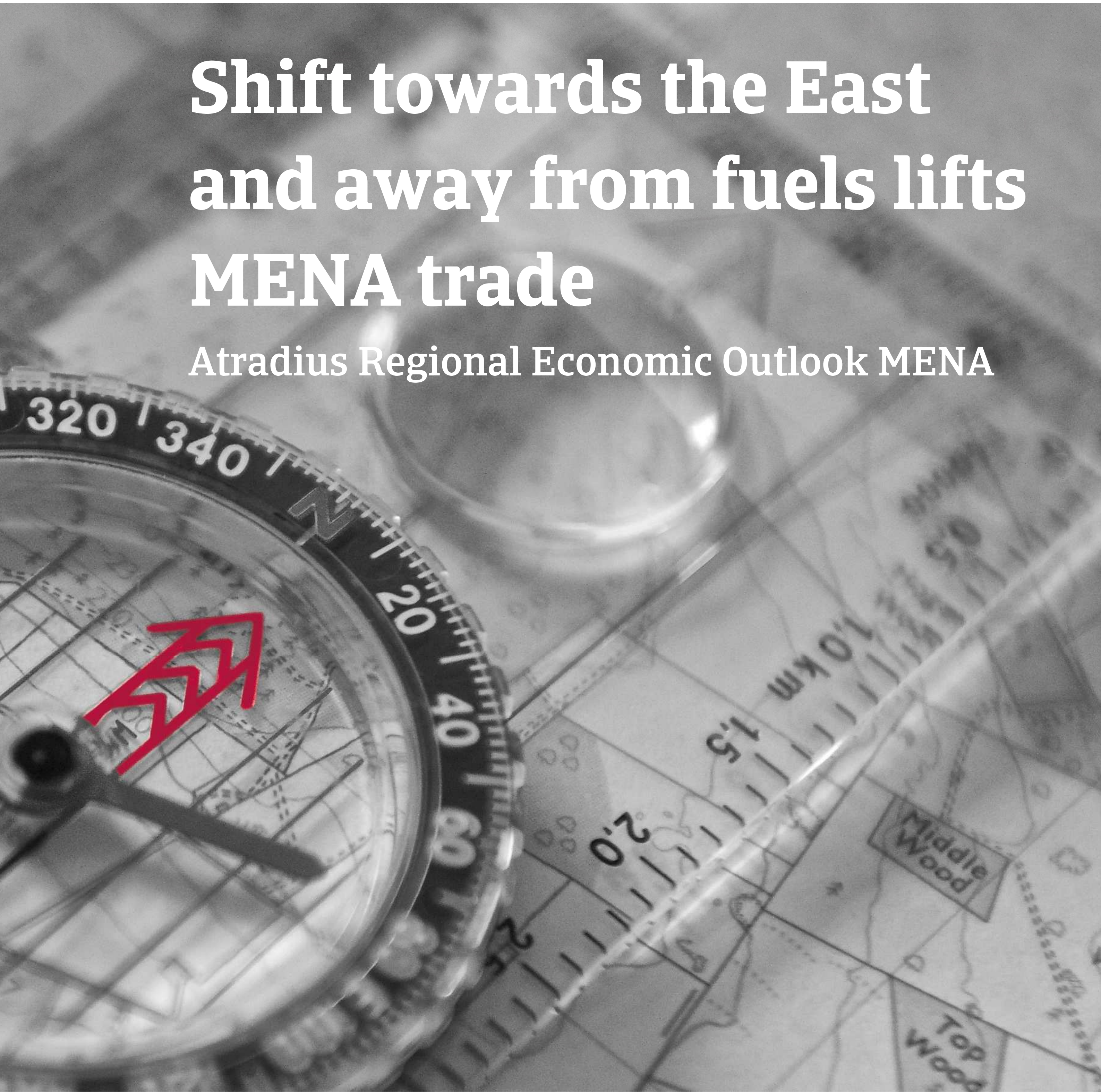
Shift towards the East and away from fuels lifts MENA trade

Atradius Regional Economic Outlook MENA



Atradius Economic Research

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Executive summary

Oil-producing countries in the Middle East and North Africa (MENA) have grown steadily since the disastrous corona year of 2020 and will continue to do so, albeit at a more moderate pace. They still benefit from the elevated oil price, but are affected by the oil production cuts imposed by the OPEC+ cartel to prevent oil prices from falling. Energy-importing countries face tougher times as high inflation eases only gradually and continues to depress private consumption. The investment outlook is also brighter for fuel-exporting than for energy-importing countries, where fiscally weak governments have limited scope for capital expenditure and private investors are discouraged by political uncertainty and higher interest rates. If the oil market balances out as expected in 2024, at a price between USD 80 and USD 85 per barrel, this will lead to a more broad-based economic recovery. Overall we expect economic growth in MENA to slow to 1.8% this year and normalise to 3% in 2024.

MENA's trade prospects are one of the best in the world, but this mainly offers opportunities for Asian trading partners. Western countries are increasingly disconnected from the region, with the exception of LNG imports for which MENA is becoming Europe's alternative supplier since Russian gas is shunned due the war in Ukraine. For the Gulf states in particular, it is part of a national strategy to deepen trade ties with countries in emerging Asia and also Africa. These fast-growing economies will have an unrelenting demand for their fossil fuels for years to come, while they are also suitable partners in the greening and diversification drive of the GCC economies. Energy-importing countries in the region also benefit from the improved trading environment, for example via reduced geopolitical tensions, but to a lesser extent, as they continue to lean on slow-growing Europe as their main trading partner.

