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Gulf Economic Update

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*Economic Diversification for a
Sustainable and Resilient GCC*



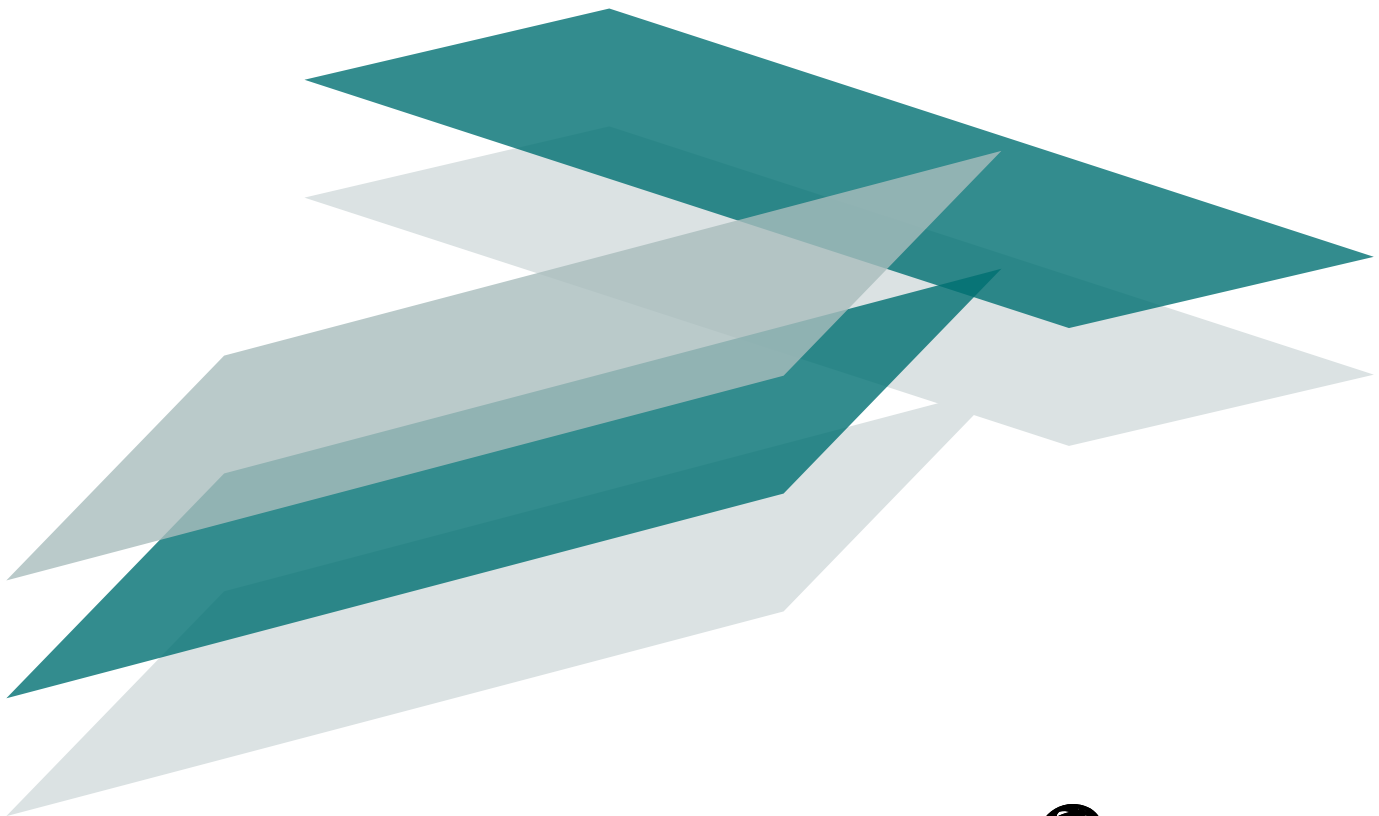
WORLD BANK GROUP



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ABBREVIATIONS

AED	Emirati dirham	JODI	Joint Organizations Data Initiative
ADGM	Abu Dhabi Global Market	KWD	Kuwaiti dinar
ANS	adjusted net savings	LNG	liquefied natural gas
AQI	air quality index	MENA	Middle East and North Africa
BHD	Bahraini dinar	MW	megawatt
bp	basis points	MWh	megawatt hour
CCS	carbon capture and storage	NDC	nationally determined contribution
CCU	carbon capture and use	NOx	nitrogen oxide
CO ₂	carbon dioxide	OECD	Organization for Economic Cooperation and Development
CPI	Consumer Price Index	OMR	Omani rial
DIFC	Dubai International Financial Centre	OPEC	Organization of Petroleum Exporting Countries
€	Euro	PIF	Public Investment Fund
EDGAR	Emission Database for Global Atmospheric Research	PMI	Purchasing Managers' Index
EU	European Union	PM _{2.5}	fine particulate matter
e-KYC	electronic know your customer	PM ₁₀	atmospheric particulate matter
EMBI	Emerging Markets Bond Index	PPP	public-private partnership
EPI	Environmental Performance Index	QAR	Qatari riyal
FDI	foreign direct investment	q/q	quarter-on-quarter
FIFA	Federation Internationale de Football Association	SABIC	Saudi Arabia Basic Industries Corporation
GCC	Gulf Cooperation Council	SAGIA	Saudi Arabian General Investment Authority
GDP	gross domestic product	SAR	Saudi riyal
GHG	greenhouse gas	SO ₂	sulfur dioxide
GNI	gross national income	SWF	sovereign wealth fund
GW	gigawatt	UNCCD	United Nations Convention to Combat Desertification
ICO	initial coin offering	UNEP	United Nations Environment Programme
IEA	International Energy Agency	US\$	U.S. dollar
IFS	International Financial Statistics	VAT	value added tax
ILO	International Labor Organization	VOC	volatile organic compound
IMF	International Monetary Fund	WEO	World Economic Outlook
IPP	independent power producer	y/y	year-on-year

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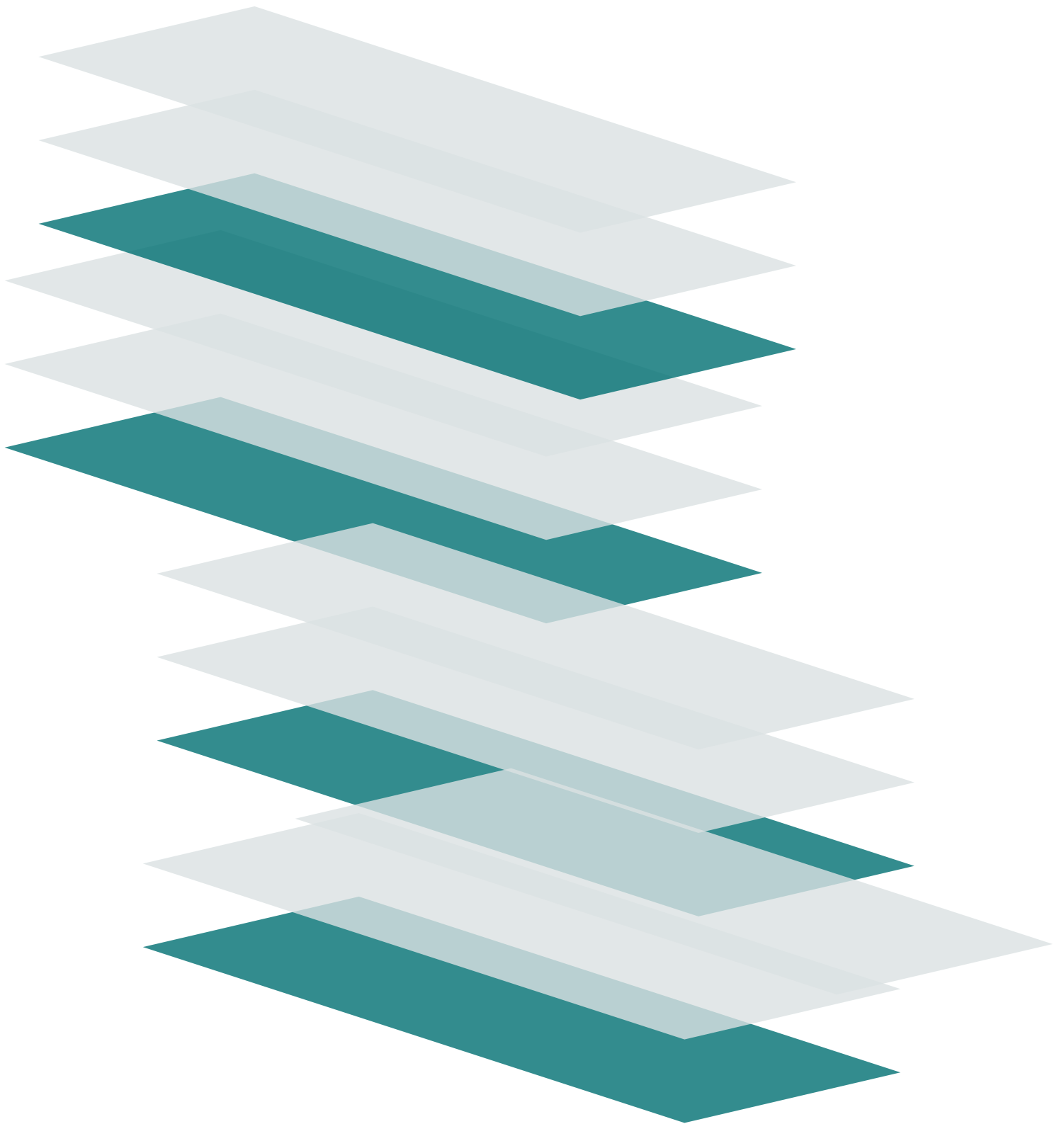
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From the Regional Director, GCC Countries
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ISSAM ABOUSLEIMAN



FOREWORD

The Gulf Cooperation Council (GCC) countries face a challenging global environment. Oil prices are muted, and excess supply has undermined the price impact of three consecutive years of Organization of Petroleum Exporting Countries (OPEC) production cuts. Most GCC countries retained strong external positions in 2019, but the ongoing slowdown in China and the continued global trade war are hindering their efforts to boost non-oil exports. Meanwhile, resurgent geopolitical risks are raising risk perceptions, which could hurt prospects for investment.

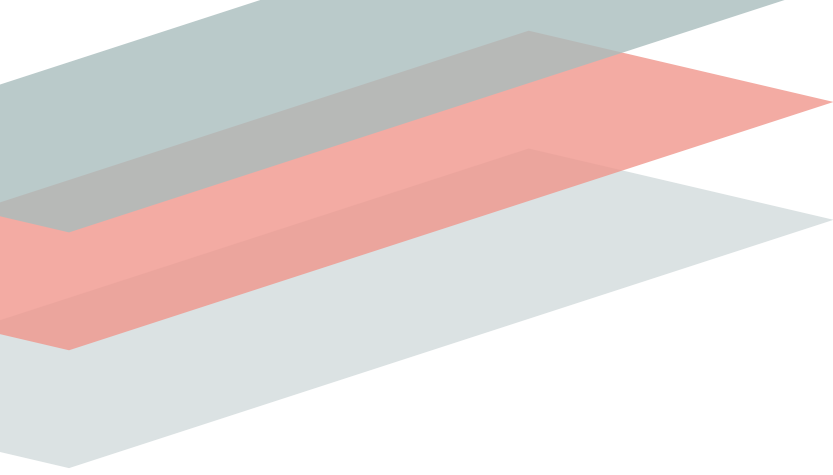
GCC economies grew slowly in 2019. The aggregate regional GDP growth rate is estimated at 0.8 percent, with oil-related growth exhibiting a sharp deceleration. However, non-oil sectors across the region expanded at a robust pace, driven by extensive public investment programs targeting transportation, energy, and logistics infrastructure. Ultimately, developments in the non-oil sectors will have a decisive impact on the trajectory of GCC economies, as acknowledged by the diversification initiatives that underpin the implementation of country development strategies.

Many GCC countries have recently implemented critical economic and social reforms. Saudi Arabia was the world's most improved country in the World Bank's 2020 *Doing Business* report, while Bahrain and Kuwait ranked among the top 10 reformers. Along with various measures to improve the business climate, Saudi Arabia recently eased travel restrictions for women and young people. Nonetheless, an important agenda of "next generation" reforms targeting job creation, human capital formation, and private-sector-led growth remains. Authorities across the region are beginning to make inroads on these reforms, though challenges persist.

Measures to diversify away from oil and gas production are beginning to yield results. In the past, many GCC countries pursued "traditional" diversification strategies, leveraging their comparative advantage in fossil-fuels production to diversify into hydrocarbon derivatives and energy-intensive heavy industry. However, while the majority of regional economic activity remains linked to the hydrocarbon value chain, recent developments signal a clear shift toward lower-carbon industries and sectors. Across the region, investments in renewable energy are helping meet rising domestic power demand while promoting environmental sustainability and gradually attenuating dependence on the oil sector. The rapid expansion and increasing sophistication of financial services, coupled with high rates of technological adoption and innovation, are driving the creation of a robust financial-technology ecosystem and expanding financial access to underserved households.

The natural ecosystems in the GCC countries face profound pressures that threaten long-term growth and development. Climate change impacts will further amplify these threats. Looking forward, a diversification scenario that does not consider environmental sustainability is no longer a viable option. Ensuring environmental sustainability and ecosystem resilience are key for continued economic growth, development, and the quality of life and health of future generations.

This edition of the *Gulf Economic Update* explores the links between economic diversification and environmental sustaina-



bility. The analysis highlights the need to integrate environmental sustainability and ecosystem resilience considerations into the decision-making process on the diversification paths and options in the GCC countries.

Diversifying the GCC economies toward more environmentally friendly industries and sectors will be vital to both reduce greenhouse gas emissions and hedge against the risks, costs, and tradeoffs involved in the decarbonization of global production. Around the world, intensifying regulatory controls on emissions, growing demand for goods and services with a smaller environmental footprint, and the advent of new low-carbon technologies are steadily increasing the share of carbon-neutral economic activity. Though still in their early stages, these trends pose a long-term threat to economic models dominated by hydrocarbon production. Fortunately, the GCC countries are well positioned to manage the risks associated with the low-carbon transition and exploit the opportunities it offers. In addition to low production costs for oil and gas, GCC countries can leverage their reputations for macroeconomic and financial stability, well-developed infrastructure, and an improving business climate to accelerate diversification beyond the hydrocarbon value chain.

The *In Focus* section in this edition of the *Gulf Economic Update* identifies three important ways through which regional investment strategies could better align diversification with environmental sustainability and climate resilience.

First, GCC countries should embrace investment strategies that target the diversification of national wealth. This strategy, also known as asset diversification, moves beyond the composition of outputs and exports to encompass the portfolio of a country's national wealth, which includes human capital, natural and produced capital, and foreign assets. Most GCC countries score below their peers on the World Bank's Human Capital Index, and human capital typically represents a smaller share of their national wealth. Over the long term, regional diversification strategies must focus on building human capital and other environmentally sustainable asset classes.

Second, GCC countries can hedge the risks of traditional diversification by scaling up investments that help mitigate the impacts of climate change. Many countries are implementing renewable-energy projects, and the GCC has enormous scope to expand investments in carbon capture and storage. This report examines the current state of regional investments in climate-change mitigation.

Third, GCC countries should continue to implement policy reforms to align economic growth and development in the environmentally sustainable sectors of the economy. To do this, it is essential to strengthen environmental institutions and management; build capacity for environmental research and development, close data gaps, and relying on evidence-based decision making; and, integrate environmental sustainability approaches into economic policymaking in line with global best practice. A strong institutional framework to help deal with issues related to water scarcity, air pollution, coastal and marine degradation, climate change impacts, and waste management will be critical to ensure that the region builds the resilience of its fragile ecosystem and maximizes its natural resources advantages as it invests heavily in new areas of economic activity.

Executive Summary

Economic growth in the Gulf Cooperation Council (GCC) states significantly weakened in 2019; overall real GDP growth is estimated to drop to 0.8 percent in 2019 from 2 percent in 2018. Lower oil demand caused by a global economic slowdown and lower global commodity prices dampened oil sector growth. However, most countries saw non-oil growth steadily increase and contribute to growth outcomes. Fiscal and external balances deteriorated, tracking oil sector performance and sluggish non-oil export demand. Debt levels continue to trend upwards across the GCC, as some countries returned to debt markets to finance fiscal deficits. With smaller financial buffers, Oman and Bahrain remain the most vulnerable to debt sustainability concerns.

GCC governments have made substantial progress in implementing structural reform, which is laying the foundation for a policy environment conducive to diversified economies. Countries across the GCC have progressively reformed their domestic business and foreign investment environments. This year, the GCC hosts three of the top 10 global improvers in the World Bank's Doing Business Indicators – Saudi Arabia, Bahrain, and Kuwait—with Saudi Arabia being the world's most improved country. GCC governments have also implemented reforms designed to facilitate trade and attract foreign investment and expatriate workers. Financial-sector reforms are accelerating across the GCC, with Bahrain, Saudi Arabia and the United Arab Emirates (UAE) establishing and regulating cryptocurrencies. Moreover, in line with their economic diversification strategies, GCC governments have implemented measures, including the value-added tax (VAT) and excises, to diversify the sources of fiscal revenue.

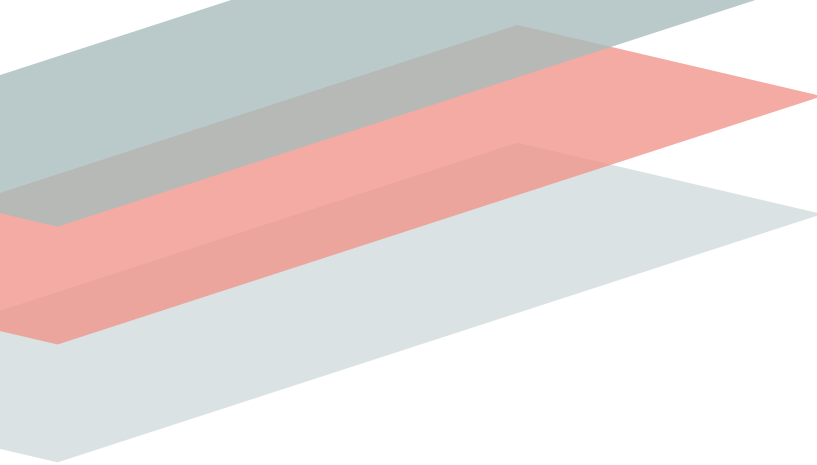
However, a weak global outlook will hamper growth prospects in the GCC. Weaker-than-anticipated global demand is expected to push oil prices below previous forecasts. Risks to the global outlook are tilted to the downside, with risks originating from a potential extension of Organization of Petroleum Exporting Countries (OPEC) production cuts, slower-than-expected growth among major economies, and new episodes of financial stress in emerging markets and developing economies triggered by idiosyncratic shocks. A longer-term risk pertinent

to GCC growth prospects is the global transition towards low carbon economies that would further reduce demand for hydrocarbons.

Economic growth in the GCC is likely to recover over the medium term to 2.2 percent in 2020 and 2.6 percent in 2021. The recovery will be conditioned on a gradual recovery in oil prices and continued spending on mega projects as well as continued growth in non-hydrocarbon sectors. Saudi Arabia's growth prospects will continue to be driven by hydrocarbon-related sectors. Non-oil sectors will drive growth in the more diversified economies; the UAE will see a boost in tourism from Expo 2020, Bahrain's growth will be driven by manufacturing and infrastructure, and Oman will continue to implement Tanfeedh-related investments in manufacturing, transportation, logistics, tourism, and fisheries. Fiscal deficits are projected to narrow but persist across most GCC countries. While current account balances are projected to remain in surplus in the larger economies, Oman and Bahrain will continue to face deficits.

Against this outlook, to achieve long term sustainable growth the GCC must build resilience by undertaking the next generation of reforms. While the GCC countries have made important progress on their development agendas, several outstanding issues remain to be addressed. Further economic diversification will require deepening labor-market and education reforms to generate productivity gains and expand economic opportunities for the regional workforce. Female labor-force participation rates remain low across the GCC, and measures to improve the employability of women could more fully leverage the productive potential of the region's human capital. In addition, efforts to align education and training with employer demand could help narrow the persistent skills gaps observed in regional labor markets. Immigration policies can do more to attract and retain skilled workers to support robust private-sector-led growth.

The recovery of non-oil sectors across the region continues to depend on government stimulus policies. Moving forward, GCC fiscal policy priorities should focus on ensuring intergenerational equity and debt sustainability. To avoid disruption to



growth, governments must complement fiscal consolidation with reforms that enhance public expenditure efficiency, reform energy and utility pricing, diversify revenue sources, and improve the management of fiscal risks. Non-oil revenue mobilization will be critical for GCC countries to reduce the fiscal impact of oil-price volatility, and further delays in VAT implementation in Kuwait, Oman, and Qatar must be avoided.

Progress on structural reforms has been complemented by strategic investments that are supporting diversification and establishing new areas of economic activity. Strategic investments in the renewable sectors across the GCC are poised to increase the contribution of renewable sources to power generation, with the UAE taking the lead. The UAE accounts for about 70 percent of the GCC's renewable energy capacity; Saudi Arabia accounts for about 17 percent; and Kuwait accounts for less than 10 percent. GCC countries have also embraced the potential of fintech. Reforms to the financial sector's regulatory framework and investments in a robust fintech ecosystem are supporting the growth of financial services and digital financial inclusion.

Finally, the *In Focus* section of the *Gulf Economic Update* sheds light on a critical topic: the link between diversification and long-term sustainability of growth amid local and global environmental concerns. Gulf countries exhibit high rates of greenhouse gas emission intensity; Bahrain, Saudi Arabia, and Oman are among the world's most emission-intensive economies relative to their economic size. The GCC region faces multiple environmental sustainability challenges. An arid landscape, rapid climate change, and land degradation have led to poor air quality in the GCC, while air quality management systems are significantly underdeveloped. The GCC is also one of the most water scarce regions in the world. Arable land and permanent cropland account for only 1.63 percent of the region's total land area. Construction and manufacturing, overgrazing, unsustainable agricultural practices, and deforestation are key drivers of desertification and land degradation. Most solid waste management systems do not meet environmental standards, which also contribute to the degradation of the marine environment.

The GCC countries have made important strides toward creating greener, more diversified economies, but sustainability risks including air pollution, coastal degradation, water scarcity, desertification, and land degradation are mounting. This is risking the health and quality of life of GCC populations and hindering the competitiveness of urban areas. Many countries in the region have pursued '*traditional diversification*', which focused on activities closely linked to the comparative advantage afforded by fossil fuels. In most GCC countries, the

share of oil and gas in total exports has decreased over time, but this trend has been driven by rising export revenues from downstream sectors and heavy industries that use oil and gas as feedstock. While advancing diversification objectives, the emissions-intensive nature of 'traditional diversification' has increased the GCC countries' exposure to disruptive low-carbon technologies, international policy efforts to address climate change, and negative public perceptions of fossil fuels and their derivatives. Ensuring that diversification efforts are climate-friendly is critical not only for environmental sustainability but also to help the GCC invest in sources of growth that are sustainable.

Aligning diversification strategies to environmental sustainability objectives can be done through several ways. *First*, by ensuring that diversification strategies take an 'asset diversification' approach. Unlike the 'traditional' approach to diversification, asset diversification offers a more attractive path toward sustainable growth in the GCC; it moves beyond the concept of diversifying outputs and exports, to broaden the composition of a country's national wealth, which includes human capital, in addition to natural and produced assets and foreign assets. Most of the new investments should be incentivized to seek new, greener assets. *Second*, GCC countries can hedge the risks of traditional diversification by scaling up investments in renewable energy and carbon capture and storage to help mitigate the impacts of climate change; increased investment in renewable energy is already underway in the Gulf. *Third*, the GCC must establish effective environmental management institutions and practices to ensure that the region protects its fragile ecosystem as it invests heavily in new sources of economic growth. The report elaborates on these recommendations.

The Pulse of the Region

Recent Developments

The downside risks to global growth have materialized.

The economic slowdown among major advanced economies in the Euro area and Asia has proven more severe than previously anticipated, while idiosyncratic shocks are undermining growth in large emerging markets and developing economies in Latin America, Asia, and Africa. The trade war between the United States (U.S.) and China has worsened, with details of a trade truce still murky. Many governments in the region face limited policy space, as years of low interest rates and bond yields' recent plunge into negative territory have contributed to rising debt levels. An attack on Saudi Arabia's key oilfield and largest oil processing facility in September cut global oil supplies and caused a temporary spike in oil prices (Annex).

The effects of both the global economic slowdown and the trade war between the world's two largest economies have spilled over into commodity markets. Estimates of global demand for oil have persistently dropped throughout the year, and spot oil prices fell below US\$60 per barrel at end-October despite the recent attack on Saudi facilities. The largest suppliers from the Organization of Petroleum Exporting Countries (OPEC) and their non-OPEC partners ("OPEC+") reduced oil production in 2019 to a greater extent than previously agreed upon, and they have extended their production cutback agreement to March 2020. Weakening oil demand and lower global commodity prices have negatively impacted the growth performance of the Gulf Cooperation Council (GCC) states.

Growth slowed markedly across the GCC in the first half of 2019

Most GCC countries experienced slowing growth in the

first half of 2019. In many cases, growth slowed on both a year-on-year and a quarter-on-quarter seasonally adjusted basis.¹ Falling oil production and export volumes across almost all GCC states dragged down growth in the oil sector, which is still the mainstay of most of the region's economies. Consequently, accelerating economic activity in the non-oil sector drove the bulk of the positive first- and second-quarter growth outcomes observed in the region, continuing with the trend in recent years (Figure 1).

Saudi Arabia's economy decelerated sharply in the first half of 2019. GDP growth was modest at 1.7 percent (y/y) during the first quarter and 0.5 percent during the second quarter. The oil sector, which represented just one-fourth of economic growth in the first quarter, deducted 1.1 percentage points from growth in the second quarter, as Saudi Arabia led OPEC's supply-reduction drive for the third consecutive year. Meanwhile, the non-oil sector posted its best quarterly performance in more than three years in the first quarter and offset the contraction of the oil sector in the second quarter.

Economic growth in the United Arab Emirates (UAE) surprised on the upside in the first quarter of 2019. While the UAE has not released economywide numbers for the second quarter, the Purchasing Managers' Index (PMI) and other indi-

¹ Year-on-year figures compare growth outcomes for one quarter to outcomes in the same quarter the previous year. Quarter-on-quarter figures compare growth outcomes for one quarter to outcomes in the previous quarter. Because directly comparing growth during different quarters of the year could be misleading, the GDP data are adjusted to account for typical seasonal fluctuations, and the growth rate is expressed as an annual total.

FIGURE 1

GDP growth, and contribution to GDP growth Percent, and percentage points

Source: Haver Analytics

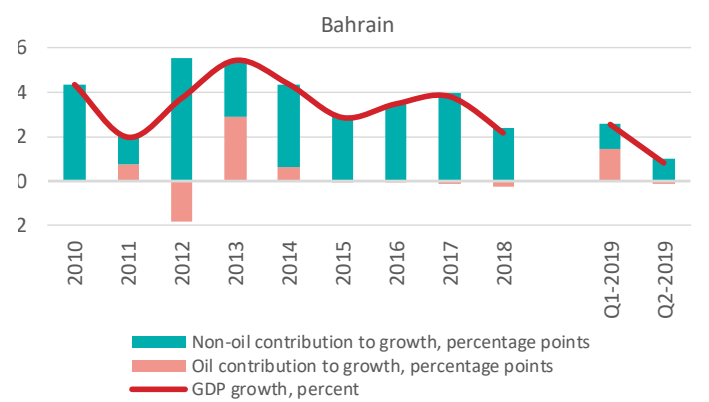
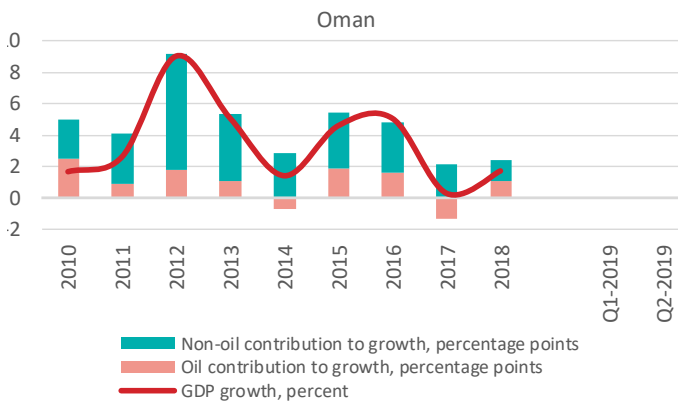
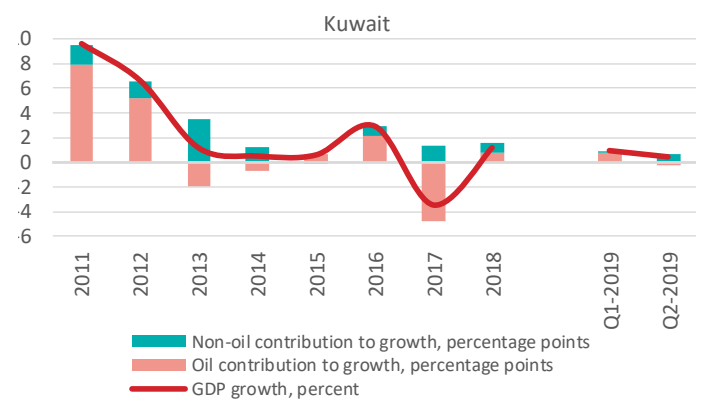
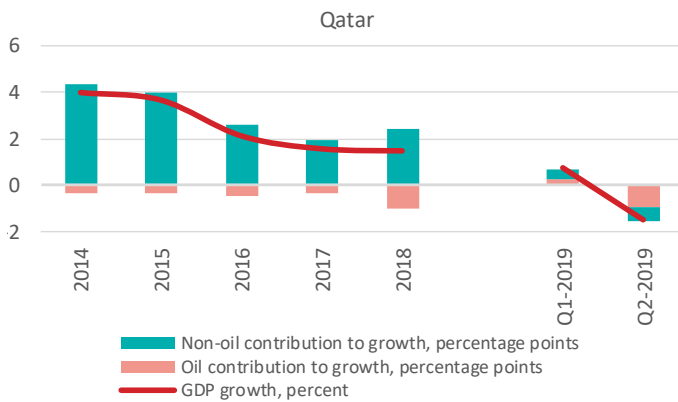
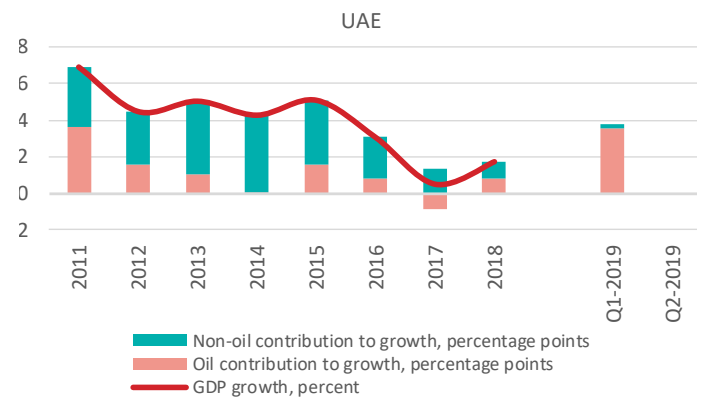
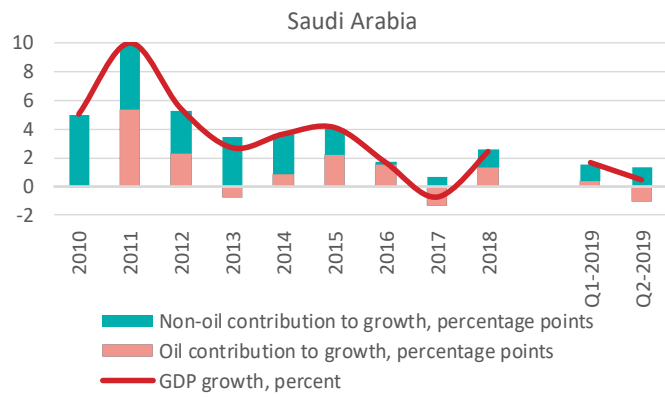
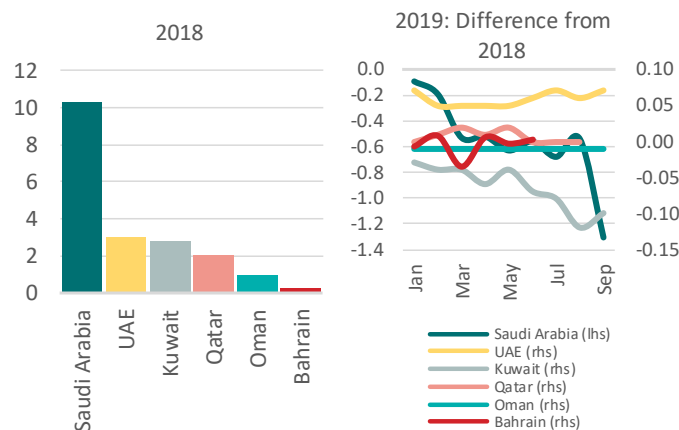


FIGURE 2

Oil production, Million barrels per day

Source: International Energy Agency, *Oil Market Report*, January – October 2019.



icators of economic sentiment suggest that non-oil growth maintained its momentum from 2018 through at least mid-2019, while a 7 percent decrease in oil production weakened growth in the oil sector. Growth slowed in Abu Dhabi, the largest emirate, from 2.2 percent in the fourth quarter of 2018 to 2 percent in the first quarter of 2019.² Unlike the other emirates, Abu Dhabi’s non-oil sector appears to have lost momentum since 2018.

Qatar, the world’s fifth-largest gas producer and second-largest gas exporter, contracted 1.5 percent (y/y) in the second quarter of 2019, after posting a tepid 0.8 percent growth rate in the first quarter. The downturn in the second quarter was driven by both the oil and non-oil economies. The oil sector, which grew by just 0.6 percent in the first quarter, contracted by 1.9 percent in the second quarter. The non-oil sector, which grew by 0.9 percent in the first quarter, contracted by 1.1 percent in the second quarter.

In Kuwait, modest growth of 0.9 percent (y/y) in the first quarter of 2019 dropped to 0.4 percent in the second quarter. Kuwait is the GCC’s most oil-dependent economy. The oil sector contributed 0.8 percentage points to growth in the first quarter but deducted 0.2 percentage points from growth in the second quarter.

Bahrain posted a 2.6 percent year-on-year growth rate in the first quarter of 2019 and 0.8 percent in the second quarter. The oil and non-oil sectors made a roughly equal contribution to year-on-year growth in the first quarter. However, low base effect skews Bahrain’s year-on-year growth figures, as its economy contracted by 0.2 percent in the first quarter of 2018. In the second quarter, modest growth in the

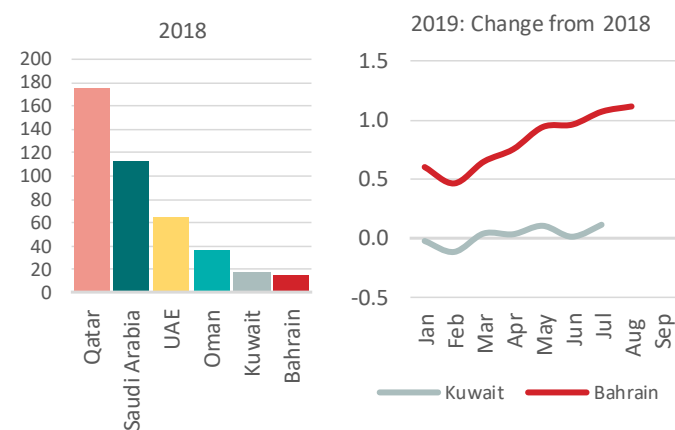
2/ These figures are measured in quarter-on-quarter seasonally adjusted terms.

3/ Oman does not report quarterly national-accounts data in price-adjusted terms, making it difficult to estimate real growth figures, both for its economy as a whole and for individual sectors.

FIGURE 3

Gas production, Billion cubic meters

Source: BP, *BP Energy Outlook 2019 Edition*, and Joint Organizations Data Initiative, JODI-Gas World Database.



non-oil sector partially offset a contraction in the oil sector.

Oman reported negative nominal growth rates in the first half of 2019. Nominal GDP growth was -2.2 percent y/y in the first quarter and -1.9 percent in the first half of the year. Using the same nominal GDP data, the oil sector posted an anemic 2.1 percent growth in the first half of 2019, and the non-oil sector, -3.4 percent.³

Weakening global oil demand, falling oil prices, and OPEC production cuts slowed oil-sector growth

Major OPEC members, including Saudi Arabia, the UAE, and Kuwait, led oil production cuts by GCC states in the first half of 2019. Saudi Arabia, OPEC’s largest and the world’s second-largest oil producer, cut production from 10.3 million barrels per day in 2018 to 9.9 million barrels per day in the first half of 2019 (Figure 2) and further to 9.5 million barrels per day in the third quarter, the latter also reflecting the disruption in supply following the attack on Saudi production facilities in September 2019. The UAE, OPEC’s fourth-largest and the world’s eighth-largest oil producer, reduced its output from 3.3 million barrels per day in 2018 to 3.1 million in the first three quarters of 2019. And, Kuwait, OPEC’s fifth-largest and the world’s ninth-largest oil producer, decreased its output from 2.8 million barrels per day to 2.7 million.

GCC non-OPEC members have kept production fairly steady. Qatar slightly increased its oil production in the first half of 2019.⁴ Oman and Bahrain had marginal reductions in output over the first three quarters of the year. Oman cut its oil production from 0.99 million barrels per day in 2018 to 0.98

4/ These figures are reported by the International Energy Agency. Its oil production data cover “oil and liquids,” the latter referring to liquids derived from hydrocarbon sources (including coal to liquids and gas to liquids) and natural gas liquids; liquefied natural gas and liquid hydrogen are not included in this category. Excluding liquids, oil production by Qatar was 0.6 million barrels per day, according to OPEC data.

million in the first to third quarters of 2019 and Bahrain from 196 thousand barrels per day to 192 thousand.

There are no equivalent monthly natural gas production data for the GCC countries, except for Kuwait and Bahrain, the two smallest natural gas suppliers in the GCC.

Kuwait and Bahrain report their natural gas production to the Joint Organizations Data Initiative (JODI), a data-user community for the global oil and gas industries. Kuwait reported increasing its natural gas production from 1.46 billion cubic meters in 2018 to 1.47 billion in the first half of 2019, while Bahrain boosted its output from 1.23 billion cubic meters to 1.83 billion (Figure 3).

The OPEC+ states have now cut oil production for the third straight year. In January 2017, 12 OPEC producers, led by Saudi Arabia, and 10 non-OPEC producers, led by Russia, pledged to reduce their output by a combined 1.8 million barrels per day (from their October 2016 levels) in a bid to balance the global oil market and bolster international prices. The original six-month pact has been extended repeatedly, with the latest agreement in May 2019 extending production cutbacks of 1.6 million barrels a day (from their October 2018 levels) from July 2019 to March 2020.

The compliance rate⁵ among OPEC producers was 95 percent in 2017 and 122 percent from January to October 2018. The rate among non-OPEC suppliers was 82 percent in 2017 and 58 percent from January to October 2018. OPEC members further increased their compliance rate to 152 percent in January to September 2019, while the compliance rate among non-OPEC partners rose to 110 percent.

The GCC OPEC members have overshoot their agreed output cuts during the first three quarters of 2019. Monthly compliance rates averaged 268 percent for Saudi Arabia, 115 percent for the UAE, and 148 percent for Kuwait. At these rates, output cuts by the GCC OPEC members over the full year will likely be deeper than originally planned, and the oil sector's drag on economic growth will intensify during the last quarter of the year. Lower oil production is already being reflected in the quarterly national accounts, which show overall GDP growth rates weakening markedly in Saudi Arabia and Kuwait during the first and second quarters of 2019.

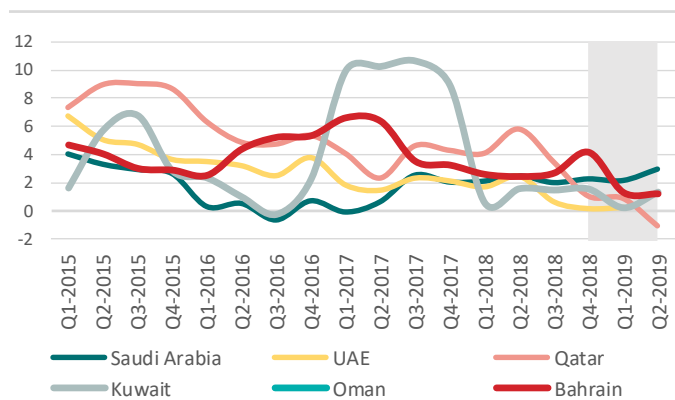
Increasing activity in the non-oil economy generally supported regional growth in the first quarter

The non-oil sectors drove the modest growth rates observed in GCC states during the first and second quarters of 2019 (Figures 4 and 5). In Saudi Arabia and Qatar, services accounted for most of non-oil growth during the first and second quarters of 2019. In Saudi Arabia, the finance, insurance, and real estate subsectors grew at a rate of 4.9 percent (y/y) in the first quarter and 5.4 percent in the second quarter. Transportation, storage, and communications, which also grew at a rate of 4.9 percent in the first quarter, advanced 6.4 percent in the second quarter. Wholesale and retail trade and restaurants and hotels posted a moderate 1.9 percent growth rate in the first quarter and a substantial 5.8 percent growth rate in the second quarter, and government services grew by 1.1 percent in the first quarter. Saudi Arabia's service sector represents two-fifths of its economy. Meanwhile, three of Qatar's largest service subsectors—finance, insurance, and real estate; trans-

FIGURE 4

**Non-oil GDP, real growth rate
Percent, (y/y)**

Source: Haver Analytics



portation, storage, and communications; and public administration—grew by 2.6-3.5 percent in the first quarter of 2019 and 2.0-2.9 percent in the second quarter. However, Qatar's service sector represents just one-quarter of its economy. In Bahrain, where the nonoil economy is significantly larger than the oil sector, the service sector contributed 0.4 percentage points to the 2.6 percent growth reported for the first quarter and 0.4 percentage points to the 0.8 percent growth in the second quarter. Financial services—the largest of Bahrain's service subsectors at about 16 percent of GDP—grew by 3.5 percent in the first quarter and 2.6 percent in the second quarter. Construction expanded by 2.9 percent adding another 0.3 percentage points to overall growth in the first quarter and by 4 percent adding 0.2 percentage points to growth in the second quarter, but manufacturing suffered a 3.1 percent contraction and deducted 0.5 percentage points in the first quarter. Bahrain's manufacturing industries include aluminum smelting, iron palletization, and fertilizer production.