With the expected stabilisation of the oil price, macroeconomic imbalances are also improving. It allows most hydrocarbon-exporting countries to balance their budgets or even maintain surpluses. For energy-importing countries, a stable oil price around USD 80/85 per barrel means a resumption of the downtrend in fossil fuel imports, as the impact of expanding domestic renewable energy capacity takes hold. Nevertheless, oil price fluctuations pose a downside risk to the economic growth forecasts and country risk. The risks are acute in Egypt, Tunisia and Lebanon. Besides low economic growth rates, high inflation and high public debt levels, they have insufficient liquidity to absorb new external shocks.

Key points

- We forecast a normalisation of economic growth to around 3% in 2024, based on the central tenet that the oil price balances out between USD 80-85.
- Inflation is easing only gradually in energy-importing countries and continues to depress private consumption. The vulnerability of Tunisia, Morocco, Egypt and Lebanon to currency depreciation remains a risk in this regard.
- The investment outlook is the brightest in oil-producing countries, with Saudi Arabia and the UAE leading the way. Ample oil-related liquidity, coupled with a balanced approach between nurturing their traditional hydrocarbon industries and making their economies greener and more diverse, offers a range of opportunities.
- MENA's enormous trade potential is bolstered by a proactive trade shift towards fast-growing regions like Asia. This move is accompanied by a geopolitical reorientation in the same direction.
- Payment risks are the highest in Egypt, Tunisia and Lebanon. Lack of political commitment to solve balance of payment issues has affected the availability of hard currency there.

Plenty of trading opportunities

Stable oil price allows for economic growth normalisation

Overall, the MENA economy grew strongly in 2022 by 5.5%. It surpassed the already impressive 5.0% growth in 2021, when the economic rebound from the coronavirus pandemic was just getting underway. The further increase in the oil price from an average of USD 70 in 2021 to above USD 100 per barrel in 2022 was the main impetus for the economic growth acceleration in this region that is dominated by hydrocarbon producing countries.

Through the same channel, MENA's real GDP growth is slowing significantly this year to a projected rate of just 1.8% (table 1). In line with the global economic slowdown, the oil price fell well below USD 80 per barrel during the first half of this year. At the same time, oil export volumes have declined due to a string of output cuts imposed by OPEC+ since October 2022 in an attempt to put a floor in the oil price fall. This policy appears to be paying off as the oil price has been rebounding since August, helped by signs of an economic recovery in China. The recent outburst of violence between Hamas and Israel is also creating upward pressure on the oil price, but we assume that this is temporary and that this conflict will not escalate regionally. If the oil market balances out as expected in 2024, at a price between USD 80 and USD 85 per barrel, this will also benefit the oil-importing countries. A more broad-based economic recovery will follow. The resulting growth rate of around 3% is lower than in 2021/22, but more sustainable. However, new disruptive oil price swings cannot be ruled out and represent the main risk to this outlook.

Table 1 Economic growth takes as step back before normalising

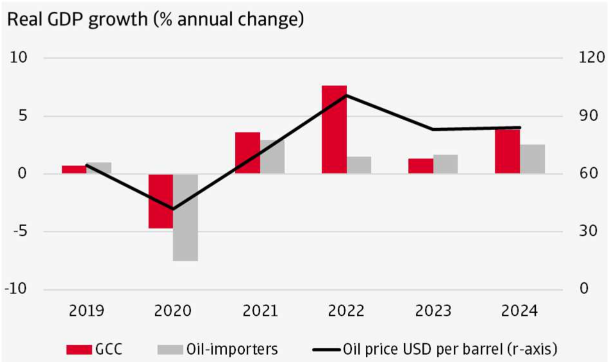
	2021	2022	2023f	2024f
Saudi Arabia	3.9	8.7	0.4	4.3
United Arab Emirates	4.4	7.9	2.2	4.4
Qatar	1.5	4.4	1.5	2.5
Morocco	8.0	1.3	1.8	3.1
Egypt	7.1	4.3	2.2	2.4
Tunisia	4.4	2.4	2.0	2.3
GCC	3.6	7.6	1.4	3.8
MENA	5.0	5.5	1.8	3.0

Source: Oxford Economics, Atradius

GCC maintains regional growth lead

Logically, the hydrocarbon-producing countries of the Gulf Cooperation Council (GCC) – which includes Saudi Arabia, the UAE, Bahrain, Oman, Kuwait and Qatar – are in for the sharpest economic slowdown, from an oil-driven expansion of 7.6% in 2022 to a mere 1.4% growth this year. However, as non-oil growth in those economies remains robust, and the oil price is rebounding, they will again grow faster next year – at a rate of 3.8% – than their energy-importing counterparts Morocco, Jordan, Lebanon, Tunisia and Egypt (figure 1). Economic growth of these economies was already low in 2022 and remains subdued at 1.6% this year. High inflation driven by commodity prices continues to erode household purchasing power, while government spending is low as fuel subsidies weigh on already strained government budgets. Tighter global financial conditions and increases in domestic interest rates are also dampening economic growth. The post-pandemic recovery in tourism, a sustained healthy inflow of remittances and production expansion in the phosphate mining industry are some of the few positive impulses for this group of energy-importing countries.