In both Saudi Arabia and Qatar, activity in the non-oil industrial sector⁶ was broadly flat during the first and second quarters, with some exceptions. Non-oil manufacturing⁷ in Saudi Arabia, which represents less than 10 percent of GDP, is concentrated in the chemical production and metal industries. Similarly, Qatar's nonoil manufacturing sector, which represents just over 10 percent of GDP, includes steel, fertilizers, and petrochemicals. Saudi Arabia's construction industry appears to have rebounded, growing by 1.3 percent (y/y) in the first quarter of 2019—its first positive growth rate in three years—and 4.9 percent in the second quarter. However, the

5/ The compliance rate is the ratio between actual production cuts and pledged production cuts. Compliance data are from the International Energy Agency.

6/ The industrial sector includes manufacturing, construction, and electricity, gas, and water.

7/ The nonoil manufacturing sector excludes oil refining but includes petrochemical products.

FIGURE 5

Sector contribution to GDP growth, 2019 Percentage points

Source: Haver Analytics



construction industry's contribution to economywide growth remains modest.

In Kuwait, which has the GCC's smallest non-oil economy as a share of GDP, the service and non-oil manufacturing sectors made roughly equal contributions to growth.

Wholesale and retail trade grew by 2.5 percent (y/y) in the first quarter of 2019, while other services, including education and healthcare, grew by 9.1 percent. Manufacturing surged by 10.3 percent, though from a small base. Kuwait's non-oil manufacturing sector represents just one-fifteenth of its economy and primarily produces chemicals, cement, and construction materials.

While the non-oil sectors have supported growth across the GCC during the first half of the year, their ability to continue doing so over the second half of the year is uncertain.

As of September 2019, the PMI, a leading indicator of economic trends in the non-oil sectors, remained expansionary for Saudi Arabia, while the PMI trend for the UAE dipped from a previous high at mid-year and that for Qatar recovered slightly after falling deep into contractionary territory through most of the year (Figure 6). Activity in the non-oil sector, while supportive of overall economic growth in the first half of 2019, remains on a downward trend from the first half of 2015.

Fiscal deficits persisted in most of the GCC

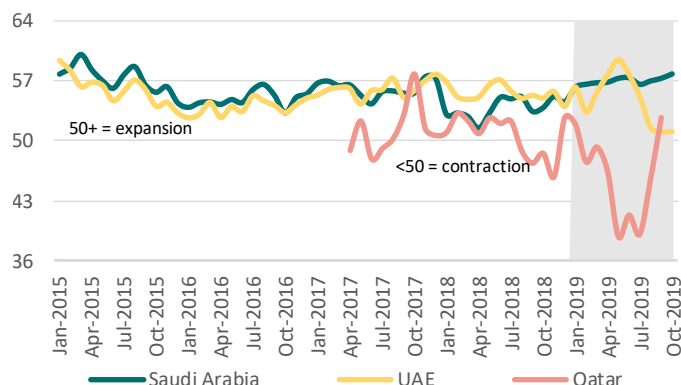
Saudi Arabia posted a fiscal deficit in the second quarter of 2019. Saudi Arabian Oil Company (Saudi Aramco) paid US\$20 billion to the general government budget in 'special dividends' which boosted the fiscal accounts to a surplus of 3.9 percent of GDP in the first quarter. However, in the second quarter, the government loosened its fiscal policy stance, and increased spending combined with low oil revenue growth contributed to a fiscal deficit of 4.5 percent of GDP. The government's pre-budget statement for 2020 indicates that the budget deficit will reach 4.7 percent of GDP in 2019, a little above the initial target of 4.2 percent (Figure 7).

In the UAE, where both the federal and emirate budgets for 2019 call for increased spending, the government reported a fiscal deficit of 0.3 percent of GDP in the first quarter. The federal and Abu Dhabi budgets are significantly expansionary, but the Dubai budget is less so, as most World Expo 2020 infrastructure projects are already complete. The federal government prepared a balanced budget for 2019, with projected revenue increases offsetting a 17.3 percent expenditure increase, from UAE dirham (AED) 51.3 billion (US\$14 billion) in 2018 to AED 60.3 billion (US\$16.4 billion) in 2019, more than one-third of which is allocated to social spending.

FIGURE 6

Global Purchasing Managers' Index
Index value seasonally adjusted, 50+ = expansion

Source: IHS Markit.

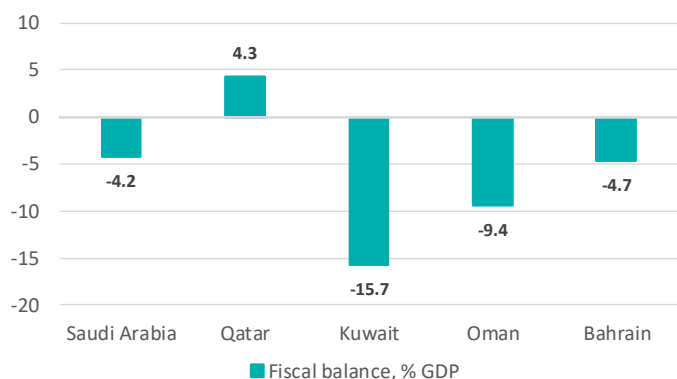


The first quarter outturn suggests that while revenue growth is expected to be modest in 2019, with low oil prices compounded by fee reductions, the VAT may mitigate revenue losses in the oil sector. The overall fiscal balance is expected to return to deficit in 2019 before gradually improving over the medium term. Expansionary spending by Abu Dhabi will be driven by the stimulus measures set forth in Ghadan-21, a three-year development program aimed at boosting the emirate’s competitiveness. Ghadan-21 was announced in 2018, and its expected outlays total AED 50 billion (US\$13.6 billion). An update to Ghadan-21 was announced in June 2019, which targets reduced energy bills, easier access to banks loans, and a new AED 4 billion (US\$1.1 billion) research and development fund. Meanwhile, Dubai’s more moderate spending increase reflects the completion of most infrastructure projects for World Expo 2020. The emirate is projecting revenues of AED 51 billion (US\$13.9 billion) in 2019, up 1.2 percent from 2018, and expenditures of AED 56.8 billion (US\$15.5 billion), up just 0.4 percent from 2018.

FIGURE 7

General government budgets for 2019
Percent of GDP

Sources: National authorities.



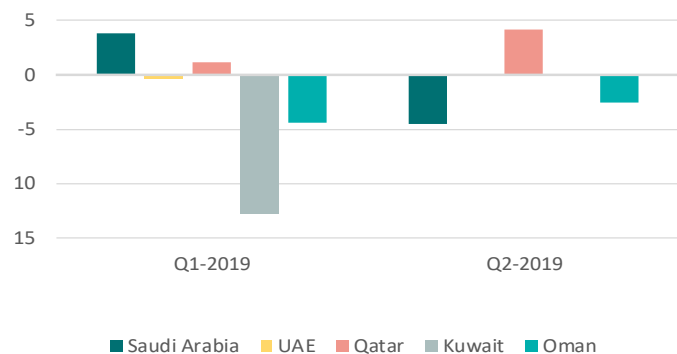
Qatar posted a fiscal surplus of 1.2 percent of GDP in the first quarter of 2019 and 4.2 percent in the second quarter. The government’s 2019 budget aims to achieve the country’s first surplus since 2016, with a target of 4.3 percent of GDP. Revenues are projected to surge by 20.5 percent to Qatari riyal (QAR) 211 billion (US\$58 billion) over the year, while expenditures are projected to increase by just 1.7 percent to QAR 206.7 billion (US\$56.8 billion). The government has also realigned its expenditure priorities, with capital spending expected to fall by 4 percent while spending on wages rises by 10 percent to accommodate the staffing costs of newly completed healthcare and education projects.

FIGURE 8

Fiscal balance, Q1 and Q2 2019
Percent of GDP

Source: Haver Analytics.

Note: Kuwait’s fiscal balance is calculated after the mandatory transfer of 10 percent of revenue to a sovereign wealth fund, understating the size of surpluses or overstating the size of deficits.



Kuwait reported a fiscal deficit of 12.6 percent of GDP in the first three months of 2019 (Figure 8).⁸ The country’s budget for fiscal year 2019-2020 projects a deficit of Kuwaiti dinar (KWD) 6.2 billion (US\$20.4 billion), with revenues of KWD 16.3 billion (US\$53.6 billion) and expenditures of KWD 22.5 billion (US\$74 billion). Because this deficit is calculated after the mandatory transfer of 10 percent of total revenue to the Future Generations Fund, a sovereign wealth fund (SWF), it is not directly comparable to the deficits of other GCC states. Anticipated oil revenues were estimated based on an oil-production forecast of 2.8 million barrels a day and an oil-price forecast of US\$55 per barrel. For prudential reasons, Kuwait tends to set relatively low oil-price assumptions.

Oman incurred a fiscal deficit of 4.4 percent of GDP in the first quarter of 2019 and 2.5 percent in the second quarter. The Omani government has begun publishing monthly fiscal data this year. The data show fiscal restraint, with current expenditures declining 4.4 percent (y/y) in the second quarter after growing 3.7 percent in the first quarter. The 2019 budget assumes a deficit of Omani rial (OMR) 2.8 billion (US\$7.3 billion), with revenues of OMR 10.1 billion (US\$26.3 billion) based on a conservative oil-price assumption of US\$58 a barrel and expenditures of OMR 12.9 billion (US\$22.6 billion).

⁸ Figures for January-March 2019 are included in fiscal year 2018-19, as Kuwait’s fiscal year runs from April to March.

FIGURE 9

International government debt securities outstanding US\$ billion

Source: BIS, Statistics – Debt Securities.

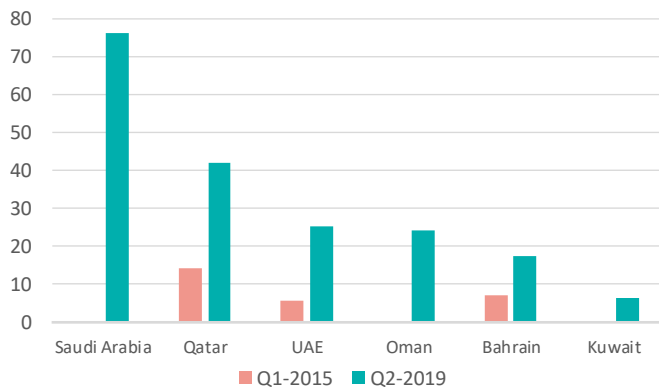
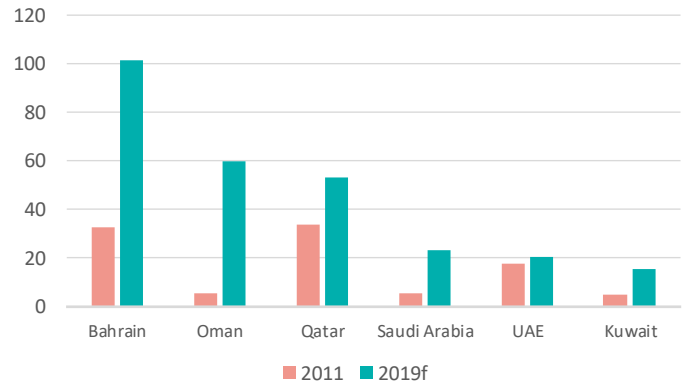


FIGURE 10

General government gross debt Percent of GDP

Source: IMF, World Economic Outlook Database, October 2019.



Bahrain launched its Fiscal Balance Program in October 2018, and the government aims to balance the budget by 2022. Under the program, implementation of consolidation measures will be accompanied by US\$10 billion in financing from Saudi Arabia, the UAE, and Kuwait. The government received US\$2.3 billion in 2018 and is scheduled to receive another US\$2.3 billion in 2019. Bahrain's 2019 state budget projects that the deficit will narrow from 6.2 percent of GDP in 2018 to 4.7 percent in 2019 and 3.9 percent in 2020. The deficit was US\$1.07 billion in the first half of 2019, down from US\$1.7 billion in the first half of 2018, indicating that the deficit-reduction program is on track or even ahead of schedule.

The GCC countries continue to maintain market access, but Bahrain's and Oman's debt levels are high

As in the past, GCC countries are expected to finance their fiscal deficits through a combination of debt issuances, foreign exchange reserve drawdowns, and the liquidation of assets from SWFs and other savings vehicles. Saudi Arabia, the UAE, and Kuwait have typically funded 70 percent of their deficits with debt, which has risen markedly from 2015 (Figure 9), and 30 percent with asset drawdowns. Qatar and Bahrain, which have smaller asset bases to draw on, have funded their deficits almost exclusively with debt.

Saudi Arabia completed its first Euro-denominated Euro-bond issue in July 2019. The issue totaled €3 billion (US\$3.39 billion), divided into a €1 billion (US\$1.13 billion) eight-year tranche and a €2 billion (US\$2.26 billion) 20-year tranche. The eight-year bond carried a coupon of 0.75 percent, and the 20-year bond carried a coupon of 2 percent. After pricing, the eight-year bond offered a 0.782 percent yield, and the 20-year bond offered a 2.042 percent yield. The debt sale was 4.5 times oversubscribed. The Eurobond sale followed a US\$7.5 billion issue in January 2019 which attracted \$27 billion in orders. Saudi Arabia's general government debt stock rose sharply from less than 2 percent of GDP at end-2014 to around 19 percent at end-2018, but it remains modest by the standards

of Organization for Economic Cooperation and Development (OECD) countries.

In the UAE, Abu Dhabi issued US\$10 billion in bonds, marking its first bond issuance in two years. Abu Dhabi issued US\$3 billion in five-year bonds, US\$3 billion in 10-year bonds, and US\$4 billion in 30-year bonds. The market also continues to focus on the US\$60 billion in debt issued by Dubai's government-related entities, which now equals about 50 percent of the emirate's GDP. Those liabilities were at the crux of the UAE's debt problems in 2009, and concerns about them have resurfaced, as most instruments are due to mature in the next few years. If the downturn in the property market continues, the revenues of Dubai's government-related entities may fail to meet expectations, which could impact their ability to service the debt.

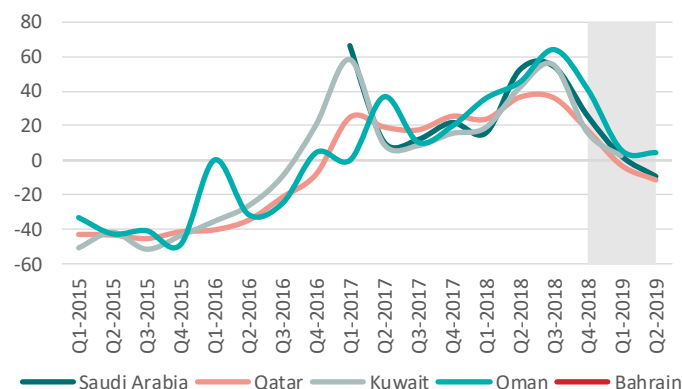
In March 2019, Qatar sold a triple-tranche jumbo bond to raise US\$12 billion. The sale drew US\$50 billion in international demand, indicating that Qatar continues to attract interest from investors in Europe and Asia, if not from the GCC. The three tranches offered 90-basis points over US Treasuries for the US\$2 billion five-year note, 135-basis points over US Treasuries for the US\$10 billion ten-year bond, and 175 basis points over US Treasuries for the US\$6 billion 30-year bond. The 30-year tranche was a Formosa bond, a type of debt security sold in Taiwan, China by foreign issuers and denominated in currencies other than the Taiwan dollar. The Qatari government's external debt stock stood at 48 percent of GDP at end-2018.

Kuwait has not sold any international bonds in 2019. Kuwait last tapped the international market in March 2017, selling a maiden US\$3.5 billion five-year bond with a yield of 2.8 percent and a US\$4.5 billion 10-year bond with a yield of 3.6 percent. Kuwait is the least indebted of the GCC governments. General government gross debt stood at less than 15 percent of GDP at end-2018. The National Assembly has not approved legislation, first introduced in 2017, that would raise the government's borrowing ceiling from Kuwaiti dinar (KWD) 10

FIGURE 11

Oil exports, nominal growth rate
Percent, (y/y)

Source: Haver Analytics



billion (US\$32.9 billion) to KWD 25 billion (82.2 billion) and increase debt-maturity limits from 10 years to 30 years.

Oman returned to the international market in July 2019 with a US\$3 billion bond. The issue consisted of a US\$750 million five-and-a-half-year bond with a final yield of 4.95 percent, below the initial price guidance of 5.375 percent, and a US\$2.25 billion bond with a final yield of 6 percent, also below the initial price guidance of 6.375 percent. Demand totaled US\$14 billion, indicating that below investment-grade credit ratings are not an impediment to investor demand in the presence of hydrocarbon cash flows. The government disclosed at the beginning of the year that it planned to use borrowing to fund 86 percent of its forecast US\$7.3 billion fiscal deficit for 2019. Oman’s gross general government debt spiked from less than 5 percent of GDP at end-2014 to 53 percent at end-2018.

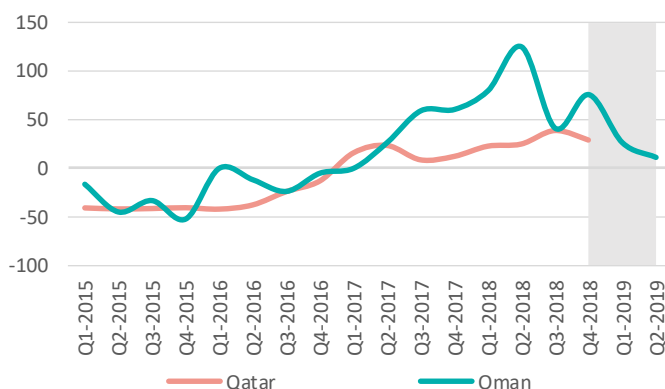
Bahrain’s government has the most debt, in percent of GDP, among the GCC (Figure 10). General government gross debt stock nearly tripled as a share of GDP, rising from 44 percent at the apex of global oil prices in 2013 to 95 percent at end-2018. By March 2016, Moody’s had rated Bahrain’s long-term foreign-currency paper as Ba, or speculative grade (i.e., junk). The rating deteriorated to B2, or highly speculative, in August 2018, on concerns about the pending maturation of Bahrain’s US\$750 million sukuk (Islamic bond) in November 2018. The US\$10 billion financial-support package pledged by Saudi Arabia, the UAE, and Kuwait calmed fears. Bahrain has given no indication that it will access the international market this year. The government last issued a sukuk worth US\$1.2 billion in September 2017.

The inclusion of Saudi Arabia, the UAE, Qatar, Kuwait, and Bahrain in JPMorgan’s emerging-market government bond indexes is expected to boost GCC government bonds this year. The investment bank added the GCC countries to its emerging-market bond indexes in phases between January 31 and September 30 of 2019. The indexes are performance benchmarks for emerging-market debt, and inclusion in the indexes can help countries sell bonds and cut borrowing costs.

FIGURE 12

Gas exports, nominal growth rate
Percent, (y/y)

Source: Haver Analytics



Before the GCC countries were added to the indexes, more than US\$15 billion in new money had already been invested in GCC sovereign debt.⁹

Lower production volumes and prices slashed the growth of oil exports

GCC oil exports grew modestly during the first half of 2019 in a context of declining global oil demand, falling prices, and OPEC production cuts. Oil exports by Saudi Arabia, the world’s largest oil exporter, increased by just 2.3 percent (y/y) in the first quarter, far below the 15.9 percent growth rate observed a year ago, and contracted 9.3 percent in the second quarter, even farther below the 45.2 percent growth rate a year earlier (Figure 11). At 70 percent of total production, export volumes averaged 7.0 million barrels a day between January and June of 2019, as output averaged 9.9 million barrels a day. Similar to Saudi Arabia, Kuwait’s oil exports increased by only 2.5 percent in the first quarter of 2019, down from a growth rate of 18.7 percent a year earlier.

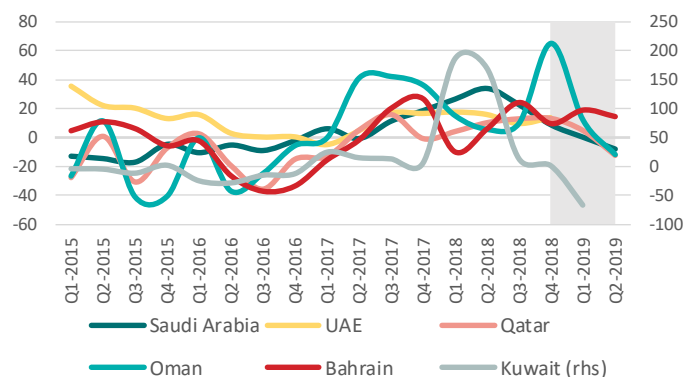
The GCC’s smaller oil producers performed no better than their larger peers. Qatar saw its oil exports drop by 3.4 percent and 11.6 percent (y/y) in the first two quarters of 2019, in stark contrast to the quarterly growth rates of 23.5 percent and 36.2 percent observed a year earlier. Qatar’s gas exports grew by 25.1 percent in 2018, making it the world’s largest gas exporter. However, Qatar has not yet reported gas export data for 2019. Oman’s oil exports increased by 5.5 percent in the first quarter of 2019, compared to 35.9 percent a year earlier, and 4.3 percent in the second quarter, compared to 45.2 percent a year earlier. The second-largest gas exporter in the GCC, Oman reported gas exports rising by 26.5 percent in the first quarter of 2019, down from 80.2 percent a year earlier, and 11.3 percent in the second quarter, down from 125.6 percent a

^{9/} These sovereign-debt figures are reported by Emirates NDB Asset Management, a UAE-based investment firm.

FIGURE 13

Non-oil exports, nominal growth rate
Percent, (y/y)

Source: Haver Analytics



year earlier (Figure 12). Bahrain’s oil exports grew by 2.6 percent in the first quarter of 2019.

Sluggish global growth has depressed non-oil exports

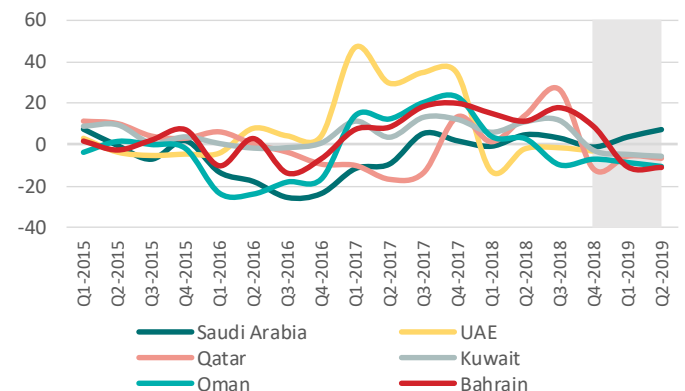
In Bahrain, the UAE, and Oman, where non-oil exports represent a greater share of goods exports than in the other GCC economies, weak global demand for industrial materials depressed non-oil exports in the second quarter. Non-oil exports by Bahrain grew by a robust 19.3 percent (y/y) in the first quarter of 2019 after contracting by 9.6 percent a year ago (Figure 13). During the second quarter, non-oil exports increased by 14.8 percent up from 6.4 percent a year ago. Bahrain’s non-oil exports account for 60 percent of its total merchandise exports and consist primarily of manufactured goods (40 percent of total exports) and chemicals and inedible crude materials (10 percent). The UAE has not reported export figures for 2019, but non-oil exports typically represent more than 40 percent of total exports. In Oman, non-oil exports grew by 11.9 percent in the first quarter, compared to 15.1 percent a year earlier, before contracting by 11.5 percent in the second quarter. Non-oil exports represent 40 percent of total exports in Oman and consist principally of chemicals (12 percent of total exports), manufactured products (10 percent), inedible crude materials (less than 10 percent), and machinery and transport equipment (just over 5 percent).

In Kuwait, Qatar, and Saudi Arabia, where oil exports dwarf non-oil exports, the negative effect of slower global demand for industrial materials was more pronounced. Saudi Arabia’s non-oil exports represent 17 percent of total exports. Non-oil exports grew by just 0.3 percent (y/y) in the first quarter of 2019, down from 26.6 percent in the previous year, before contracting by 7.9 percent in the second quarter. Non-oil exports are principally chemicals (13 percent of total exports) and manufactured goods (2 percent). After growing by 4.9 percent in the first quarter of 2019, roughly unchanged from the previous year, Qatar’s non-oil exports declined by 12.1 percent in the second quarter. Non-oil exports account for just 12 percent of Qatar’s total exports and consist mainly of

FIGURE 14

Imports, nominal growth rate
Percent, (y/y)

Source: Haver Analytics



chemicals and manufactured goods (10 percent of total exports). In Kuwait, oil exports continue to represent over 90 percent of total exports. Non-oil exports are both small and volatile, dropping by 66.2 percent in the first quarter of 2019. Kuwait’s non-oil exports are primarily chemicals (5 percent of total exports).

Meanwhile, subdued domestic demand kept imports flat

In most GCC countries, total imports slid, year-on-year, in nominal terms, in one or both of the first two quarters (Figure 14). Bahrain recorded double-digit contractions in non-oil imports in the January-March and April-June periods, Oman came close to a double-digit decline in January-March and experienced a double-digit decrease in April-June. In Oman, imports of electrical machinery led the contraction, falling by 32 percent (y/y) in the first quarter while base metals dropped by 13 percent. In Saudi Arabia, the largest two-consecutive-quarter reductions were recorded for imports of animal and vegetable fats, arms and munitions, paper and paper products, machinery and electrical appliances, metals, and chemical products. Qatar reported 6-7 percent reductions in imports in the first and second quarters, and Kuwait reported an average 5 percent reduction in the first and second quarters. In Qatar, machinery and transportation equipment imports declined by 19 percent in the first quarter of 2019, and by 21 percent in the second quarter. In Kuwait, capital goods imports dropped by 18 percent in the first quarter, and intermediate goods imports fell by 6 percent. However, consumption goods imports remained strong, growing by 4 percent in the first quarter.

Central banks across the region cut policy rates in July, September and October

The Saudi Arabia Monetary Authority and the Central Bank of the UAE quickly reduced their key policy interest rates after the US Federal Reserve cut the federal funds rate by 25 basis points each on July 26, September 18, and October 30, 2019 (Figure 15). The Central Bank of Bahrain

FIGURE 15

Policy interest rates Percent

Source: Haver Analytics

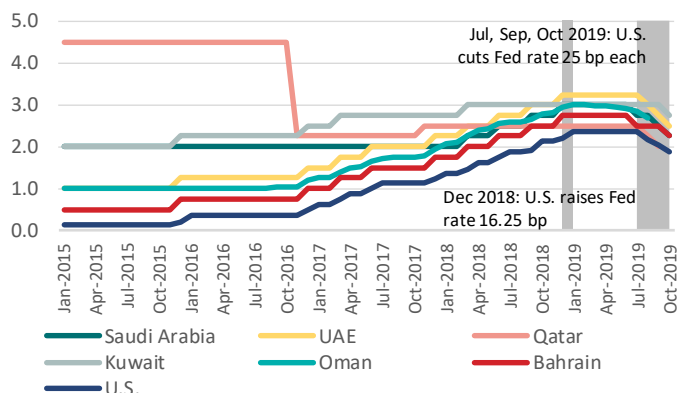


FIGURE 16

Interbank rates Percent

Source: Haver Analytics

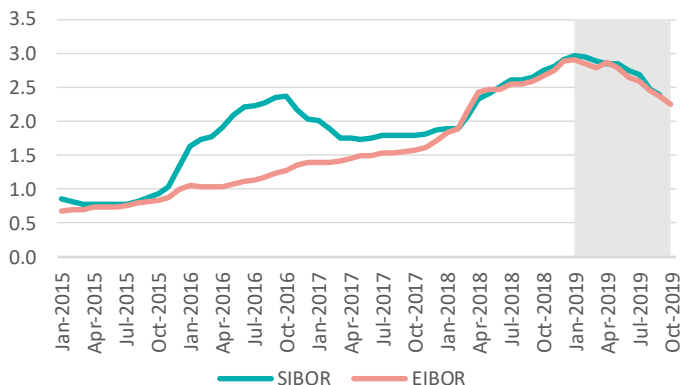


FIGURE 17

Bank lending rates, nominal and adjusted for inflation Percent

Source: Haver Analytics

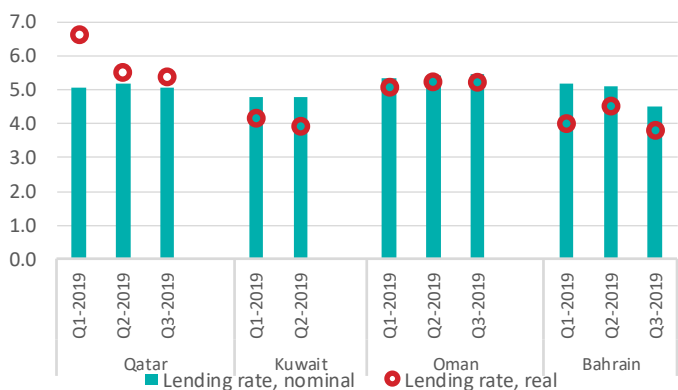
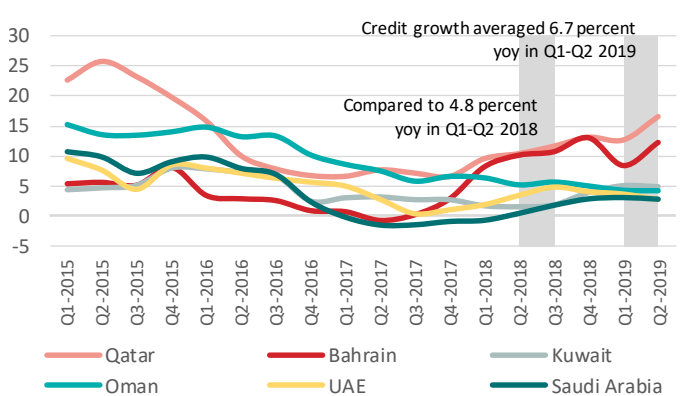


FIGURE 18

Credit to the private sector, nominal growth rate Percent, (y/y)

Source: Haver Analytics



reduced the one-week deposit rate by 25 basis points in July and September, and the Qatar Central Bank, the repo rate by 25 basis points in September and October. Meanwhile, the Central Bank of Oman, which has maintained a practice of following US Federal Reserve decisions incrementally and with a lag, is expected to continue to let their policy rates track the federal funds rate. The Central Bank of Kuwait was the only GCC central bank to keep its policy rate unchanged, as it had during the preceding twelve months.

The response of the GCC central banks to the reduction in the federal funds rate highlights their commitment to maintaining their currency pegs against the US dollar. Oil and gas exports by the GCC are denominated in US dollars, and the currencies of five of the six GCC (except Kuwait) countries are pegged to the U.S. dollar. GCC policy rates are expected to continue to track the US federal funds rate to maintain the currency pegs.

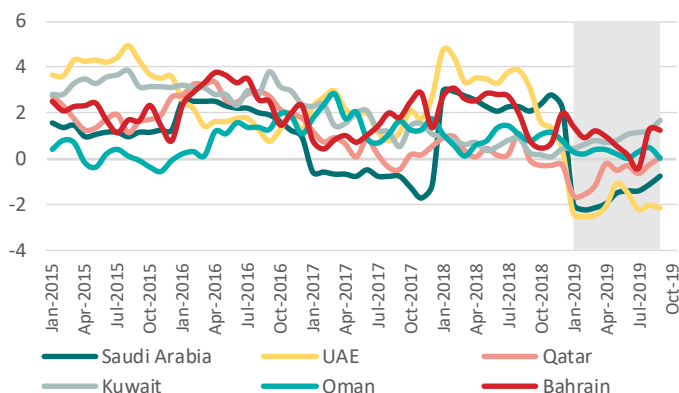
As monetary policies eased, interbank rates and lending rates dropped in nominal terms. The Saudi interbank offered rate was 37 basis points lower in September than at mid-year, and the Emirates interbank offered rate was 41 basis points lower in October than at mid-year (Figure 16). Qatar’s bank lending rate fell from 5.51 percent in June to 5 percent in September, but, due to negative inflation, real lending rates exceeded nominal rates (Figure 17).

In principle, lower interest costs should encourage borrowing by households and corporations, including to refinance costly debt, which could boost nonoil growth. Bank credit to the private sector increased, year on year, in the first three quarters of 2019 (Figure 18). In Qatar, lending by Islamic banks outpaced lending by traditional banks, with most new loans focused on real estate and consumption. Meanwhile, traditional lenders more than doubled their trade-related lending and expanded their lending to service firms by one-third in

FIGURE 19

Consumer price inflation Percent

Source: Haver Analytics



July. Bahraini banks received a boost from the GCC financial-support package and Moody’s upgraded the country’s outlook from “negative” to “stable.” Credit to the private sector expanded by 8.4 percent (y/y) in the first quarter, 12.1 percent in the second, and 9.2 percent in the third. Meanwhile, credit growth in Kuwait eased slightly from 4.8 percent in the first quarter to 5.2 percent in the second quarter, as lending for home purchases and lending to the oil and gas sector both diminished, the latter skewed by base effects¹⁰. The central bank projects that the growth of bank lending to the private sector will average 4-5 percent over the year, up from 2.3 percent in 2018, based on solid job creation and a global interest-rate cycle tilted toward easing.

Consumer prices have been low and declining in some GCC countries, tracking weak domestic demand

Consumer prices have been weak across the GCC, reflecting subdued domestic demand in a number of sectors. Falling rents in Saudi Arabia and the UAE, as well as declining food prices in the UAE, resulted in negative consumer price changes in both countries, though the latest data for Saudi Arabia indicates that prices are beginning to firm up as the pace of decline has slowed (Figure 19). In Qatar, core consumer prices moved in and out of negative-change territory in 2019. Compounding the effects of lower oil prices, Qatar’s continuing diplomatic rift with Saudi Arabia, the UAE, Bahrain, and other Arab states has dragged down housing prices in the country.

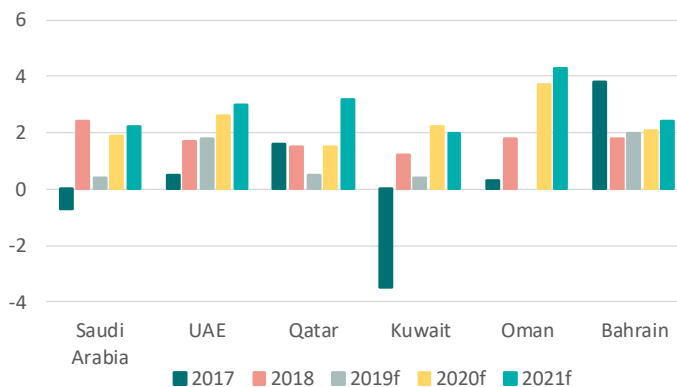
The other GCC countries have experienced low and, in some cases, negative changes in consumer prices. In Bahrain, the introduction of the VAT in January 2019 lifted consumer prices in the first half of the year. However, consumer price changes turned negative in July, as the price effects of the

10/ Massive bank lending supported a large liquefied natural gas project in mid-2018.

FIGURE 20

GDP growth, real Percent

Source: World Bank Group



tax were offset by lower oil prices and by slowing domestic economic activity outside of financial services and construction. In Oman, consumer prices were flat in June, rose slightly to 0.3 percent in July, then fell flat again in September. Consumer price changes will likely be subdued over the year, as growth is projected to remain weak. Consumer prices picked up in Kuwait in the first three quarters of 2019. Lower food prices were countered by a recovery in credit growth, boosting activity in the non-oil sectors, which contributed 1.9 percentage points to an overall growth rate of 2.6 percent (y/y) in the first quarter of 2019.

Near Term Prospects

GCC growth will be weak in 2019, before recovering in 2020 and 2021. Global growth has been downgraded for 2019, but the expectations are that global growth will stabilize in 2020-21, albeit at a lower rate than previously forecast (Annex). Weaker-than-anticipated global demand is also expected to push oil prices below previous forecasts. Risks to the global outlook are tilted to the downside, and would likely result from a worsening of the trade war between the U.S. and China. Other risks include slower-than-expected growth among major economies and new episodes of financial stress in emerging markets and developing economies triggered by idiosyncratic shocks.

Growth in the GCC will be modest in 2019 but gradually accelerate in 2020 and 2021

Economic growth in the GCC is projected to gradually recover in 2020-21 after falling below expectations in 2019 (Figure 20). Since January, regional growth projections for 2019 have been revised downward by more than a percentage point. Growth in 2020-21 will be driven by capital investment and household consumption, as strategic investments designed to promote diversification accelerate while private economic activity picks up (Table 1 and Figure 21). Imports of capital

TABLE 1

MENA GCC forecast summary

(annual percent change,
unless otherwise specified)

	2017	2018	2019f	2020f	2021f
AGGREGATE GCC COUNTRIES					
GDP growth	-0.2	2.0	0.8	2.2	2.6
<i>Contributions to growth:</i>					
Private consumption	1.1	0.5	0.4	0.9	0.9
Government consumption	1.0	0.9	0.5	0.4	0.4
Fixed investment	-0.5	-0.3	0.5	1.0	1.3
Net exports, GNFS ¹	-1.2	1.8	-0.5	-0.1	0.1
Current account balance (% of GDP)	2.8	9.7	6.0	6.3	6.7
Fiscal balance (% of GDP)	-7.4	-3.5	-4.6	-3.6	-3.1
Terms of trade (% change)	-2.6	3.1	-1.3	-0.9	-0.6
INDIVIDUAL GCC COUNTRIES					
GDP growth					
Bahrain	3.8	1.8	2.0	2.1	2.4
Kuwait	-3.5	1.2	0.4	2.2	2.0
Oman	0.3	1.8	0.0	3.7	4.3
Qatar	1.6	1.5	0.5	1.5	3.2
Saudi Arabia	-0.7	2.4	0.4	1.9	2.2
United Arab Emirates	0.5	1.7	1.8	2.6	3.0

Source: World Bank Group.

Notes: f = forecast. Aggregate GCC GDP at market prices measured in constant 2010 U.S. dollars.

1/ Exports less imports of goods and non-factor services (GNFS).

and intermediate goods required for the investment program will likely reduce the contribution of net exports to GDP growth. Government spending is also expected to contribute less to growth than in 2017-18, as governments rationalize expenditures to control fiscal deficits.

Saudi Arabia's GDP growth rate will likely slow to 0.4 percent in 2019 before rising to an average of 2.1 percent over 2020-21. The global economy's gradual stabilization at a forecast growth rate of 2.5 percent in 2021 should boost oil demand and stabilize oil prices at US\$59 per barrel in 2020-21. While the Saudi Arabian government aims to diversify the economy away from oil, it also appears to remain firmly committed to leveraging the value of its oil resources by refocusing investment away from upstream activities toward downstream industries, such as oil refining and petrochemical production. Nevertheless, this strategy also has significant implications for environmental sustainability, which is discussed in more detail in the final section. Saudi Arabia plans to raise its global refining capacity from 5 million to 8-10 million barrels per day and triple its chemical production to 34 million metric tons by 2030. Over 2018-19, Saudi Aramco has committed US\$10 billion for a refining and petrochemical complex in China, US\$7 billion for a stake in a refining and petrochemical project in Malaysia, US\$6 billion for the expansion of a refinery in South Korea, and an undisclosed amount for a majority stake in a planned US\$44 billion refinery in India.

Efforts to diversify the economy away from oil have advanced slowly, but the government's plans remain ambitious. Many projects rely on the Public Investment Fund (PIF) for a large share of their financing. Vision 2030 envisaged a

huge liquidity boost to the PIF financed by the initial public offering of Saudi Aramco. In April 2019, Saudi Aramco completed a US\$12 billion debut bond sale, which enabled it to purchase a 70 percent stake in Saudi Basic Industries Corporation (SABIC), the state petrochemicals firm, from the PIF for US\$69.1 billion. In November 2019, the government announced plans to sell a percentage of its shares in Saudi Aramco on the local stock exchange, the Tadawul. Meanwhile, PIF resources are invested in various ventures, including in funds run by the U.S. asset-management firm Blackstone and by Japan's Softbank, as well as stakes in Uber Technologies Inc., Tesla Inc., Lucid Motors, and Noon.com, an e-commerce platform established by GCC investors. PIF funds are financing massive domestic projects, including the construction of Neom, a vast high-tech city; the completion of the Red Sea Project, a luxury tourism destination; and the establishment of a domestic arms and defense industry.

The UAE's GDP growth rate is projected to accelerate from 1.7 percent in 2018 to 3 percent by 2021. The UAE's economy is more diversified than the economies of most of its GCC peers, and the non-oil sector accounts for roughly 70 percent of GDP. Economic stimulus measures announced by Abu Dhabi and Dubai in mid-2018 seek to further strengthen the non-oil economy of the two emirates through a combination of regulatory reform, business promotion, and public investment. The AED 50 billion (US\$13.6 billion) Abu Dhabi plan encompasses 10 initiatives, including the issuance of dual licenses to free-zone companies to submit tenders for government contracts, the implementation of the Ghadan-21 accelerated development program, and the creation of 10,000 jobs in the private and public sectors over the next five years. The

Dubai plan includes a reduction of fees on commercial entities from 5 to 2.5 percent, the cancellation of 19 fees related to the aviation industry, the waiver of the 4 percent fee imposed by the Land Department for delayed property registration, and a freeze on tuition fees for all private schools for the 2018-19 school year. The government recently introduced a series of measures designed to encourage private investment, including opening 122 economic activities to full foreign ownership outside of free zones, and it launched expatriate-friendly initiatives to curb the exodus of skilled professionals.

Hosting Expo 2020 is expected to boost the economy. Dubai has already spent US\$40 billion (9.7 percent of 2018 GDP) on major infrastructure projects for Expo 2020, including US\$13.4 billion for the Dubai Exhibition Centre and the Dubai South Villages, and US\$2.9 billion for the new Metro line. A study prepared for the government by the consulting firm Ernst & Young estimates that Expo 2020 will create AED 37.7 billion (US\$10.3 billion) in value for the UAE between 2013, when preparations began, to October 2020, before the event starts, and another AED 62 billion (US\$16.9 billion) from April 2021, after the event ends, to 2031. The calculation of post-event benefits assumes, inter alia, that Dubai will be able to redevelop the 4.4 square-kilometer exposition site into a full-fledged urban center. Nevertheless, the projected global economic slowdown will continue to negatively impact trade, transportation, and tourism dynamics in the UAE.

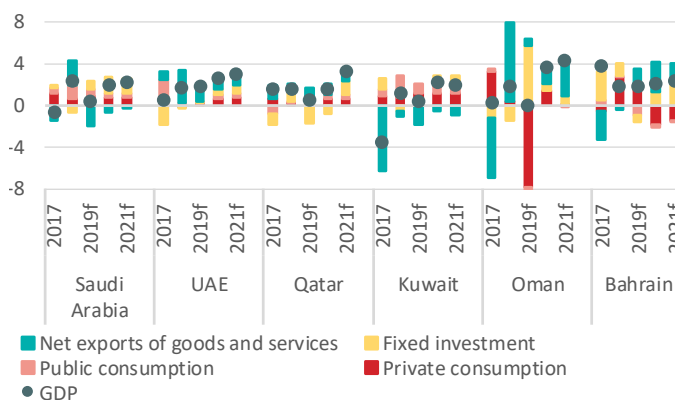
Qatar's economy is projected to grow by a modest 0.5 percent in 2019 before accelerating to 1.5 percent in 2020 and 3.2 percent in 2021. The Barzan Gas Project, which is scheduled to start operations in November 2019, will boost production by RasGas, a joint venture of Qatar Gas and Exxon Mobil, by 2 billion cubic feet per day to a total of 11 billion cubic feet per day—a modest but significant addition to Qatar's total gas production, which reached 176 billion cubic feet per day in 2018. The US\$10.3 billion project (5 percent of Qatar's 2018 GDP) is designed to extract gas from Qatar's massive North Field via both onshore and offshore facilities. New production will go toward meeting the country's rising power requirements, including for desalination plants, the new Doha Airport, and the new Doha Seaport. In addition to gas, the plant will produce about 6,000 barrels per day of plant condensate, 7,500 barrels per day of butane, 10,500 barrels per day of propane, 22,000 barrels a day of field condensate, and 34,000 barrels per day of ethane to be used as a feedstock for Qatar's growing petrochemical industry.