Figure 1 GCC maintains growth lead, despite falling oil price



Source: Oxford Economics

In 2024, economic growth in MENA will pick up the pace to 3.0% on the back of a gradual recovery of the world economy and the oil market. From 2024, monetary tightening could also go in reverse and easing inflation will gradually revive consumption in the energy-importing economies. The Moroccan economy will recover in 2024-25 from the earthquake on the back of reconstruction spending. However, the economic outlook is subject to significant downside risks that are not limited to oil price shocks. Climate risks, for instance, are relevant to the relatively large agricultural sectors in energy-importing economies, such as Morocco and Tunisia, where weather-related poor harvests have caused economic growth swings in the recent past. But also the recovery from the balance of payment crises that Egypt and Lebanon are currently in – and Tunisia is on the brink of – is difficult to predict. Political commitment to reform (or better the lack thereof) is a decisive factor here.

In the next two sections, we elaborate on how investment and consumer spending are still benefiting from elevated oil liquidity, especially in the GCC countries, while oil-importing countries are struggling with inflation. The focus of the remainder of the report is on the other major contributor to GDP: trade. Diversification away from oil trade and (geopolitical) reorientation towards trade partners in fast growing markets, create a relatively favourable trade outlook for MENA as a whole.

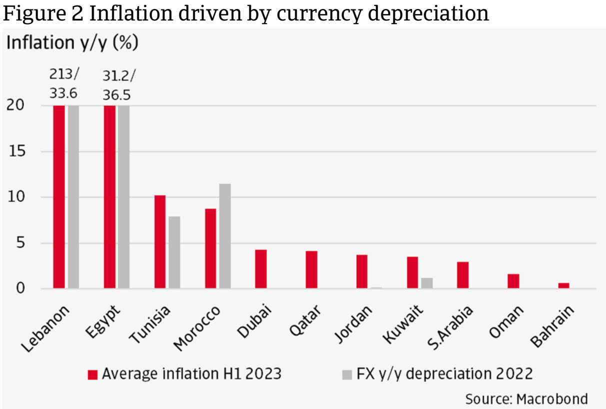
High oil price and liquidity drive domestic demand

It is encouraging that non-oil activity in the GCC is maintaining momentum. We expect non-oil growth in the GCC to slow only mildly from 6.1% in 2022 to 4.3% in 2023 and 3.9% by 2024. The central tenet of this forecast is that the oil price remains well above the historical average. This enables the government to continue to support large investment projects and dole out lavish support for residents to ease cost-of-living pressures. Unfortunately, their private sectors are not yet developed enough to run without a sufficient inflow of petrodollars. Oil-importing countries, face a more subdued outlook for consumption and investments due to higher inflation and limited budgets for fuel subsidies and capital spending.

Inflation splits consumption outlook

The ample availability of petrodollars clearly outweighed the negative impact of inflationary pressure coming from rising commodity prices and steadily rising interest rates on private consumption in the GCC. Governments in these Gulf states have used higher oil revenues to finance price caps and subsidies to contain inflationary pressures and support the broader economy. In Saudi Arabia and the UAE, private consumption grew steadily at 4.8% and 20.8% respectively in 2022, compared to only about 3.5% in Jordan and Egypt and about 1.8% in Tunisia and Morocco. Oil-importing economies are still struggling with the aftermath of the global surge in food and energy prices. They rely heavily on imports of these products and were therefore much more affected than their oil-exporting counterparts. Inflation may have peaked, but the disinflation process is relatively slow, and the renewed rise in the oil price could frustrate this.

Figure 2 Inflation driven by currency depreciation

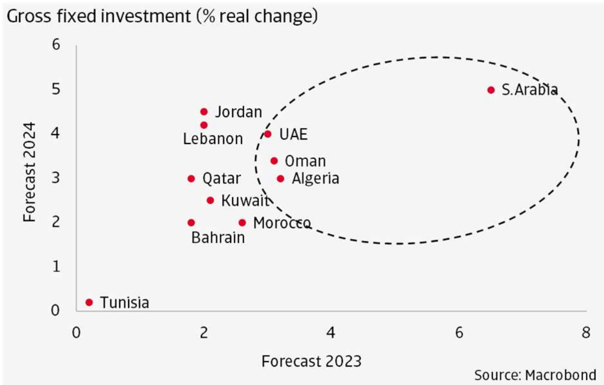


The depreciation of their flexible or quasi-flexible exchange rates is also a major factor driving inflation, as a weaker currency makes imports more expensive. Actually, it was their overly accommodative monetary policies that backfired. In order not to dampen economic growth, interest rates were hiked too little too late. This is in stark contrast with the oil-exporting countries and Jordan, where it was the strength of the dollar, to which their currencies are pegged, that helped mitigate the pass-through of imported inflation (figure 2).

Strong investment drive in oil-exporting countries

The investment outlook is also brighter for oil-exporting than for energy-importing countries, where fiscally weak governments have limited scope for capital expenditure and private investors hit the brakes in view of heightened economic and political uncertainty and higher interest rates (figure 3). Subdued investment growth is especially a concern for Tunisia and Morocco, where, next to private consumption, gross domestic investment is an important contributor to GDP. In case of Morocco, post-earthquake reconstruction is likely to provide an investment boost in the near-term.

Figure 3 Brighter investment outlook for hydrocarbon states



Ever since the worst effects of the pandemic subsided in 2021 and the oil price recovered, oil-rich GCC economies have started launching large-scale investments. Real gross fixed investment growth jumped to almost 25% in Saudi Arabia in 2022, while the UAE recorded an even higher annual growth rate. These two countries will continue to lead this renewed investment drive in 2023 and 2024, albeit at a more moderate pace. They are taking a balanced approach in nurturing and expanding their traditional hydrocarbon industries on the one hand and diversifying and greening their economies on the other hand.