Meanwhile, the construction of facilities associated with Qatar's hosting of the FIFA World Cup in 2022 is winding down. The contracting process for US\$200 billion (105 percent of 2018 GDP) worth of infrastructure, which had been expanding at a rate of 18 percent per year since the end of 2012, shrank for the first time during the first quarter of 2019, contracting by 1.2 percent (y/y). However, services activity is picking up as the event nears. The government has also prepared a new US\$16.4 billion (8.5 percent of 2018 GDP) investment program targeting infrastructure and real estate, to be implemented over the next four years. These developments should support economic activity, particularly in the non-oil sector, as Qatar enters the third year of its diplomatic rift with Saudi Arabia, the UAE, Bahrain, and other Arab countries. The lack of a resolution will continue to weigh on investor sentiment, though Qatar has made strategic investments, including in ports, that have enabled it to substantially reroute trade toward its non-GCC partners.

FIGURE 21

Contribution to GDP growth Percentage points

Source: World Bank Group



Kuwait's growth rate is expected to dip to 0.4 percent in 2019 before picking up to 2.2 percent in 2020, when the OPEC production cuts are slated to expire, and 2 percent in 2021¹¹. Kuwait, the most oil-reliant of the GCC economies, plans to invest US\$115 billion (82 percent of 2018 GDP) in the oil industry over the next five years. The government aims to boost total capacity from 3 million barrels per day to 4 million. If implemented, these investments should substantially increase oil production in the medium- to long term. In the near term, the resumption of production in the Partitioned Neutral Zone, which Kuwait shares with Saudi Arabia, offers more immediate prospects for an oil boost. The two countries halted production at their jointly run oilfields—the onshore Wafra and the offshore Khafji—in 2014-15 due to a dispute over sovereignty issues related to Kuwait's extension of a concession to the U.S.-based oil company Chevron. The disruption cut the global oil supply by some 500,000 barrels per day or 0.5 percent. In February 2019, the two countries reported a breakthrough in discussions to resume production from the joint oilfields.

Meanwhile, on the non-oil front, the government is planning to establish a Northern Economic Zone that will help diversify Kuwait's economy and galvanize trade with Iraq, Iran, and China. However, the proposed project is facing political questions from legislators. Unveiled in mid-2018, the project outlines an economic free zone, a deep seaport, an airport, an Olympic stadium, and a tower taller than Dubai's Burj Khalifa to be built in phases over 25 years in the northern territory, which will be linked with the newly opened Sheikh Jaber al Ahmed causeway. However, details on both the project itself and its financing arrangements are sparse. The project was initially tagged to cost US\$86 billion (61 percent of Kuwait's 2018 GDP), and a cooperation agreement was reportedly

11/ These projections assume that the oil production cuts will indeed expire in 2020, in line with the current OPEC agreement.

signed with China's Development Bank at a One Belt One Road summit in Beijing in April 2019. However, a proposal to endow the development with significant legal, financial, and administrative autonomy, following the example of the Dubai International Financial Center (DIFC), has become the focus of legislative attention and debate.

Oman's growth rate is projected to accelerate from an estimated 0 percent in 2019 to 3.7 percent in 2020 and 4.3 percent in 2021, supported by rising natural gas production.

Oman was the GCC's fourth-largest gas producer in 2018, but output is rising from new gas fields. Jointly developed by Oman Oil Company and British Petroleum, the first phase in the development of Oman's giant Khazzan gas field, which started production in September 2017, has reportedly reached its design capacity of around 1 billion cubic feet of gas per day and around 35,000 barrels a day of condensate. The second phase development, which was sanctioned in April 2018 and is expected to come onstream in 2021, will add 1,150 square kilometers to the original 2,860 square kilometers of concession area and deliver an additional 0.5 billion cubic feet of gas per day and over 15,000 barrels of condensate. Meanwhile, the Ministry of Oil and Gas signed an agreement in April 2019 to award France's Total SA with an exploration license for a 10,000 km² block in central Oman; the first well is due in 2020.

Oman's National Program for Enhancing Economic Diversification (Tanfeedh) aims to boost non-oil development.

The Tanfeedh Program is derived from the Ninth Five-Year Plan covering 2016-2020, which consolidates the government's strategies for manufacturing, transportation, logistics, tourism, and fisheries. Some 121 projects and initiatives have been launched in five areas, including non-oil manufacturing (a new ammonia fertilizer plant, the expansion of Sohar Aluminum, two new cement plants, food production, etc.), logistics (the Cargo Village at the Muscat Airport, the Salalah Port development, etc.), tourism (multiple national heritage sites), financial services, and labor markets. The Tanfeedh Program was developed through the active participation of the private sector, the academic community, civil society, state-owned enterprises, and public agencies. Supported by the Tanfeedh Program, Oman's non-oil economy is projected to grow by 4 percent per year over the medium-term.

Bahrain's economy is expected to grow at a moderate rate of 2 percent in 2019 and average 2.3 percent over 2020-21.

In March 2019, the state-owned oil firm Bahrain Petroleum Company launched a US\$4.2 billion (11 percent of 2018 GDP) expansion of the Sitra oil refinery via a turnkey engineering, procurement, construction, and commissioning contract awarded to a consortium that includes the U.K.'s TechnipFMC, Korea's Samsung Engineering, and Spain's Tecnicas Reunidas. Reputedly the largest industrial project in the country's recent history, the Bapco Modernization Program will have a saturated gas plant and include units for sulfur recovery, tail gas treatment, sour water stripping, amine recovery, bulk acid gas removal, and sulfur solidification. The expansion will increase the Sitra oil refinery's capacity from 267,000 to 380,000 barrels per day by 2022.

However, Bahrain is only a minor oil producer, and its non-oil economy is projected to drive growth. Bahrain's oil sector accounts for about one-fifth of its GDP. Non-oil GDP is projected to grow at a rate of 3 percent per year during the forecast period, driven by an increase in manufacturing output

and higher levels of infrastructure spending. The Line 6 Expansion Project at Aluminum Bahrain began producing hot metal from the smelter's sixth pot line in December 2018, positioning Aluminum Bahrain to become world's largest aluminum smelter when the project is completed in 2019. The US\$3 billion expansion (8 percent of 2018 GDP) will increase the smelter's capacity by 540,000 metric tons to 1.5 million metric tons per year.

Fiscal deficits are projected to narrow but persist across most GCC countries

Saudi Arabia is was originally expected to reduce its fiscal deficit from 5.9 percent of GDP in 2018 to 4.1 percent by 2021, a target that the government has recently revised upward to 5 percent according to the pre-budget statement for fiscal year 2020. The government initiated energy-price reforms to rationalize public expenditures, implemented a 5 percent VAT to increase non-oil revenues, and introduced social policies (e.g., the Citizens' Account Program) to compensate low- and middle-income households for the cost of the fiscal reforms. The government had increasingly relied on public spending to support growth, incurring deficits and drawing down fiscal buffers in the process. The lower deficits forecast for 2019-2021 are aligned with the targets of the fiscal balance program, which aims to balance the budget by 2023. To achieve its fiscal objectives, the government must focus on: (i) implementing additional energy- and water-price reforms; (ii) reducing the public sector wage bill; (iii) more effectively targeting social benefits; (iv) improving public expenditure efficiency; and (v) better prioritizing capital spending. Balancing socioeconomic development and fiscal sustainability objectives would require that the government maintain adequate space to rebuild its fiscal buffers and reduce its external vulnerabilities in a context of weakening global oil demand and intensifying oil-price volatility.

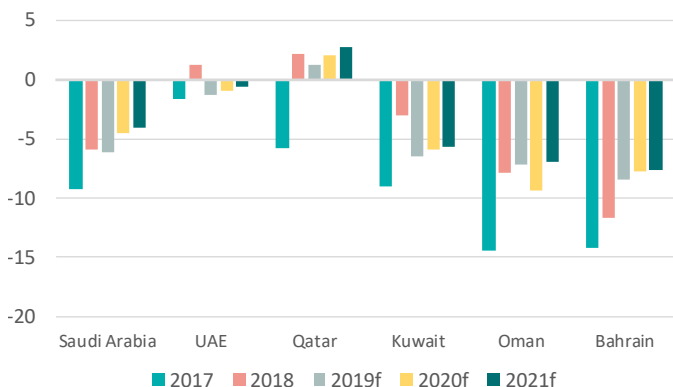
The UAE is projected to incur small fiscal deficits in 2019-2021. Along with Saudi Arabia, the UAE was among the first GCC states to implement the excise tax on tobacco, carbonated drinks, and energy drinks, which it began levying in 2017, and the VAT, which it began levying in 2018. As capital spending for Expo 2020 tapers off toward the end of 2019, the UAE is expected to accelerate the implementation of emirate-level stimulus plans. Meanwhile, government-related entities are also embarking on new investment programs. Fiscal reform priorities for the near and medium term include: (i) leveling the playing field between government-related entities and private corporations; (ii) strengthening the management of contingent liabilities arising from debts by government-related entities, government guarantees, and public-private partnerships; and (iii) enhancing transparency among federal and emirate-level authorities. The government should also develop a medium-term fiscal framework that balances macroeconomic stabilization with saving for future generations.

Qatar is the only GCC country expected to post fiscal surpluses for all years of the forecast period. Qatar's surplus is forecast to rise from 1.3 percent of GDP in 2019 to 2.8 percent in 2021 (Figure 22). It was also able to record a fiscal surplus in 2018, which was underpinned by expenditure restraint. Qatar implemented the excise tax on tobacco, energy drinks, and carbonated drinks in 2019 and plans to introduce the VAT in 2020. Combined with sustained expenditure control, these

FIGURE 22

Fiscal balance Percent of GDP

Source: World Bank Group.



revenue measures should enable the government to achieve the fiscal surpluses forecast for the period. Expenditure-side reforms will focus on rationalizing utility subsidies, containing the public-sector wage bill, and improving public investment management.

Kuwait’s fiscal deficit is expected to average 6.1 percent of GDP between 2019 and 2021, significantly larger than had been forecast at the beginning of the year. By delaying the implementation of excise taxes on tobacco, energy drinks, and carbonated drinks until 2020, and the VAT until 2021, Kuwait will forego 2.3 percent of GDP per year in additional revenue. The authorities took initial steps to rationalize some public employment benefits and cut utility subsidies, but the legislature has pushed back against further reductions in energy and water subsidies or measures to reduce government spending. Even without new tax revenues or deeper expenditure reforms, a set of budgetary streamlining mechanisms should help strengthen the fiscal accounts. On the revenue side, these measures include repricing government services, enforcing penalties on businesses that fail to meet “Kuwaitization” quotas, and strengthening revenue collection by public utilities. Expenditure-side measures include closing transfer loopholes, improving procurement, limiting grants to priority sectors, and rationalizing capital spending. A draft debt law pending legislative approval would raise the country’s borrowing limits; otherwise, the government would have to draw on its General Reserve Fund assets to finance the fiscal deficit.

Oman has recorded annual fiscal deficits since 2009, and projected deficits range from 8.4 percent of GDP in 2020 to 6.5 percent in 2021. These high but narrowing deficits would keep gross general government debt to an average of 63 percent of GDP in 2019-2021. The authorities implemented ex-

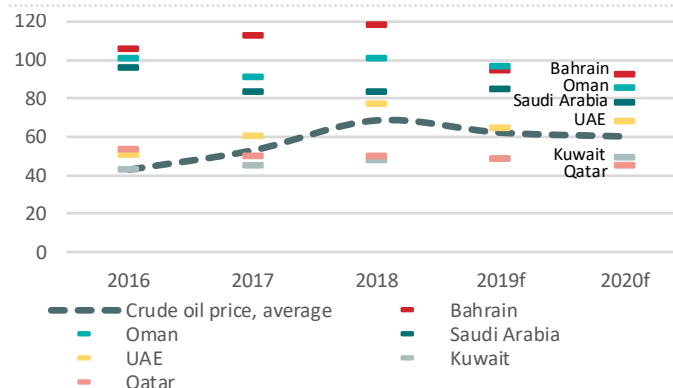
12/ The voluntary retirement scheme now covers 8,000 people and could reduce the wage bill by Bahraini dinar (BHD) 122 million (US\$324 million) by end-2019. The costs of the scheme would be financed off-budget.

13/ Public sector debt sustainability analyses are drawn from IMF Article IV Consultation reports.

FIGURE 23

Fiscal break-even price of oil US\$ per barrel

Source: IMF, *Regional Economic Outlook: Middle East and Central Asia*, October 2019.
Note: The oil price at which the fiscal balance is zero.



cise taxes on tobacco, energy drinks, and carbonated drinks in 2019, but delayed plans to introduce the VAT. The government’s extensive fiscal reform agenda is designed to reduce public-sector vulnerabilities by boosting non-oil revenue, mitigating expenditure rigidities, streamlining public investment, and addressing constraints to growth, while focusing the burden of the fiscal adjustment on wealthier households. Going forward, a formal medium-term fiscal framework could help anchor the fiscal adjustment effort.

Bahrain is expected to continue implementing the fiscal reforms defined in its fiscal balance program. The fiscal deficit is forecast to narrow from 10.9 percent of GDP in 2019 to 7.3 percent by 2021. This projection assumes that the government will phase out untargeted subsidies while protecting vulnerable households, continue to leverage the voluntary retirement scheme as a tool to contain the wage bill¹², and reduce VAT exemptions introduced in 2019. As the fiscal deficit is projected to persist through 2021, with the country’s fiscal break-even price for oil exceeding the forecast market price (Figure 23), the general government debt stock is expected to remain above 100 percent of GDP during the forecast period. Efforts to strengthen debt management would support the fiscal adjustment.

Public sector debt sustainability analyses suggest that fiscal reforms remain important to ensuring long-term debt sustainability in the GCC countries. Except in Bahrain and Oman, general government gross debt remains modest in most of the GCC compared to the standards of the OECD countries (Figure 24). And the GCC governments continue to maintain access to domestic and international debt markets at reasonable rates. Still, the increase in debt in recent years and expectations of fiscal deficits in the near-term suggest that fiscal reforms are necessary to contain financing needs and keep debt on a sustainable growth path. Deeper fiscal reforms are needed in Kuwait to ensure long-term debt sustainability, according to the IMF¹³, while a more gradual fiscal consolidation would not endanger debt sustainability in Qatar considering the availability of substantial fiscal space. Meanwhile, general government debt is expected to remain stable in percent of GDP in the UAE through 2024.

FIGURE 24

General government gross debt Percent of GDP

Source: IMF, *World Economic Outlook – Global Manufacturing Downturn, Rising Trade Barriers*, October 2019.

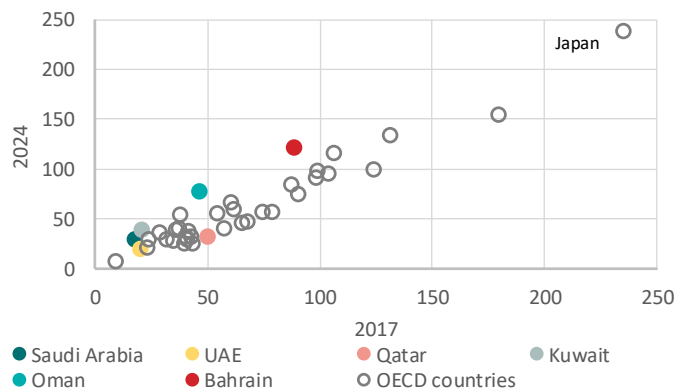


FIGURE 25

Current account balance Percent of GDP

Source: World Bank Group.

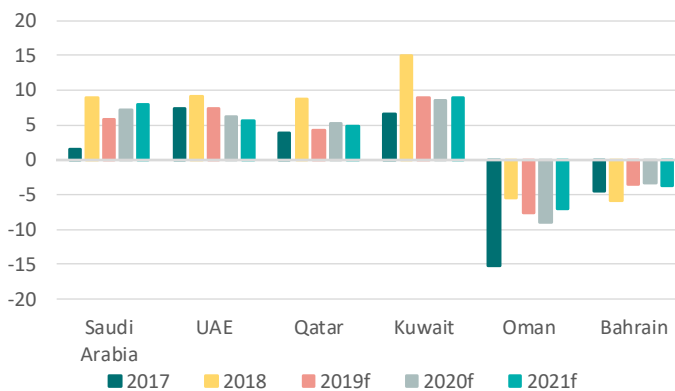
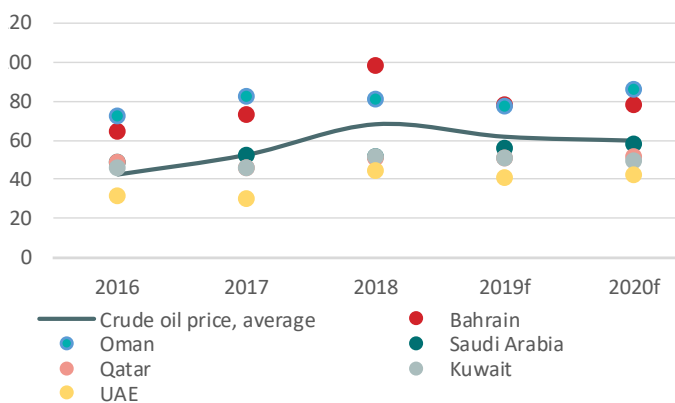


FIGURE 26

External break-even price of oil US\$ per barrel

Source: IMF, *Regional Economic Outlook: Middle East and Central Asia*, October 2019.
Note: The oil price at which the current account balance is zero.



Current account surpluses are forecast in all GCC states except Oman and Bahrain

Saudi Arabia will likely achieve current account surplus ranging from about 5.9 percent of GDP in 2019 to 7.9 percent in 2021 (Figure 25). Oil and gas still account for eight-tenths of Saudi Arabia's goods exports, and the near-term trajectory of oil prices will determine the country's trade and current-account performance during the forecast period—the country's external break-even price of oil is approximately at par with the forecast market price of the commodity in 2020 (Figure 26). Meanwhile, rising domestic demand by the private sector and increased public infrastructure spending will likely bolster imports, narrowing the trade surplus.

The UAE's current account surpluses is projected to narrow from 7.4 percent of GDP in 2019 to 5.7 percent in 2021. The UAE has a relatively diversified export profile that includes manufactured goods, machinery and equipment, and chemicals, which account for a combined two-fifths of goods exports. Non-oil products are expected to drive the increase in exports. Meanwhile, the emirate-level stimulus plans, new capital investment by government-related enterprises, and the conversion of the Expo 2020 facilities into urban centers will boost imports during the forecast period.

Qatar's current account surplus is forecast to narrow from 8.7 percent of GDP in 2018 to 4.4 percent in 2019 before rising to 5.6 percent in 2020. The Barzan Gas Project, which is focused on the domestic market, is slated to come online in 2020, which will free up more of the country's current gas output for export. Qatar is also planning a second phase of the Barzan Gas Project that will increase its capacity by another 2 billion cubic feet per day and a third phase that will boost its capacity by a further 2.5 billion cubic feet per day. Production and exports from the latter phases are not expected until after the forecast period.

After surprising on the upside in 2018, Kuwait's current account surplus is projected to average 9 percent of GDP from 2019 to 2021. Oil exports account for nine-tenths of Kuwaiti goods exports. In principle, the prospective resumption of production in the Partitioned Neutral Zone should boost Kuwaiti oil exports, but in practice exports will likely remain broadly stable, as global oil demand remains depressed and the OPEC production cuts are still in effect. Meanwhile, imports for the country's infrastructure program are expected to pick up during the forecast period, which should increase pressure on the trade and current account balances.

Oman's current-account deficit is projected to narrow from 8 percent of GDP in 2020 to 6.6 percent by 2021. Following the collapse of global oil prices in mid-2015, Oman began running current account deficits in 2015. The recovery of global oil prices in early 2017 spurred oil-export growth in 2017 and 2018 despite the production cuts. Oman remains dependent on oil exports, which account for 70 percent of goods exports, and oil will continue to dominate its export performance during the forecast period. However, chemicals, manufactured goods, and crude materials now account for 30 percent of Oman's exports, and the wide-ranging economic diversification agenda launched under the Tanfeedh Program should help spur non-oil export growth over the medium term.

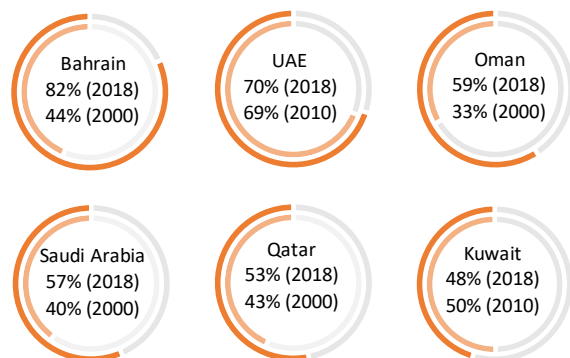
Bahrain's current account deficit is expected to average 4.3

FIGURE 27

Non-oil GDP Percent of GDP

Source: Haver Analytics.

Note: Non-oil versus oil sector data before 2010 are not available for the UAE and Kuwait.



percent of GDP in 2019 and 2020. Bahrain has reported annual current account deficits since 2015. Rising foreign worker remittances (remittances in 1Q-2019 were \$770 million, up from \$610 million in 4Q-2018) and higher interest payments on external debt, which now exceeds 100 percent of GDP, are projected to offset future trade surpluses.

Tracking Progress towards Diversification in the GCC

The GCC countries are striving to reduce their dependence on oil and gas, and regional economies are gradually diversifying away from the oil sector. Over the past two decades, all GCC countries have seen their non-oil sectors expand, with non-oil growth frequently outpacing oil-sector growth, albeit from a lower base. Rates of non-oil growth have varied by country, along with the relative sizes of the oil and non-oil sectors. At the end of 2018, Bahrain and the UAE had the most diversified economies in the region, while Kuwait and Qatar were the most dependent on oil (Figure 27).

This section evaluates the GCC countries' progress on structural reforms and strategic investments in selected areas to support economic diversification¹⁴. The GCC coun-

14/ Subsequent editions of the *GCC Economic Update* will address other policy areas and other economic sectors.

15/ These requirements are based on European Union (EU) and OECD guidance. They are designed to ensure that companies operating in a low- or no-corporate-tax jurisdiction have a substantial purpose other than tax reduction and that their economic outcome is aligned with value creation. To conform with the UAE's economic substance rules, a company's activities in the UAE should be directed and managed in the UAE; its core income-generating activities should be performed in the UAE; and it should have an adequate level of qualified employees, premises, and annual operating expenditures.

tries have achieved important progress on their reform agendas, and this edition of the *GCC Economic Update* examines three areas where significant gains continue to be made: (i) the business and investment climate; (ii) the financial sector; and (iii) fiscal revenue mobilization. The analysis also highlights: (i) recent and planned investments in renewable energy, and (ii) the ongoing elaboration of the regulatory framework for the financial technology (fintech) sector.

Structural Reforms

Countries across the GCC have progressively reformed their business environments. This year, the GCC hosts three of the world's best performer top 10 global improvers in the World Bank's Doing Business Indicators – Saudi Arabia, Bahrain, and Kuwait – and they account for about two-thirds of the region's 35 reforms. Saudi Arabia carried out a record number of business reforms in the past year, making it this year's most improved country. Bahrain moved up 19 places to 43rd place since last year and is world's best performer in terms of fiscal compliance time. The UAE maintains the highest ranking in the Middle East and North Africa (MENA) region and is among the top 20 best performing economies globally at number 16 (Table 2). Bahrain has introduced a competition law, a bankruptcy law, and legislation regulating the processing and transfer of data for commercial purposes, which should help reinforce the country's position as a regional hub for information and communications technology. The UAE recently passed two new pieces of legislation with the potential to significantly alter the country's business environment. On July 2, 2019, the UAE Cabinet announced that onshore companies licensed in 122 specific activities in 13 business sectors will be eligible for up to 100 percent foreign ownership. The Cabinet subsequently published two resolutions dealing with economic substance requirements¹⁵ and annual compliance and tax reporting for multinational companies as part of a broader effort to promote the global framework for tax compliance. In June, a new insolvency regime for public and private companies incorporated in the DIFC was enacted. Meanwhile, Saudi Arabia approved a new competition regime that will regulate anticompetitive collusion, economic concentration, and the abuse of market dominance. Finally, Oman's new Commercial Companies Law has helped modernize the country's framework for regulating public joint stock companies and listings of shares, bonds, and sukuk.

Several regional governments have implemented reforms designed to facilitate trade and attract foreign investment and expatriate workers. The Abu Dhabi Investment Office was established to oversee strategies for attracting foreign investment in the emirate. Abu Dhabi also introduced a law regulating public-private partnerships (PPPs) to encourage private-sector participation in technology, urban infrastructure, education, healthcare, housing, transportation, and other strategic sectors. Qatar has ratified a new investment law that will promote foreign investment in real estate by allowing 100 percent foreign ownership in certain areas.

Saudi Arabia has overhauled its foreign-investment restrictions and processes, including the "Negative List" used by the Saudi Arabian General Investment Authority (SAGIA). The revised list permits foreign investment in road

TABLE 2

Progress with the Doing Business Indicator

Source: World Bank, *Doing Business 2020 – Sustaining the Pace of Reforms*, 2019.

Rank 2017/18	Rank 2018/19	Change	Economy	Score 2018/19
11	16	↓	UAE	80.9
62	43	↑	Bahrain	76
92	62	↑	Saudi Arabia	71.6
78	68	↑	Oman	70
83	77	↑	Qatar	68.7
97	83	↑	Kuwait	67.4

transportation, real estate brokerage, audiovisual services, and recruitment and related services. SAGIA also made several changes to its foreign-investment licensing rules and procedures, establishing e-licenses and authorizing the discretionary use of five-year investment licenses instead of annual licenses subject to renewal. Licensing procedures were simplified: the number of required documents was reduced from 12 to two, and the time taken to process them was cut from three days to three hours. SAGIA announced that 291 new investor licenses were issued in the second quarter of 2019, double the number issued during the same period in the previous year. The sectors with the largest shares of new licenses were construction (61 licenses), information and communications technology (51), and manufacturing (45). SAGIA recently reported that 55 percent of the 300 reforms planned under Vision 2030 have been implemented. To attract private investment in the health sector, the government has lifted restrictions on foreign ownership of private healthcare institutions.

To facilitate labor mobility, Saudi Arabia and UAE both enhanced their expatriate residency permits. However, Saudi Arabia also increased its levy on foreign workers, which spurred the departure of almost 1.8 million mostly less-skilled workers in 2018. The UAE replaced bank guarantees for labor with low-cost insurance policies, and the new Permanent Residency Scheme aims to boost investment by allowing longer visas for skilled expatriates. Qatar's government announced it will grant residency permits to foreign investors for the first time.

Regional governments are upgrading customs-clearance processes to boost international trade. Bahrain has deployed portal scanners and upgraded the single-window system to improve cross-border trade efficiency by streamlining bureaucratic processes. The Saudi Customs Authority is implementing a modernization program that includes the establishment of a National Targeting Centre to improve customs compliance and advance the government's vision of transforming Saudi Arabia into an international logistics hub. The Saudi Customs Authority and the Saudi Port Authority have partnered with the Danish shipping and logistics conglomerate Maersk to champion the use of blockchain technology in the shipping industry.

Financial-sector reforms are accelerating across the GCC.

The UAE is now in the final phase of implementing new central-bank rules regulating the capital adequacy of commercial banks operating in the UAE in line with Basel III. Bahrain, Saudi Arabia, and the UAE have also moved to establish and regulate cryptocurrencies. Bahrain's central bank issued new cryptocurrency regulations, including rules on licensing, governance, and risk management that treat cryptocurrencies as a new asset class. In January, Saudi Arabia and the UAE announced plans to launch a new common cryptocurrency known as ABER. The Abu Dhabi Global Market (ADGM) became the first regulator in the MENA region to issue regulations on cryptocurrency-related activities conducted in or from its jurisdiction.

In line with their economic diversification strategies, GCC governments have implemented measures to diversify the sources of fiscal revenue. Most domestic-revenue mobilization policies have focused on two measures, VAT and excise taxes (Figure 28 and Figure 29), and only Oman has increased its corporate income tax rate. Saudi Arabia and the UAE implemented a 5 percent VAT in early 2018, and Bahrain followed suit in early 2019. However, Kuwait and Oman have postponed VAT implementation until 2021. Saudi Arabia and the UAE introduced excise taxes on tobacco, energy drinks, and soft drinks in 2017, and Oman and Bahrain did so in 2018. Qatar and Oman introduced a 100 percent tax on alcohol in early 2019, but Oman then halved the tax rate to 50 percent to ease concerns of a tourism industry that caters for Western clients. Saudi Arabia reduced VAT registration threshold from SAR 1 million (US\$267,000) to SAR 350,000 (US\$93,000) and expanded excise taxes to include electronic tobacco devices and sweetened drinks. Corporate income taxes are limited in the GCC. Oman is the sole GCC country to apply a corporate income tax to all companies, both foreign and domestic, and in 2017 it raised its corporate tax rate from 12 percent to 15 percent. In the UAE, the corporate income tax only applies to oil companies and foreign banks.

Saudi Arabia took important steps toward opening the country to tourism and strengthening women's rights. Saudi Arabia recently launched a new tourist-visa category that allows 49 nationalities to apply for a visa online or on arrival. This reform brought in 24,000 foreign visitors within the first 10 days of its implementation. Saudi Arabia also took limited

FIGURE 28

Excise tax and VAT implementation schedule

Source: World Bank Group.

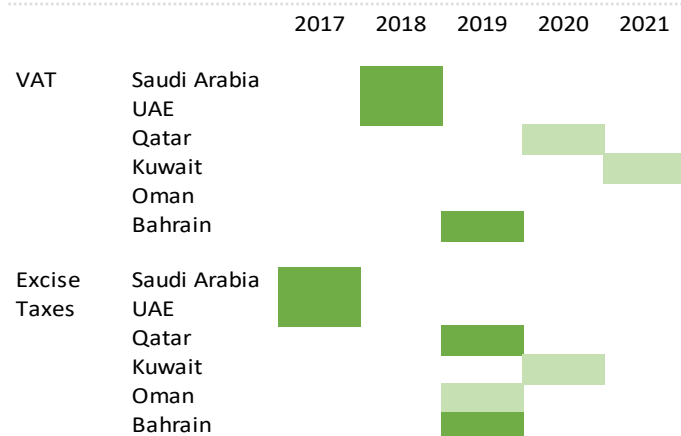
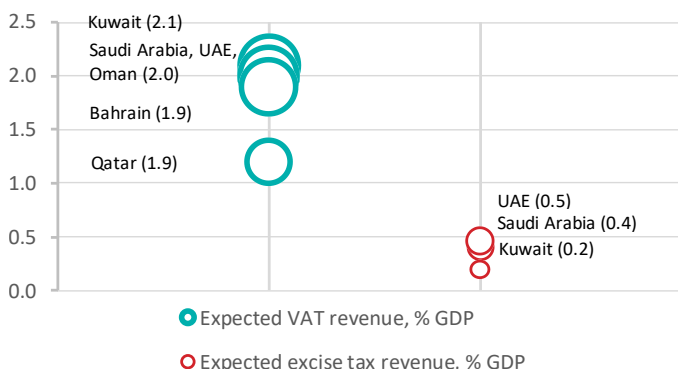


FIGURE 29

Estimated excise tax and VAT revenues Percent of GDP

Source: International Monetary Fund



but important steps toward enhancing women’s rights by announcing the relaxation of its longstanding guardianship laws. Travel restrictions for women over the age of 18 were lifted this year.

While the GCC countries have made important progress on their development agendas, several outstanding issues remain to be addressed

GCC governments have taken critical steps to improve their business environments and attract investment, but structural reforms will be necessary to ensure broad-based and sustainable long-term growth. Further economic diversification will require deepening labor-market and education reforms to generate productivity gains and expand economic opportunities for the regional workforce. Female labor-force participation rates remain low across the GCC, and measures to improve the employability of women could more fully leverage the productive potential of the region’s human capital. In addition, efforts to align education and training with employer demand could help narrow the persistent skills gaps observed in regional labor markets. Immigration policies can do more to attract and retain skilled workers and build human capital to support robust private-sector-led growth.

The recovery of non-oil sectors across the region continues to depend on government stimulus policies, which are largely focused on non-tradable sectors such as construction. Because further fiscal consolidation may disrupt growth,

governments must continue enhancing public expenditure efficiency, diversifying revenue streams, and improving the management of fiscal risks. Non-oil revenue mobilization will be critical for GCC countries to reduce the fiscal impact of oil-price volatility, and further delays in VAT implementation in Kuwait, Oman, and Qatar must be avoided.

The 2014 oil-price shock spurred significant progress in reforming energy and utility prices, but this process has slowed. Between 2014 and 2017, all GCC countries introduced a combination of price hikes on vehicle fuels, natural gas, electricity, and/or water¹⁶. However, in early 2019 the UAE slashed federal electricity tariffs to boost the growth of industrial sector and to support lower-income households in the northern emirates. In May 2019, Bahrain cancelled plans to reform its complex subsidy system due to fears of social unrest. The GCC countries can build on the progress achieved to date by committing to a comprehensive energy-pricing reform program designed to rationalize private consumption, reduce the burden on public finances, and incentivize energy-efficient investments, especially as global demand continues to trend toward renewables. Key elements of a successful energy-pricing reform program would include¹⁷: (i) the integration of price increases into a broader long-term strategy to promote energy efficiency, (ii) compensatory measures to offset the impact of the reform on lower-income households, (iii) a consultation process and communication strategy designed to build public support and foster political consensus, (iv) efforts to depoliticize the reform process to reduce the risks of policy reversal and facilitate the transition to a fully liberalized pricing system, and (v) a phased implementation period to give businesses and households time to adjust to the new price structure.

16/ In 2014, Qatar raised diesel prices and electricity tariffs. In 2015, the UAE linked domestic transportation fuel prices to international market prices; Abu Dhabi hiked water and electricity prices; Kuwait doubled diesel prices; Oman and Bahrain raised natural gas prices for industrial users; and Saudi Arabia announced a five-year program to gradually increase energy and utility prices. In 2016, Qatar floated domestic fuel prices to track international prices.

17/ IMF, 2017.

FIGURE 30

Investment in renewable energy projects, US\$ million

Source: International Renewable Energy Agency, *Renewable Energy Market Analysis – GCC, 2019*.

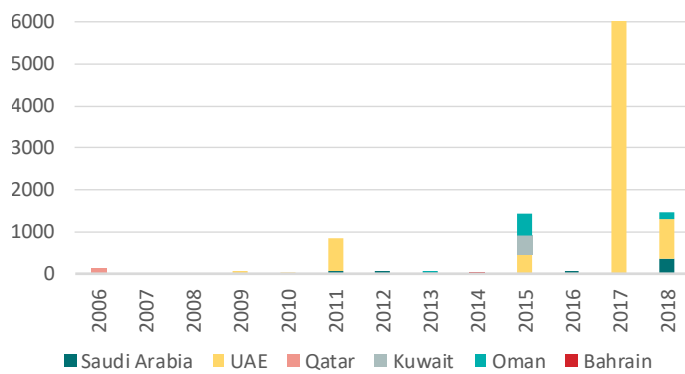


FIGURE 31

Installed renewable energy electricity capacity Megawatts, 2018

Source: International Renewable Energy Agency, *Renewable Energy Market Analysis – GCC, 2019*.

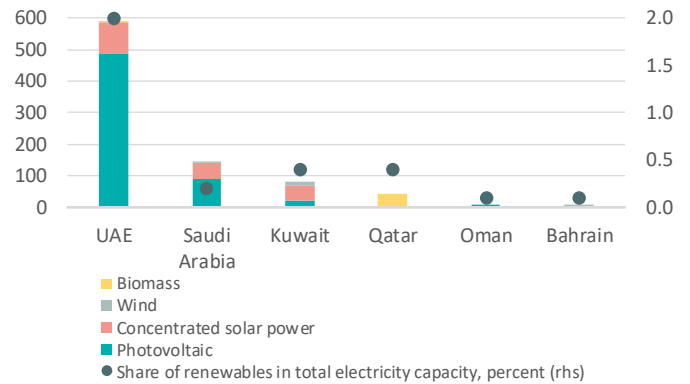


FIGURE 32

Forecast share of renewable energy in global power generation Percent

Source: British Petroleum, *BP Energy Outlook 2019 Edition*.

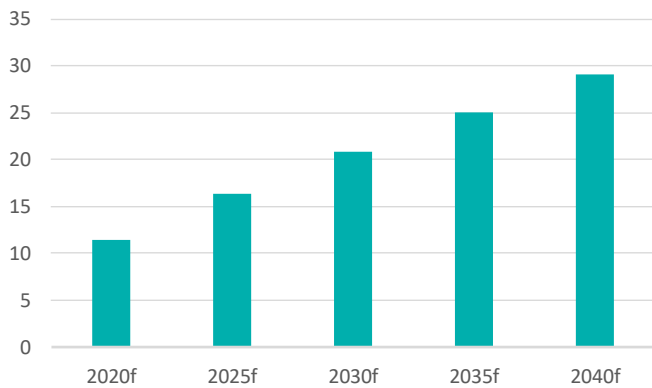
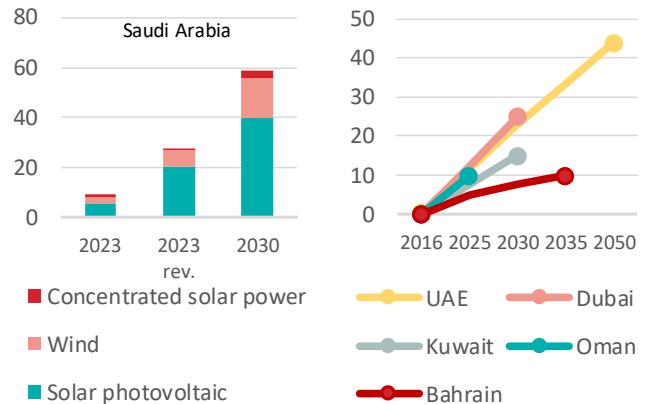


FIGURE 33

Renewable energy targets Gigawatts (Saudi Arabia), Percent share of power generation (UAE, Kuwait, Oman, and Bahrain)

Source: UAE, "Energy Strategy 2050"; Saudi Arabia, "National Renewable Energy Program"; and, International Renewable Energy Agency, *Renewable Energy Market Analysis – GCC, 2019*.



Strategic Investments

The structural reforms described earlier are laying the foundation for a business-friendly policy environment, but the GCC authorities are also directing public spending towards strategic investments in sectors critical for the diversification agenda. Some of these investments in the renewable energy and financial sectors are highlighted below.¹⁸

18/ Accounts of project launches, commercial contracts, and financial closes cited in this section are drawn from various business, finance, and trade news media.

Renewables have potential to make a greater contribution to power generation

Rising domestic electricity demand, the high opportunity cost of using oil and gas for power generation, and declining prices for solar panels and wind turbines are driving the hydrocarbon-rich GCC countries to accelerate the development of their renewable energy industries. Between 2006 and 2018, GCC countries committed about US\$10.1 billion to investments in renewable energy (Figure 30). However, their combined renewable energy output currently totals just 867 megawatts (MW), less than 1 percent of the 145 gigawatts of the region's installed power capacity at end-2018 (Figure 31). The UAE accounts for about 70 percent of the GCC's renewable energy capacity; Saudi Arabia accounts for about 17 percent; and Kuwait accounts for less than 10 percent.

Renewables are expected to grow as a share of total energy consumption between 2019 and 2023, broadly in line with global trends. Worldwide, the share of renewables in total consumption is projected to rise from 11 percent in 2020 to 16 percent by 2025 and reach 29 percent by 2040 (Figure 32). In the GCC, the UAE, Saudi Arabia, and Oman are leading the increase in the share of renewables in total consumption (Figure 33). Qatar, Kuwait, and Bahrain are also implementing renewable energy projects, though their incentives are weaker because they either have huge gas resources that can be tapped for power generation (Qatar) or smaller populations with relatively limited power needs (Kuwait, Qatar, and Bahrain). Renewable energy investments are projected to reach US\$16 billion by 2020 and US\$25 billion by 2022. Medium-term targets for renewable energy are included in various national strategic documents, and the push toward renewables is expected to facilitate economic diversification in the GCC.

In 2017, the UAE launched its Energy Strategy 2050, which aims to increase the share of renewables to 40 percent of the Federation's generating mix by 2050. The two largest emirates, Abu Dhabi and Dubai, are pursuing both emirate- and federal-level projects. Abu Dhabi completed its first utility-scale solar project in 2013, when it commissioned the 100 MW Shams concentrated solar power plant near Madinat Sayed. Abu Dhabi's current initiatives include the 1,177 MW Noor Abu Dhabi solar independent power producer¹⁹ (IPP) in Sweihan and the 2,000 MW photovoltaic plant in Al Dahfra. The Noor Abu Dhabi IPP produces enough power for 90,000 households and is expected to reduce Abu Dhabi's CO2 emissions by 1 million metric tons. The Sweihan project started commercial operations in June 2019. In February 2019, the Emirates Water and Electricity Company reported receiving expressions of interest from 25 companies for the Al Dahfra project, and it is expected to issue a request for proposals. The project is expected to start commercial operations in 2022.

Dubai, which has competed with Abu Dhabi to pioneer renewable energy development in the federation and in the region, also completed its first utility-scale solar project in 2013. The original 13 MW plant at the Mohammed bin Rashid al-Maktoum Solar Park in Dubai's desert interior has since been expanded into an AED 50 billion (US\$13.6 billion) 5,000 MW project which, when it becomes fully operational, could power up to 1.3 million homes. Now in its eighth year of development, the completion of the project's second phase has increased its capacity to 200 MW. The third phase, which will boost its capacity to 800 MW, is expected to be commissioned in 2020 by the UAE's Masdar, Spain's GranSolar, and France's EDF. The fourth phase was originally planned as a concentrated 700 MW solar power project and was awarded to Saudi Arabia's ACWA Power and China's Silk Road Fund in September 2017, but it has since been amended to include a 250 MW photovoltaic component, the technology used for the first three phases. The fifth phase will follow the typical model for an IPP, with the winning developer taking a 40 percent stake in the operating company and executing a 25-year power purchase agreement with the Dubai Electric and Water Authority. The agency issued the request for proposals in June 2019

for the 900 MW photovoltaic project, which is planned to be commissioned in stages beginning in 2021.