First, they want to capitalise on the high energy prices and the hydrocarbon supply gap left by Russia. Oil production capacity in Saudi Arabia will rise from 12.2 million b/d today to 13 million b/d in 2027 as new projects come on stream. In the UAE, oil production is planned to increase by 1 million barrels per day to 5 mbpd by 2027. LNG output is projected to increase by more than 50% by the end of this decade in Saudi Arabia, while the construction of a new liquefied natural gas export terminal will nearly double UAE's liquefaction capacity. As low cost producers, they have good cards to be one of the last survivors in the declining fossil fuel market. Also in Oman, Algeria, Egypt and particularly in Qatar gas production is being ramped up.[1]

Saudi Arabia and the UAE are also the frontrunners in terms of economic diversification related investments. The Public Investment Fund plays a critical role in Saudi Arabia's Vison 2030 and aims to channel USD 40 billion annually (or about 5% of GDP) into domestic investment. Large contracts are for instance awarded for the construction of the futuristic city NEOM worth USD 500 billion. The kingdom's renewable energy program adopted in early 2019 is also accelerating after a slow start. In the UAE, USD 163 billion has been earmarked for investment in the energy transition, following its landmark announcement in 2021 of its commitment to net-zero emissions by 2050. All these investments, supported by structural reforms laid out in the various national development strategies, could continue to spur economic growth in the short to medium term.

In the spotlight

Saudi Arabia

Real GDP growth of 8.7% made Saudi Arabia the fastest growing economy in the G20 in 2022. However, this year economic growth is slowing significantly to below 0.5% as Saudi Arabia bears the brunt of the oil production cuts agreed with its OPEC+ partners. The kingdom's voluntary unilateral cut of 1 million barrels implemented in July has been extended until the end of this year and brings its production quota down to only 9 million barrels a day from 11 million b/d in August 2022. The upside of this policy is that the oil price remains high enough to provide sufficient domestic liquidity for expansionary fiscal policies and to uphold the robust expansion of non-oil sectors. Next year, the oil market is forecasted to recover slightly and overall growth will strengthen to 4.3%. Beyond the short-term, sustaining non-oil growth depends on building a diversified economy through ongoing structural reforms. Key growth sectors are construction, manufacturing and tourism.

UAE

UAE's economy grew strongly by 7.9% in 2022. The oil boom coupled with the post-pandemic recovery has also led to a strong upswing in non-oil industries such as tourism, real estate and logistics. Recent oil price volatility, combined with tighter oil output limits imposed by OPEC+ and the cumulative interest rate hike of 500 bps, will slow economic growth to about 2.2% this year before normalising to 4.4% next year. The UAE's growth potential is strong, as it is one of the most diversified Gulf countries with about 72% of GDP coming from non-oil sources. The top-notch business environment is constantly being improved to attract foreign investment. A new property crisis is a downward risk as the rapid recovery in real estate prices, especially in Dubai, may not hold up against rising interest rates and remaining overcapacity.

Egypt

Egypt faced large capital outflows in early 2022 due to the global normalisation of interest rates and the fallout from the Russian invasion of Ukraine. Real GDP growth has plummeted from 7.1% in 2021 to 4.3% in 2022 and 2.2% this year, and will hardly improve in 2024. A flexible exchange rate – as required by the new IMF program it entered into at the end of 2022 to avoid a balance of payments crisis – has not been implemented and the first review of the program is therefore postponed. Successive currency devaluations have led to high inflation and high interest rates, which dampen domestic demand, as have government's attempts at fiscal consolidation to reduce the large budget deficit. The exchange rate misalignment has not yet been resolved and another devaluation is in the cards. The recovery in tourism, some progress in privatisation of the state-controlled economy and the related inflow of foreign direct investment, are remaining growth drivers and sources of foreign exchange earnings.

Morocco

A poor harvest has contributed to a sharp slowdown in economic growth to 1.3% in 2022. The devastating earthquake that struck a key tourist area in September will have less impact on this year's real GDP growth, which will accelerate modestly to 1.8% and then rebound to just above 3% in 2024. The slowdown in Morocco's main trading partner Europe also poses risks to tourism, as well as to exports, and remittances inflows. On the other hand, inflation is easing and fiscal policy remains expansionary and geared towards economic development via capital spending and social support. A USD 11.7 billion (8.5% GDP) earthquake reconstruction package by the government will support the recovery. Automotive, aerospace and phosphate mining remain resilient growth sectors.