Dubai Airport has installed 15,000 solar panels that will save AED 3.3 million (US\$0.9 million) annually in electricity costs while reducing carbon emissions by 3,243 metric tons. The solar project has a capacity of 5 MW and will generate 7.5 million kilowatt hours of energy annually for Dubai Airport. In addition, the Dubai Electric and Water Authority has awarded an AED 1.4 billion (US\$381 million) contract for a pumped-storage hydroelectric power station at Hatta with a target capacity of 250 MW, which will be the first hydroelectric power project in the region.

Saudi Arabia, the GCC's largest electricity consumer, has issued two contracts for renewable energy facilities with a combined capacity of 700 MW. These include the 300 MW Sakaka photovoltaic IPP being developed by Saudi Arabia's ACWA Power and the 400 MW Dumat al-Jandal wind IPP being developed by Abu Dhabi's Masdar. The latter claims the lowest leveled cost of electricity for an onshore wind farm at US\$0.0199 per kilowatt hour, far below the global average of US\$0.05 per kilowatt hour. The government announced new capacity goals in January 2019, raising the five-year renewables target from 9.5 gigawatts (GW) to 27.3 GW (20 GW of photovoltaic, 7 GW of wind, and 300 MW of concentrated solar power) and the 2030 target to 58.7 GW. Under the new plan, 30 percent of the projects are to be tendered by the Renewable Energy Project Development Office (REPDO), while 70 percent are to be overseen by the Public Investment Fund and executed via negotiated deals with international partners. To implement the plan, a second round of REPDO projects has been announced, which will deliver 1.515 GW from seven photovoltaic plants. Expressions of interest were solicited during the first quarter of 2019, and a list of 60 pre-qualifiers was compiled on June 25. Sixteen of the 60 pre-qualified companies were deemed eligible to lead the development of the four largest projects, which together account for 1.4 GW of the total generating capacity. The request for proposals is due to be issued next.

Oman, which imports natural gas, has its own ambitious renewables program. The country plans to source 10 percent of its power generation from renewables by 2025. In 2019, Oman is expected to commission its first renewable power project, the 50 MW Harweel windfarm in Dhofar, which is being developed by the UAE's Masdar and will provide power to the Oman Power and Water Procurement Company. Petroleum Development Oman, the state oil producer, launched the country's first solar project in February 2019, selecting Japan's Marubeni to develop a 105 MW photovoltaic plant in Amin. The Oman Power and Water Procurement Company launched its own seven-year renewables program in May 2018, targeting the installation of 2.6 GW of renewable energy capacity by 2025, with six major solar and wind plants. The company named Saudi Arabia's ACWA Power and its Kuwaiti partners as the preferred bidder for the 500 MW Ibri solar IPP in March 2019. The company also unveiled a plan for three solar IPPs and two windfarms, which will generate the remaining 2.1 GW of its 2.6 GW renewables target. The first solar IPP will likely be commissioned in Manah in 2022, with a capacity of 500-1,000 MW, and the other two IPPs will likely be commissioned in 2023 and 2024. Two 50-200 MW windfarms will round out the program.

19/ An IPP is a private owner of generation facilities that sells power to utilities and end users.

FIGURE 34

Financial services, value added and real growth rate
Percent of GDP (lhs)
and percent (rhs)

Source: Haver Analytics.

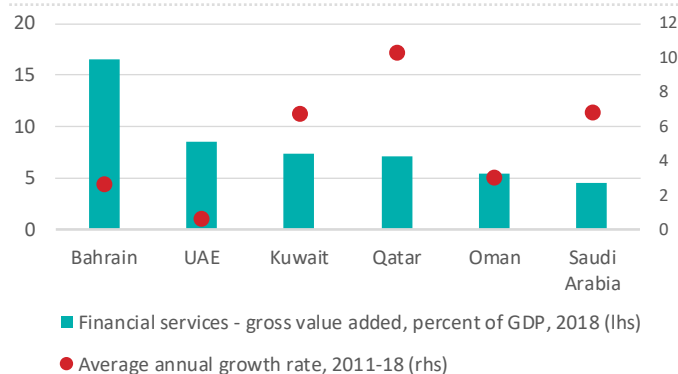
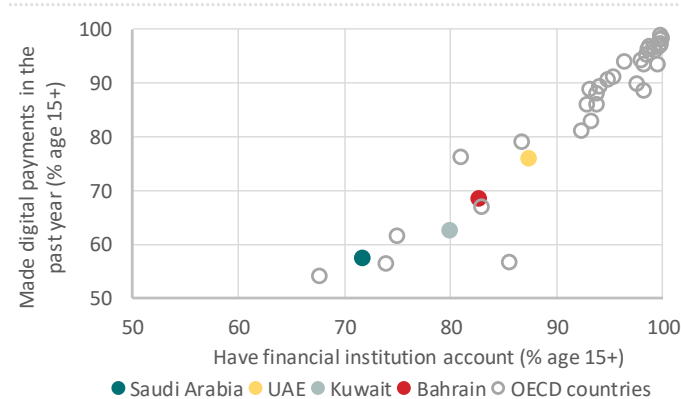


FIGURE 35

Financial inclusion (have an account with a financial institution) and digital financial inclusion (made digital payments in the past year), 2017
Percent of population aged 15+ years

Source: World Bank, Global Findex Database .



Qatar is in the process of tendering its first large-scale renewable energy project. The Qatar General Electricity and Water Corporation, a public utility, launched the prequalification process for a 500 MW photovoltaic IPP in Doha in May 2018. The company issued the request for proposals to 16 companies, most from Europe and East Asia, in February 2019 and had expected bids during the year. The project’s structure will likely resemble other private power arrangements in the GCC: the developer will take a 40 percent stake in the operating firms and sign a 25-year power-purchase agreement with the utility. As Qatar possesses the world’s third-largest gas reserves, its incentives to invest in renewable energy are among the weakest in the region, and further projects are likely to be modest. Unlike the other GCC states, Qatar has not announced a major plan for national renewable energy development, though the government has announced a target of generating 200-500 megawatt hours (MWh) of solar energy by 2020.

Kuwait aims to generate 15 percent of its power from renewable sources by 2030. The government launched the prequalification process for the 1.5 MW Al Dibdibah photovoltaic plant in 2017 and opened the project for bids in April 2019. Metallurgical Corporation of China reportedly submitted the lowest offer at US\$0.37 per kilowatt hour, and the project will be structured on an engineering, procurement, and construction plus operations and maintenance basis, rather than on an IPP basis. Oil-rich Kuwait has faced gas shortages for years and began importing liquefied natural gas in 2009 to meet its generation requirements. The 1.5 MW plant is its largest renewable energy project to date.

In February 2019, Bahrain selected Saudi Arabia’s ACWA Power to implement its first 100 MW solar IPP. Bahrain aims to source 10 percent of its power generation from renewables by 2035.

While investment commitments in renewables have risen markedly with the new project filings and launches, the

ability of the GCC states to realize their long-term ambitions with renewable energy will depend crucially on the business environment that they foster for the sector. Subsidized fuel prices for oil and gas power plants remain a barrier to the successful implementation of renewable energy projects. State-owned power companies are not inclined to contract for renewable power at prices above the subsidized cost of electricity for thermal plants, potentially leading to low bids for renewable sources and difficulties with the financial close of renewable deals. The GCC governments would need to rationalize fuel subsidies for the power sector for renewable energy to become commercially viable in the region.

Reforms to the financial sector’s regulatory framework and a robust fintech ecosystem are supporting the growth of financial services

Gross value added in the region’s financial-services sectors has been expanding at average annual real growth rates of up to 10 percent over the last decade. Financial services currently contribute between 5 and 16 percent to national GDP in the GCC countries (Figure 34). Fintech—innovative technologies and platforms that either compete with or augment traditional financial services—offers a wide range of possibilities for deepening and enhancing the efficiency of GCC financial sectors. Fintech has a demonstrated capacity to expand access to financial services among underserved populations and to support broad-based economic development and inclusive growth.

GCC countries have embraced the potential of fintech. Governments, central banks, financial firms, technology companies, and consumers have swiftly adopted fintech innovations and developed new fintech applications and services in a wide range of areas. GCC authorities began establishing legal and regulatory frameworks for the fintech subsector in 2016-17 and have since created financial centers and hubs to support fintech enterprises.

Regional financial regulators have strengthened their capacity to oversee a rapidly expanding fintech subsector.

The Dubai Financial Services Authority, the Abu Dhabi Financial Services Regulatory Authority²⁰, the UAE Securities and Commodities Authority, the Central Bank of Bahrain, the Kuwait Central Bank, the Saudi Arabia Monetary Authority, and the Saudi Arabia Capital Markets Authority have proactively designed policies and issued rules and regulations to govern the operations of digital banks, crowdfunding platforms, peer-to-peer lenders, robo-advisors, and crypto-asset exchanges.

Among GCC authorities, the Central Bank of Bahrain has an especially extensive record of fintech regulatory innovation.

The central bank opened a regulatory sandbox in May 2017, introduced crowdfunding regulations in August 2017, launched an internal FinTech and Innovation Unit in October 2017, drafted an electronic know-your-customer (e-KYC) framework in May 2018, collaborated with the Global Financial Innovation Network on a global regulatory sandbox in August 2018, issued final rules on open banking in December 2018, issued final rules on crypto-assets and pilot cross-border testing of fintech firms in February 2019, issued final rules on digital financial advice in March 2019, and drafted rules on insurance aggregators in April 2019.

The UAE has pioneered the development of fintech markets at both the federal and emirate levels. The UAE Financial Services Regulatory Authority proposed a national fintech framework in August 2016, launched the region's first fintech regulatory sandbox in November, established the region's first regulatory framework for venture-capital managers in May 2017, issued guidance on a regulatory approach to virtual currencies and initial coin offerings²¹ (ICOs) in October, and led an industry consortium on developing a proof-of-concept for a shared e-KYC utility. The Dubai Financial Services Authority released its own guidelines on cryptocurrencies and ICOs in October 2017, and the UAE Securities and Commodities Authority will introduce federation-wide regulations for ICOs in 2019. The authority approved ICOs as securities and will work with the Abu Dhabi Securities Exchange and Dubai Financial Market to develop trading platforms for ICOs in 2019, positioning the UAE as a competitive location for ICOs and other blockchain-related investments.

In October 2018, Bahrain created the Global Islamic and Sustainable FinTech Center to accelerate the development of the national fintech industry and drive the next phase of growth in Islamic finance.

The center's international partners include the Islamic Corporation for the Development of the Private Sector, which is part of the multilateral Islamic Development Bank; the Accounting and Auditing Organization for Islamic Financial Institutions, a non-government organization based in Bahrain; the Islamic Fintech Alliance, a group of eight fintech platforms; Ethis Ventures, an Islamic crowdfunding platform; and the Al Baraka Banking Group, an Islamic banking network.

20/ These are the regulatory arms of the DIFC and AMDG, respectively.

21/ ICOs are a fundraising mechanism in which new blockchain-based projects sell their underlying crypto tokens in exchange for Bitcoin and Ether.

Across the GCC, international financial centers previously established as free zones for financial services have adapted to support the development of the region's fintech industry.

In 2016, the ADGM created RegLab, the region's first regulatory sandbox. In 2017, the DIFC launched FinTech Hive, the region's first accelerator program for fintech startups. In late 2018, the Qatar Financial Center announced a collaboration with B-Hive, the Belgium-based European fintech platform, to develop the country's fintech industry in line with plans proposed by the Qatar Central Bank and the Qatar Development Bank to create a Doha Fintech Hub.

In addition to government-sponsored financial centers, the GCC's highly supportive fintech ecosystem involves a balanced mix of domestic and international private firms.

The ecosystem's main elements include: (i) regulatory and technology sandboxes to live-test innovations by private firms under controlled environments; (ii) startup incubator and accelerator programs to nurture and grow fintech startups; and (iii) fintech funds to implement strategic investments in firms and projects (Box 1).

The GCC's fintech ecosystem has supported innovation in a wide range of areas.

These include: (i) digital banking, which provides access to services that were previously only available at physical bank offices; (ii) open banking, which enables third-party developers to build applications and services around a financial institution and provide accountholders with greater data-transparency options; (iii) blockchain technology for financial transactions, which uses open distributed ledgers to record transactions efficiently and securely; (iv) robo-advisors, which use automated systems and sophisticated algorithms to provide financial advice or investment management online with minimal human intervention; and (v) cryptocurrencies, which are digital assets designed to function as a medium of exchange by using strong cryptography to secure financial transactions.

The UAE leads the GCC in digital banking, followed closely by Saudi Arabia, Qatar, Kuwait, and Bahrain.

In the UAE, Islamic Development Bank and Fidor Bank partnered to launch the region's first community-based digital bank in October 2016. Commercial Bank of Dubai announced CBD Now, the country's first digital-only bank in November 2016. Emirates NBD introduced Liv, a digital bank for smartphone users in May 2017. Mashreq Bank launched Mashreq Neo, a full-service, completely branchless, digital-only bank in October 2017. In Saudi Arabia, Alinma Bank introduced the first in a network of digital branches in February 2019, while Saudi British Bank began offering real-time cross-border transfer services using blockchain in April 2019. In Qatar, Ahilbank offered the country's first contactless credit card in 2016, while Commercial Bank created the first online remittance service for six major foreign-worker destinations. In Kuwait, Warba Bank introduced Express Finance, the country's first bank account offering an e-signature and online account-opening function in February 2018. In Bahrain, Bank ABC plans to launch a digital bank in 2019.

Bahrain's Almoayed Technologies, a digital-infrastructure provider, is working with banks to support the creation of open-banking action plans. In May 2019, the National Bank of Bahrain announced that it had enabled open-banking ser-

BOX 1

The GCC Fintech Ecosystem

Across the region, financial regulators have established regulatory sandboxes to allow the small-scale live-testing of innovations by private firms in a controlled operating environment. The sandbox model allows the regulators to authorize special exemptions, allowances, and other time-bound exceptions and observe their impact.

- Abu Dhabi created the region's first regulatory sandbox for fintech innovations in November 2016. Dubai and Bahrain followed suit in May 2017, as did Kuwait in December 2018 and Saudi Arabia in February 2019.
- Abu Dhabi's RegLab is reportedly the world's second most active fintech regulatory sandbox after London's, and it has had four cohorts since 2016. The first cohort had five entries, including a mobile app for low-income migrant workers.
- Dubai's sandbox, the Innovation Testing License Program, has had three cohorts since 2017. Fintech firms from earlier cohorts tested the digitization of sukuk issuance using smart contracts and the tokenization of equities and debt, inter alia.
- Tarabut Gateway, a subsidiary of Almoayed Technologies, was the first company to successfully pass Bahrain's sandbox. It received an in-principle approval from the Central Bank of Bahrain to launch open-banking operations.
- In Kuwait's sandbox, local banks join a central bank task force to assess fintech proposals through a four-phase evaluation process.
- Some 21 firms have participated in two versions of Saudi Arabia's sandbox, including Forus, a Saudi peer-to-peer lending platform, and Tap Payments, a Kuwaiti payment startup.

Technology sandboxes provide a controlled environment that testers can use to mimic the characteristics of computer software production and create simulated responses from all the application programming interfaces (APIs) that an application relies on.

- Dubai's DIFC FinTech Hive, a fintech hub, and Emirates NBD, a commercial bank, opened the Emirate NBD API Sandbox to provide a platform for collaboration among fintech firms involved in open banking. The digital sandbox equips fintech companies with the tools—including 200 APIs, 500 end points, and over 5 million simulated customer transactions—to transform their ideas into operational prototypes.

Startup incubators are companies that help startups to develop by providing services such as management training or office space.

- The Qatar Development Bank announced the creation a fintech incubation center to cater to startups in the financial sector. The development bank already oversees the Qatar Business Incubation Centre in Doha, which has been operating since 2014.

Startup accelerators support early-stage companies through education, mentorship, and financing. Startups join accelerator programs for a fixed period as part of a cohort group. The programs offer intensive education aimed at accelerating the development of new and

innovative firms by compressing years of learning-by-doing into a few months. Programs culminate in a graduation or “demo day.”

- Bahrain's eight-week Accelerate Me was organized by Nest, a Hong Kong startup services firm, and American Express Middle East, a major U.S. credit card company, in August 2018.
- Kuwait's Great Idea Accelerator Program was created in October 2019 by Zain, a telecommunications company; Brilliant Lab, a startup service firm; and Mind the Bridge, a U.S.-based innovation advisory firm.
- Saudi Arabia's three-day Taqadam was launched by the King Abdullah University of Science and Technology in partnership with Saudi British Bank, a private bank, in February 2019.
- Abu Dhabi's three-month Fintech Accelerator and Innovation Program is run by ADGM and Plug and Play, a U.S. venture capital firm, and it offered its first programs in 2018.
- The forthcoming Techstars Hub Accelerator Program will be launched in January 2020 by Hub71, Abu Dhabi's technology hub, which is part of Ghadan-21, and Plug and Play.
- Dubai's 12-week FinTech Hive, the region's first fintech accelerator program, was created by the DIFC and Accenture, an Irish technology services firm. It completed its inaugural program in August 2017.
- Dubai's three-month Startupbootcamp FinTech Accelerator Program was organized in 2017 by DIFC and Startupbootcamp, a U.K.-based network of industry-focused accelerators.

Fintech funds in the GCC purchase equity in firms engaged in the research, development, production, and distribution of technologies used in financial services.

- The Al Waha Fund of Funds—a pooled investment fund that invests in other types of funds—provides capital to technology startups through venture capital funds operating in Bahrain. The investment fund closed its US\$100 million fundraising round in June 2018, and by February 2019 it had committed US\$45 million to technology startups. The investment fund is owned by Bahrain Development Bank, a government development finance institution; Mumtalakat, Bahrain's sovereign wealth fund; the National Bank of Bahrain, a private bank; the Batelco Group, a telecommunications company; and Tamkeen, a semiautonomous government agency promoting private-sector development.
- Separately, the Bahrain Economic Development Board, the government agency tasked with attracting FDI in Bahrain, plans to launch a US\$100 million fund directed at promising fintech startups.
- Mabudala Investment Company, one of seven UAE sovereign wealth funds, launched a US\$1 billion fund known as Abu Dhabi Catalyst Partners in April 2019 to boost domestic investment in the UAE. The fund will be based in the AMDG and will target opportunities in asset management, specialty finance, and financial infrastructure.
- The DIFC launched a US\$100 million Fintech Fund in Novem-

ber 2017 to stimulate fintech innovation and investment in the region. The fund targets growth-stage startups with cutting-edge products in the Middle East, Africa, and South Asia. The DIFC announced the appointment of Middle East Venture Partners and Wamda Capital, two venture capital firms, to manage US\$10 million in fund assets.

- In addition, Alcazar Capital Limited, a private equity firm based in the DIFC, and InQvest Partners, the fintech investment platform of FinTech Consortium, a fintech incubator, launched a US\$100 million global fintech fund in October 2018. The fund will invest in the GCC, North America, Europe, and Asia.

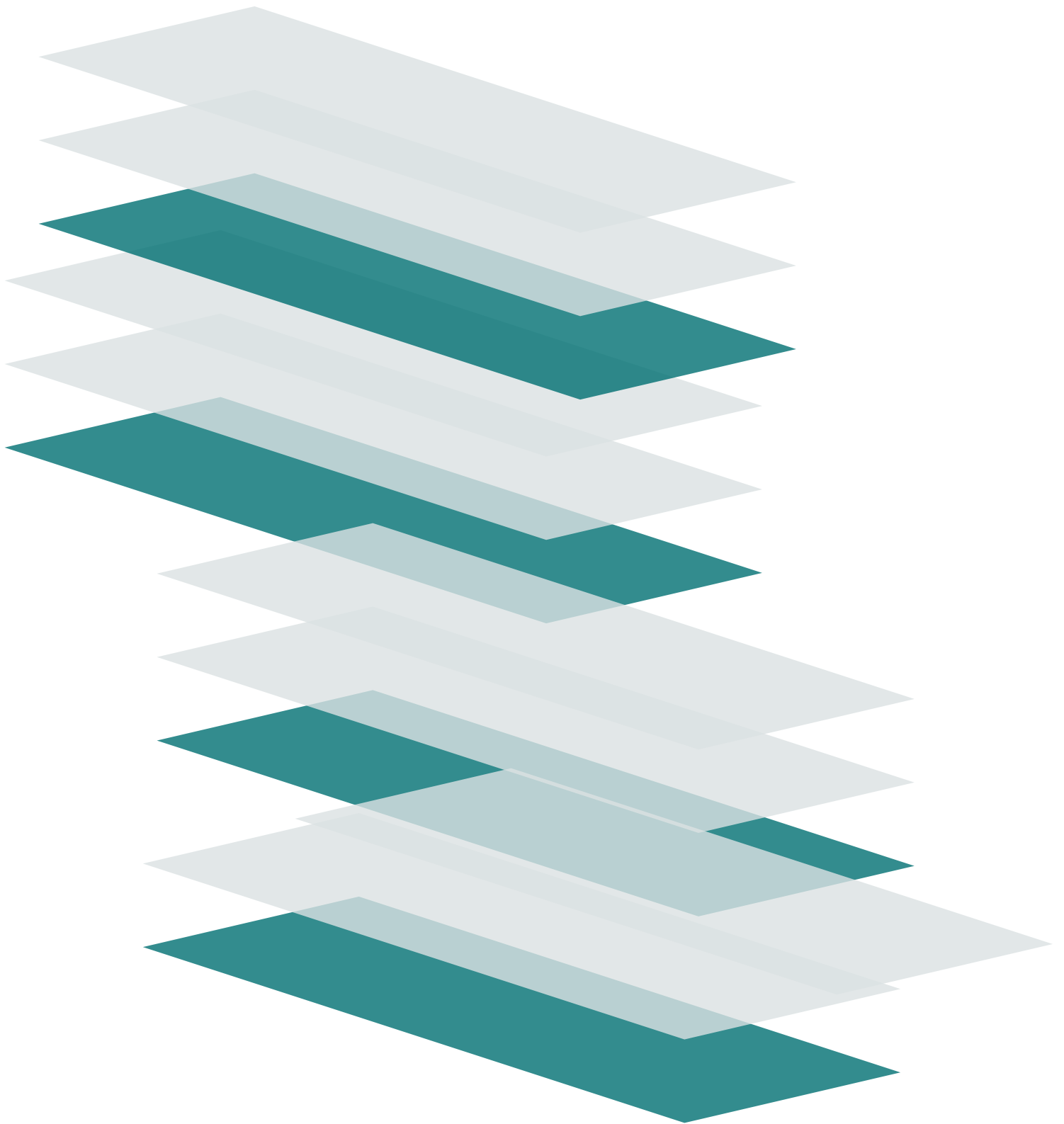
vices, allowing accountholders to share their account information and payment histories externally with other banks and with licensed third parties. The bank's new systems are provided by Tarabut Gateway, an Almoayed Technologies subsidiary. The move follows a mandate issued by the Central Bank of Bahrain in November 2018 requiring banks to adopt open banking by mid-2019.