Tunisia

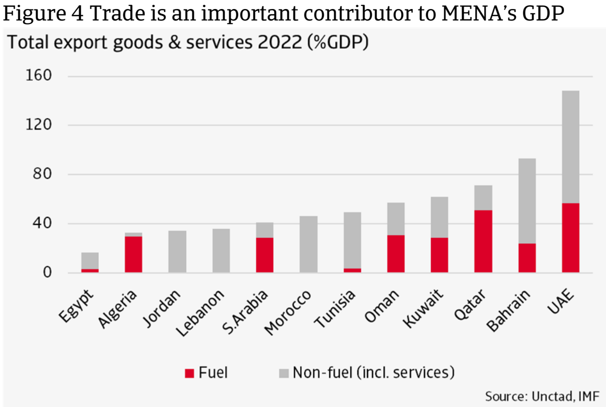
Tunisia's economic growth outlook has deteriorated further as IMF approval for the requested financial support continues to be delayed due to the lack of political commitment on Tunisia's part. Real GDP growth will slow to 1.7% in 2023 and slide further to 1.2% in 2024. The drought this year will also have a negative effect on the key agricultural sector and fuel inflation, which is still above 9%. Tourism and exports for mechanical/ electrical products is still performing strongly, but are at risk of being hit by the economic downturn in Europe. Recent (soft) loans from Saudi Arabia, the African-Export-Import bank and possibly funding from the EU migration deal will limit the erosion of foreign reserves for the time being. However, the IMF program is crucial for building confidence among other donors, as Tunisia no longer has access to the international capital market and a balance of payment crisis is looming.

[1] Negative outliers in terms of investment are Bahrain (little gas resource left), Qatar (normalisation after 2022 FIFA World Cup) and Kuwait (everlasting policy paralysis).

Promising trade outlook

Trade is an important contributor to GDP in MENA countries, most prominently in the UAE which has developed itself as a regional trade hub. World trade has been slowing in line with global economic growth from 9.6% in 2021 to 3.0% in 2022 and will decline further towards 0.8% this year. The Middle East's export growth was the world's highest in 2022 at almost 7.7%, and after briefly joining the general slowdown in 2023, it is poised to bounce back in 2024. At around 4%, trade growth in the Middle East will then once again be among the highest of any region, along with Asia and Africa. These fast-growing regions are propelling each other to greater heights as trade ties are strengthening. But there are other region specific drivers behind the promising trade outlook, such as the increased demand for gas import from Europe on the one hand, and the gradual progress with export diversification and greening of the economy on the other. Fuel-exporting countries are expanding their focus to non-fuel exports, including services, which now account for more than half of trade in the UAE and Bahrain (figure 4). A more favourable geopolitical environment is another positive factor. Oil-importing countries will also benefit, but to a lesser extent, as they continue to lean on slow-growing Europe as their main trading partner. Their net trade will nevertheless improve as commodity prices normalise.

Figure 4 Trade is an important contributor to MENA's GDP

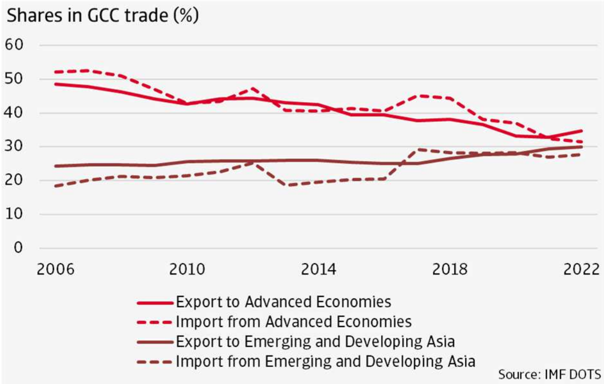


Shift to growth markets

The GCC countries are increasingly concentrating on emerging and developing Asia[2], with which trade will overtake that with the advanced economies in the coming years (figure 5). Exports and imports to and from advanced economies have fallen from half of total trade to a third in the past fifteen years. At the same time, emerging Asia has strengthened its share in GCC trade by 5 to 10 percentage points. India and China are the GCC's main trading partners in Asia and mainly responsible for this trade shift.

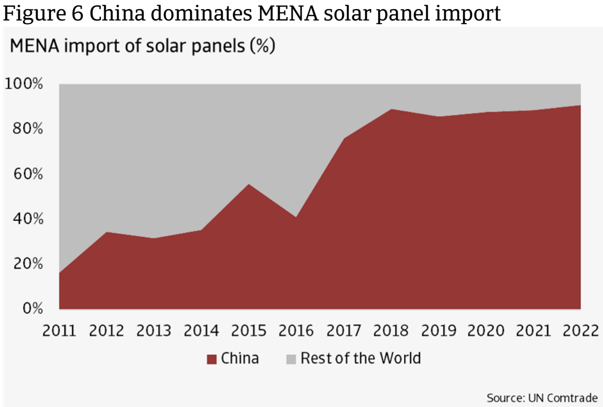
The bulk of this trade traditionally consists of hydrocarbon exports. In the coming years demand for oil and gas from Asia is expected to remain strong, despite progress with the energy transition. This is different from advanced economies where fossil fuel demand will soon peak. Asia's importance as a trading partner is also growing for non-oil trade as GCC countries are in the process of building their own manufacturing bases. More than half of the GCC countries' import from China is therefore machinery and this share is still growing.

Figure 5 Trade with the East is overtaking trade with the West



The greening of the economy is another driver of rising trade with fast-growing markets, not only with Asia, but also with Africa. Imports of critical metals from Africa like copper, which can be used to build renewable energy technologies, are on the rise. African countries also benefit from using MENA's regional trading hubs to market their commodity exports. China has become the main supplier of technologies related to the energy transition, such as solar panels (figure 6), and an important source of expertise in this field.

Figure 6 China dominates MENA solar panel import



Chemical products, including pharmaceutical products and medicines, are also increasingly imported from China. Imports from India consists of similar product categories, but India is also increasingly sought after for food security. Foodstuffs, manufactured products and machinery are no longer only imported from Asia, but are also increasingly traded in opposite direction as GCC countries are developing domestic production capacity in these areas (see paragraph on export diversification).

[2] Emerging and Developing Asia includes China and India, but excludes more advanced Asian countries such as Japan, but also Singapore, Hong Kong and South Korea.

MENA's energy-importing countries are also increasingly dependent on Asia, but only on the import side. Europe's dominance as an export partner remains unchallenged, especially for Tunisia and Morocco, where about two-thirds of export is destined for Europe. The less favourable growth prospects of Europe and other advanced economies is currently a drawback in this sense.

Strengthening of trade relations

The trade shift of GCC countries to Asia is not just a temporary phenomenon caused by business cycles or commodity price fluctuations. It is part of a national strategy to deepen trade ties with fast-growing economies in Asia and Africa while diversifying away from hydrocarbon trade. The UAE, for instance, has already concluded new Comprehensive Economic Partnership Agreements (CEPA's) or new trade deals under existing CEPA agreements with Indonesia, Israel and India last year and with Turkey, Georgia and Cambodia this year. It has more trade agreements in the pipeline including with Thailand, Vietnam and Malaysia. The UAE is also looking for deals with African countries such as Kenya. Together, these deals are expected to provide a major boost to UAE's trade within five years. For instance, bilateral trade with India is expected to jump from USD 60 billion to USD 100 billion, with Turkey from less than USD 20 billion to USD 40 billion and with Israel from just over USD 1 billion to USD 10 billion. The deals typically cover a broad range of goods, including agri-food and clean energy and also services, including tourism, fintech and logistics. Following in the UAE's footsteps, Bahrain, is having its own free-trade talks with Israel, while Saudi Arabia is opening trade discussions with Indonesia. Negotiations on a free trade agreement with China are held on a GCC level since 2004 and may be completed soon.

Geopolitical reorientation

Geopolitical developments also play role in growing trade between MENA and Asia and the more benign trade outlook in general. Souring diplomatic relations between Saudi Arabia and traditional ally the US have opened up opportunities for China to become a more important strategic partner of the region. It is not without reason that China has successfully mediated an improvement in the relationship between regional rivals Saudi Arabia and Iran. It gives China more influence in the region that goes further than trade, presenting opportunities for cooperation on security and technology. It has also reduced the risk of regional escalation, which is good for trade in general. The growing role of China and also India in Middle Eastern politics is also illustrated by the recent entry of Saudi Arabia, the UAE, Iran and Egypt into their BRICS organisation of major emerging market economies. Other MENA countries, such as Algeria, Tunisia, Kuwait and Bahrain, have also expressed interest in joining. It is a way to maintain certain independence from Western organisations such as the World Bank. A next step could be to become member of the bloc's New Development Bank (NDB) that like the World Bank finances infrastructure and sustainable development projects, but preferably in one of the member's local currencies rather than the US dollar. The UAE and Egypt are already NDB members.

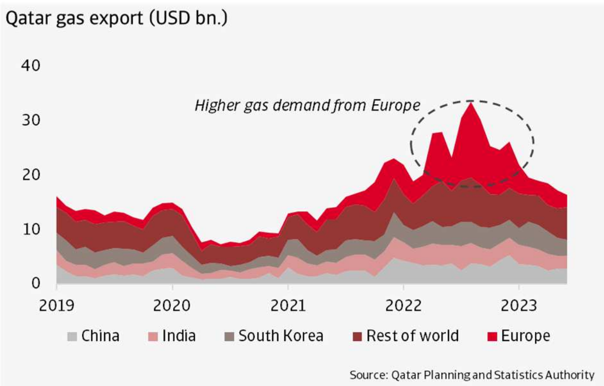
The US has been pushing back against China's rising influence in the region. The improved trade relations of the UAE and Bahrain with Israel was preceded by the signing of historic peace deals (Abraham Accords) that were brokered by the US in 2020. Now the US is following up by trying to negotiate a similar deal between Israel and Saudi Arabia. The fresh outbreak of violence between Israel and Hamas could complicate this and halt the normalisation of relations between Israel and Arab states more broadly. The new US-backed trade corridor from India via the Middle East to Europe, which was recently agreed, could also be seen as a challenge to China's Belt and Road Initiative.

Despite their pivot to the East, Middle Eastern countries try to maintain relations with all main trade blocks, including with Europe and the US, China and India in order to benefit from all sides. They are taking a more or less neutral stance in the Russia-Ukraine war and some have become valuable partners in helping to alleviate Europe's gas shortage. The strained relations between the US and China make it difficult for the GCC to become too close to China, because they do not want to lose the US as a strategic partner.

Transition to gas

Gas exports still have growth potential in the short to medium term. Gas is a transition fuel and coal-to-gas switching remains for instance a key part of China's energy transition strategy. Relatively solid demand for LNG can also be expected from Europe, for energy security reasons (figure 7). Europe has largely banned Russian gas and is looking for alternative sources, as the Russian invasion of Ukraine and its impact on the relationship with Russia is likely to continue for some time to come.

Figure 7 LNG export still has growth potential



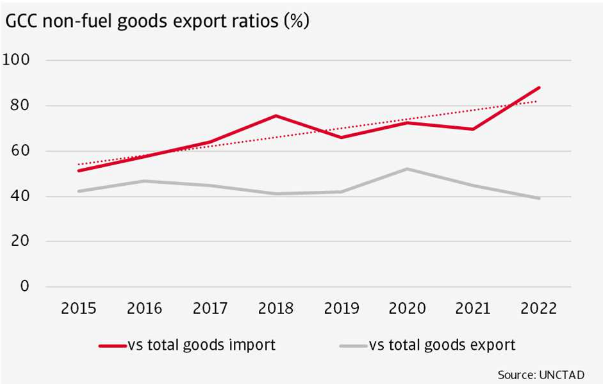
It is the global demand for oil, by far the main source of fossil fuel revenues for the GCC, which will enter a permanent decline first, brought forward by the acceleration in the energy transition. This decline is mainly driven by advanced economies, as oil demand from China will most likely not peak before 2035. Lower global oil demand will lead to a gradual change in the composition of energy trade in favour of gas. In fact, the share of gas in the GCC's total hydrocarbon revenues has already been rising steadily from 13% in 2019 to almost 20% in 2022.

MENA's largest gas producer, Qatar, will likely succeed in securing offtake contracts for all of its 60% additional gas capacity it has available when expansion works are completed between 2025-27. Other gas producing countries in the region will also see the share of Europe in their gas exports rise. Qatar has already signed major gas offtake deals with Chinese energy companies and with some European countries, including Germany. The long-term nature of these contracts will ensure that Qatar will be one of the last survivors in the declining fossil fuel market.

Diversification towards non-fuel

Export diversification is a key pillar in the GCC countries' national development strategies to diversify their economies away from oil and make them sustainable. Gradual progress in this area offers trade opportunities. Although non-fuel exports have not (yet) grown structurally as a share of total exports, a clear positive trend can be discerned as a ratio to total imports, which is less distorted by oil price swings. In 2022, non-fuel exports almost covered 90% of imports, which also bodes well for limiting future trade deficits, when global demand for fossil fuels is fading (figure 8).

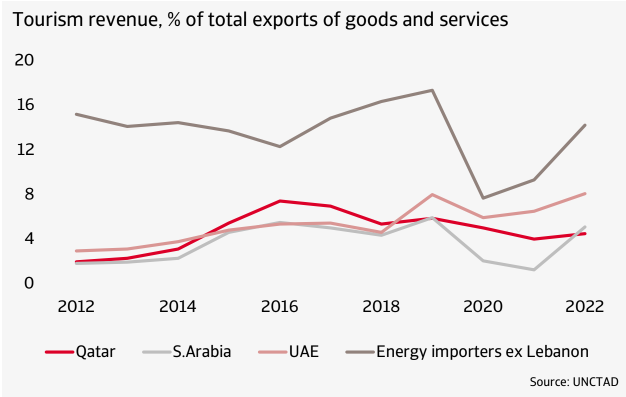
Figure 8 Non-fuel exports gain in importance



The main non-fuel export products for the GCC are chemicals, manufactured goods and machinery. Within these categories, there is another promising form of diversification going on. A move can be detected from low-tech goods such as plastics to medium/ higher-tech products such as telecommunication equipment. Although some are re-exports, the intensification of trade with higher technology partners in Asia, but also with Israel, is providing a welcome boost to the still relatively low technology content of GCC countries' exports. To stimulate technology transfers, GCC countries are welcoming foreign investments and have been relaxing their investment laws. 100% foreign ownership is increasingly allowed, especially in non-oil related sectors.

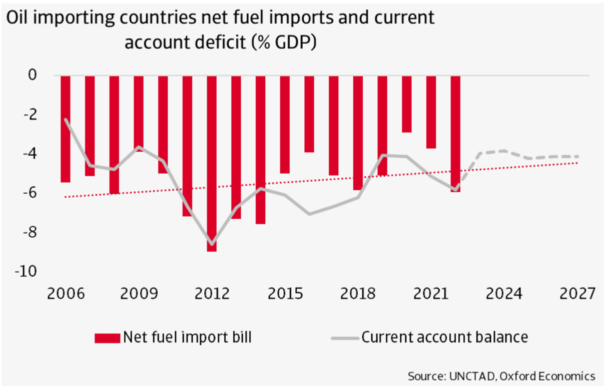
Tourism development contributes to growing trade in services and to more diversity in foreign exchange sources. Interrupted by the corona pandemic, the positive trend of this sector is resumed, boosted by various major events in the region such as the World Expo in Dubai in 2021 and the World Cup soccer in Qatar in 2022. With pilgrim visits having returned to pre-pandemic levels this year, Saudi Arabia seems back on track to increase the contribution of tourism to GDP to 10% in 2030 from about 4.5% currently. In energy-importing countries, where tourism is a larger and more established source of trade income, we see an equally strong post-pandemic recovery, which will continue this year and into 2024 (figure 9).

Figure 9 The tourism boom has resumed post pandemic



MENA's energy-importing countries have less need for diversification on the export side. The export basket of countries like Tunisia and Morocco is already quite diversified and their manufacturing base is more developed than the GCC countries'. Despite the economic weakness in Europe, demand for high-tech products such as automotives has generally held up, which supports their trade outlook to some extent. With Morocco and Jordan in the lead, these countries focus instead on reducing reliance on fuel imports by expanding domestic renewable energy generation capacity. The softening of hydrocarbon prices from the 2022 peak will bring forward a resumption of the downward trend in the fuel import bill. This will help improve the trade balance and current account deficit of energy-importing countries in the short to medium term (see figure 10).

Figure 10 The energy import bill is trending downwards

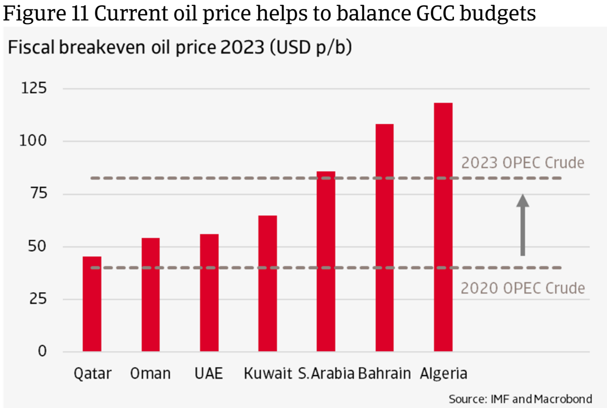


External imbalances persist

The relatively positive trade outlook does unfortunately not do much to improve the existing macroeconomic imbalances in the short term. MENA countries' remain vulnerable to external shocks, such as a new oil price shock that could already be in the making. The diversification of exports away from oil, in the case of oil-exporting countries, and the reduction of reliance on oil imports by energy-importing countries, is proceeding rather slowly. Balance of payment issues in especially Lebanon, Tunisia and Egypt are likely to last for the time being. This is also because external financing needs not only arise from the current account but also from still high debt burdens that need to be repaid or refinanced. Public finances, which are structurally weak in a number of MENA countries, are therefore also an important factor in this equation.

Oil-exporting countries have made gradual progress with fiscal reforms. Non-oil revenues as a percentage of GDP have inched up, for example amid VAT rates that have been finally introduced in in Oman in April 2021 and doubled in Bahrain in January 2022. Qatar and Kuwait are now the only remaining GCC countries without VAT. Corporate taxation is a next step in broadening the non-oil revenue base. A 9% corporate tax has been rolled out by the UAE this summer and a similar measure is on the agenda in Bahrain. The booming oil market has also been helpful in limiting the fiscal sustainability risk of GCC countries as debt levels have been reduced by high GDP growth and debt repayments were made possible by ample petrodollar inflows. Given an oil price of around of USD 80-85 per barrel, only Algeria and Bahrain will record substantial budget deficits as their fiscal break-even oil prices are well above USD 100 per barrel (figure 11). Bahrain is the most vulnerable of the two, as unlike Algeria, it has a high external debt level (above 200% GDP) and little financial buffers to absorb shocks. But as long as Bahrain can count on ongoing financial support from its Gulf neighbours, which we indeed expect to continue, the risk of sovereign default is limited.

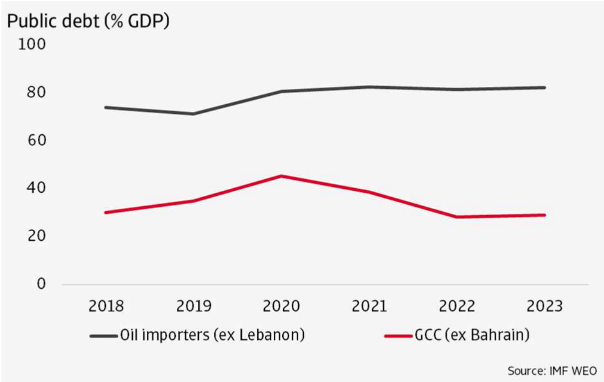
Figure 11 Current oil price helps to balance GCC budgets



For energy-importing countries, the high oil price has made fiscal reforms, such as reducing fuel subsidies, difficult to implement. The persistently high budget deficits coupled with subdued economic growth have kept public debt levels elevated (figure 12). They have also not been able to reverse the jump in debt due to corona support measures in 2020. Only Morocco and Jordan have sufficient financial buffers and access to financial markets and multilateral financial support to take more time for reforms. The shock of the earthquake will not shake Morocco's finances. Morocco has the option to draw on the IMF's Flexible Credit Line of USD 5 billion. It also got access to USD 1.3 billion from a new facility of the IMF – the Resilience and Sustainability Facility – to improve resilience to climate change and natural disasters.

Sovereign risk in Tunisia, Egypt and Lebanon is acute. They do not only have solvability issues, but also a liquidity shortage. Their foreign reserves have dropped to alarmingly low levels. Lebanon is already in default since 2019 and Tunisia is on the brink. Because political commitment to reforms is doubtful, both countries do not get their pending IMF programs approved. Although Egypt was saved by the IMF in December last year, the postponement of the first review, after failing to implement a durable shift to a flexible exchange rate regime, does not bode well either.

Figure 12 Sovereign risk is highest for energy-importing states



Conclusion

In our base case, the oil-driven economic boom in 2022 will be followed by a substantial moderation before economic growth normalises to 3% in 2024. Fossil fuel exporting economies will run on the less powerful non-oil engine for the time being, which works as long as it is fuelled by still ample petrodollar liquidity. The trade outlook is robust, as it is also supported by structural factors such as a strategic trade shift to growth markets in Asia, an opportunity to capitalise on increased LNG demand from Europe and diversification into non-fuel exports.

Energy-importing economies are adapting to the still elevated oil price level and see growth gradually picking up. A renewed increase in oil price, if it perseveres, would therefore be detrimental to their economic recovery. Countries with already existing balance of payments issues, Lebanon, Egypt, Tunisia, will be most at risk.

However, a scenario in which the oil price will actually fall in the short term should not be overlooked and is the main downward risk to the economic and trade prospects of the oil-exporting countries. For the medium term, this is certainly where the world is heading, as the energy transition continues to gain pace.

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