In July 2019, Saudi Arabia's Capital Markets Authority authorized two companies to test their robo-advisor services. Once these services are operational, investors will be able to obtain advice on securities or investment opportunities through automated online platforms operated separately by Haseed Investing Company and Wahed Capital, a U.S.-based investment firm. The latter's platform, Wahed Invest, is reportedly the world's first automated Sharia-compliant investment platform. Also in July 2019, Abu Dhabi's Financial Services Regulatory Authority issued an operating permit to Digital Investment Managers, a robo-advisor service.

After previously banning the trading of cryptocurrencies, Saudi Arabia has partnered with the UAE to pilot a shared digital currency based on blockchain technology. Aber will be used for central financial settlements between the two countries and for cross-border transactions between participating commercial banks. In October 2018, the Dubai Credit Bureau announced the launch of a new digital currency, EmCash, in partnership with Emcredit, a subsidiary of the Dubai Department of Economic Development; PundiX, an Indonesian crypto startup; and Ebooc Fintech & Loyalty Labs, a local fintech startup. In July 2019, Abu Dhabi's Financial Services Regulatory Authority approved an application by Matrix Exchange to operate a crypto-asset exchange. The UAE also has local exchanges through which domestic customers can purchase cryptocurrencies.

Advances with fintech will allow the GCC to also meet their national objectives for financial inclusion, not only for their citizens but also for the foreign workers who live and work in the region. The GCC countries compare favorably

with some OECD countries both on financial inclusion and for digital financial inclusion. However, they plot below the median in the distribution of the OECD states across both variables (Figure 35), which implies that improving access to financial services—the access to and use of credit, savings, insurance and payment services—remains a vital element in the development agenda of the GCC.



In-focus

Economic Diversification for a Sustainable and Resilient GCC

This section explores how growing global and local environmental concerns are prompting GCC policymakers to realign economic diversification with environmental sustainability. All GCC countries have identified lessening dependence on oil and gas exports as a key goal of their diversification plans and are pursuing strategies to achieve it. But in some countries the decreasing dependence on the hydrocarbon sector is partly being substituted for increasing dependence on downstream energy- and emission-intensive heavy industries. This diversification strategy increases both local environmental stress and the GCC's global impact on climate change, doubling down on the exposure to the impacts of disruptive technologies and international efforts to address environmental issues. This section highlights the risks of a traditional diversification strategy focused on heavy industrialization and describes the channels through which it can constrain growth prospects. It also presents options for policies and initiatives to realign environmental sustainability in GCC with faster and more resilient economic growth and welfare.

The GCC countries have made important strides toward creating greener, more diversified economies, but sustainability risks are mounting

Over the past several decades, the GCC countries have witnessed unprecedented growth in both their population

and economies. The region's total population rose from fewer than 10 million in 1960 to 55 million in 2017²² and is expected to reach 74 million by 2050²³, intensifying pressure on vital natural resources, including scarce water supplies and the vulnerable ecosystems of the coastal zones. GCC countries have launched ambitious research and development programs in clean technologies and started investing in public transport and renewable energy. But rapid urbanization, increased mobility, and industrialization have also resulted in rising levels of air and water pollution, challenges with reuse of treated wastewater, solid-waste management and increasing greenhouse gas (GHG) emissions. The Environmental Performance Index (EPI) ranks countries according to their success in protecting human health and ecosystems, and the GCC countries perform more poorly on the EPI than their levels of GDP per capita would predict (Figure 36).²⁴

The GCC countries face multiple environmental sustainability challenges

Air pollution is a significant issue across the region. The arid landscape is responsible for high levels of dust, with periodic sand and dust storms, exacerbated by climate change and land degradation.²⁵ Refineries, metal and chemical plants, power plants, desalination units, and transportation systems (roads and shipping) are major sources of air emissions caused by human activity, including fine particulate matter (PM10 and PM2.5), sulfur dioxide (SO₂), nitrogen oxides (NO_x), volatile organic compounds (VOC), and ozone. Air-quality management systems in the GCC are significantly underdeveloped compared to those of countries at similar income levels. Moni-

22/ GCC STAT. 2019.

23/ World Bank. 2019. Health, Nutrition and Population Portal.

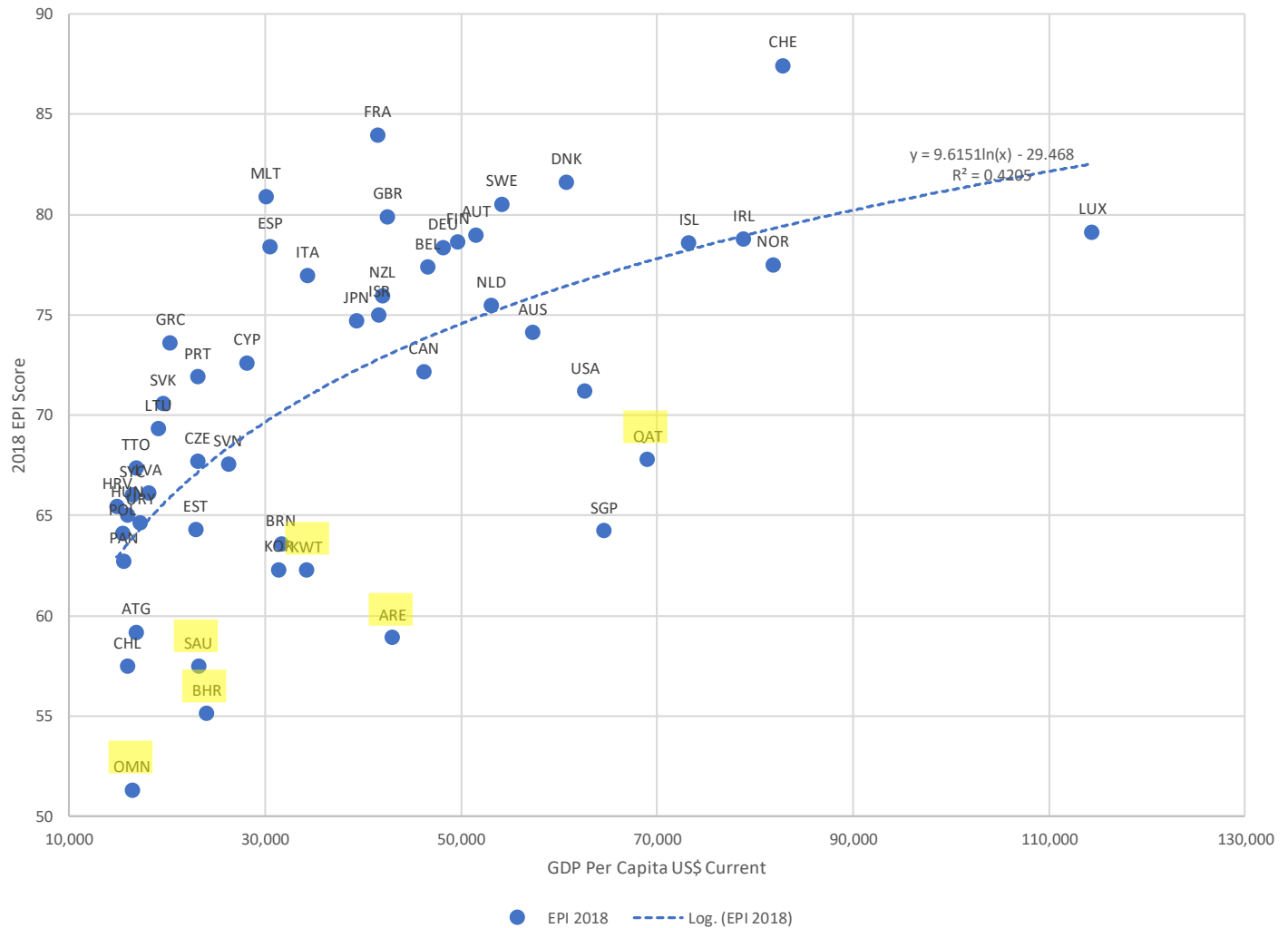
24/ Wendling et. Al. 2018.

25/ See UNEP, WMO, and UNCCD, 2016.

FIGURE 36

EPI Ranking versus GDP per Capita, high-income countries, 2018

Source: Wendling et al. 2018, and World Bank, World Development Indicators.



toring of emissions and ambient air quality is uneven and not based on a common air quality index (AQI) methodology. The region has no common data-integration platforms for air emissions and air quality.

The GCC is the most water-scarce region in the world. The share of freshwater per capita per year averaged just 103 m³ in 2012 for GCC countries, and less than 30 m³ in Kuwait, the UAE, and Qatar (Figure 37). Population growth, urbanization, and industrialization, combined with the highest share of unsustainable use of groundwater resources in the world and high domestic consumption (Figure 38), are putting intense pressure on the region’s limited water supply, with climate change further exacerbating water scarcity challenges. Nonrenewable groundwater and desalination constitute the main water sources in the GCC, but overexploitation of groundwater and the deteriorating quality of both ground and desalinated water are be-

coming a threat to population health and to sustainable economic growth. The agricultural sector is the primary user of scarce groundwater resources, accounting for approximately 88 percent of groundwater and 15 percent of desalinated water consumption in the GCC. Across the region, desalination accounts for between 50 and 100 percent of national water supplies. The key environmental challenges associated with desalination include GHG emissions and the impact of brine. Treated wastewater could serve as an important water source, particularly for agriculture. However, in 2012 the GCC countries reused an average of 19 percent of municipal water and 40 percent of treated wastewater. The discharge of treated or untreated municipal wastewater has also been identified as an important issue impacting coastal and marine environment in the Gulf.

Arable land and permanent cropland account for only 1.63 percent of the region’s total land area. Forests – mainly located in the southern highlands of Saudi Arabia, the UAE, and Oman – comprise less than 1 percent of the total land area. Construction and manufacturing, overgrazing, unsustainable agricultural practices, deforestation, and climate change are key drivers of desertification and land degradation.

Most of the rapidly increasing municipal and industrial waste generated in GCC countries still end up in dumpsites and sanitary landfills that do not meet environmental standards. This problem is especially acute in Kuwait. However, several recent announcements regarding new legislation and initiatives indicate that the governments in the region are committed to addressing this problem. Recent waste-management investments include the construction of new incineration and recycling facilities in UAE, such as the Recycling Hub for electronic waste in Dubai and some composting and landfill-gas-recovery facilities. GCC countries are moving toward an integrated approach to solid- and hazardous-waste management that includes measures to mitigate landfill gases and minimize risks to groundwater and land quality. Hazardous waste that enters municipal landfills poses additional hazards to both land and groundwater resources. Unsustainable solid-waste management practices also contribute to the degradation of the marine environment.

The region’s coastal and marine ecosystems are especially vulnerable to pollution and coastal development. Coastal and marine ecosystems play an important social and economic role at the local, regional, and the global levels. Yet despite their importance, these ecosystems are degrading at alarming rates. The GCC region is home to unique and endemic marine and coastal ecosystems that support major human populations. Unsustainable coastal development, effluent discharge, brine and oil spills, and the depletion of fish stocks are key threats to the GCC’s coastal and marine ecosystems.

The GCC countries export carbon emissions embodied in oil and gas, but the current diversification strategy is increasingly localizing emissions at home

The abundance of low-cost hydrocarbons has contributed to the relatively high GHG emission intensity of regional economies. Bahrain, Saudi Arabia, and Oman are among the world’s most emission-intensive economies relative to their economic size, with other GCC countries not far behind (Figure 39).

Over time, the CO2 emission intensity of GDP in all GCC countries was fairly constant, except in Oman, which has increased its carbon footprint relative to income (Figure 40). Going forward, the structural trends towards localization of heavy industries may cause CO2 emissions to increase faster than economic output. For example, once operational the Hasyan coal power plant will push up in carbon-intensity of the UAE.

Economic diversification in the GCC has had a mixed impact on environmental sustainability

Historically, most Gulf countries have taken a traditional

FIGURE 37

Water stress in the GCC and comparator countries

Source: Schonberger, Steven N.; Mohammed, Nadir; Vagliasindi, Maria. 2017. *Water for Prosperity and Development: Risks and Opportunities for the Gulf Cooperation Council Countries* (English). Washington, D.C.: World Bank Group.

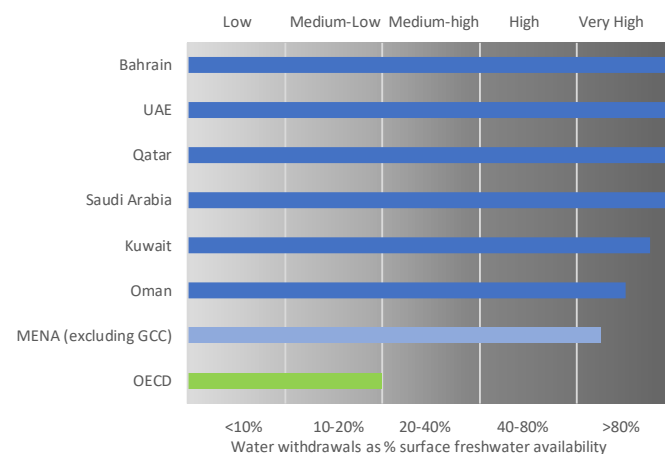
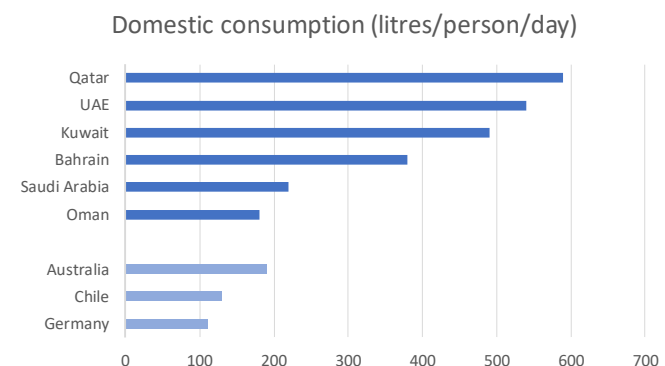


FIGURE 38

Domestic water consumption in the GCC Countries

Source: Schonberger, Steven N.; Mohammed, Nadir; Vagliasindi, Maria. 2017. *Water for Prosperity and Development: Risks and Opportunities for the Gulf Cooperation Council Countries* (English). Washington, D.C.: World Bank Group



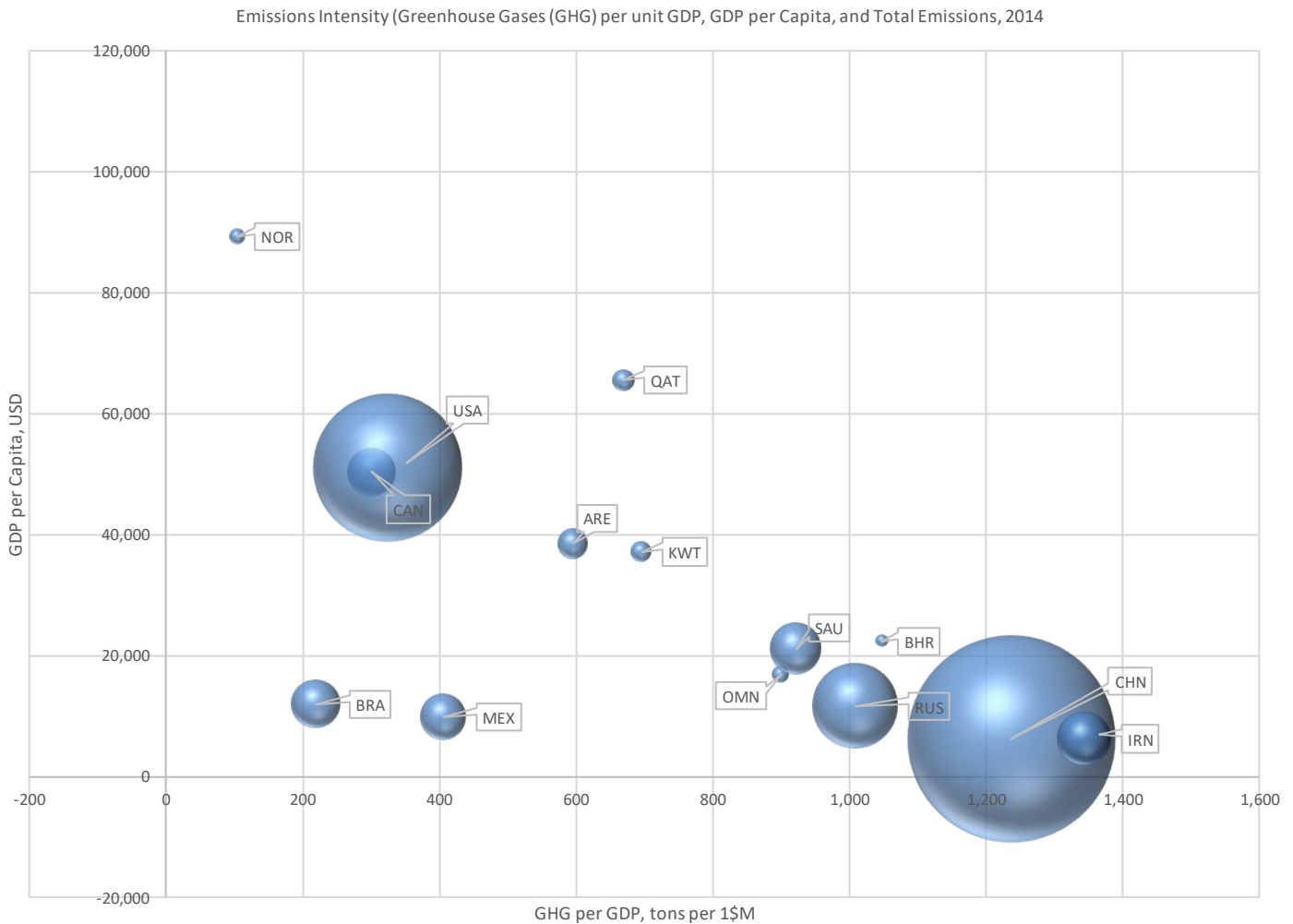
approach to diversification by focusing on products closely related to their existing hydrocarbon sectors. Diversification strategies have tended to target industries in which GCC countries already have a comparative advantage and which offer additional opportunities for value creation. A decline in global oil prices helped reduce export concentration in hydrocarbons between 2013 and 2017 (Figure 41) by driving an increase in the export shares of products closely linked to hydrocarbons, such as refinery products, petrochemicals, and metals, as well as other more indirectly related sectors such as cement, airlines, and thermal power plants. This trend has been observed in all GCC countries except Kuwait, which has not de-

FIGURE 39

Carbon dioxide (CO₂) emissions per unit of GDP, GDP per capita, and total emissions, GCC and Comparators, 2014

Source: World Bank, World Development Indicators.

Note: Size of the bubble reflects total CO₂ emissions (Mt/year) in 2014.



creased its reliance on oil revenue. Export shares from sectors with low environmental footprint in Oman and Qatar have risen modestly, but this may include goods and services tied to hydrocarbon supply chains.

The emissions-intensive nature of traditional diversification has increased GCC countries' exposure to disruptive low-carbon technologies, international policy efforts to address environmental problems, and darkening public perceptions of fossil fuels and their derivatives. The world's largest economies are implementing policies and measures designed to address global environmental challenges. Trade measures, such as border carbon taxes on the GHG emissions embodied in imported goods and services, are increasingly viewed in the countries undertaking climate action as viable means to protect their trade-exposed, energy-intensive industries from unfair competition from countries with lax climate

policies.²⁶ Environmentally motivated trade restrictions, as well as fuel and product standards, could adversely affect the access to export markets for goods and services manufactured in the GCC countries with a large environmental footprint. These restrictions can affect oil, gas, as well as refined products, traditional petrochemicals, plastics, or even metals, construction materials and light industry products manufactured using carbon-intensive technologies or non-recyclable synthetic materials. The risk that a group of large economies may eventually impose trade sanctions to encourage noncooperating countries to share the burden of the global effort to stabilize the

26/ See Economists' statement on carbon dividends or the mission letter from Ursula von der Leyen, President-elect of the European Commission, to Phil Hogan, Commissioner-designate for Trade.

FIGURE 40

Historical trends in CO2 emissions intensity of GDP

Source: World Bank, based on EDGAR Emissions Database ²⁷

Notes: Indicators in Figure 39 and Figure 40 are not directly comparable, since the former measures GDP in 2010 US\$ at current exchange rates, while EDGAR database uses IMF World Economic Outlook data of GDP (expressed in 1000 US\$ adjusted to the Purchasing Power Parity of 2011) (2017).

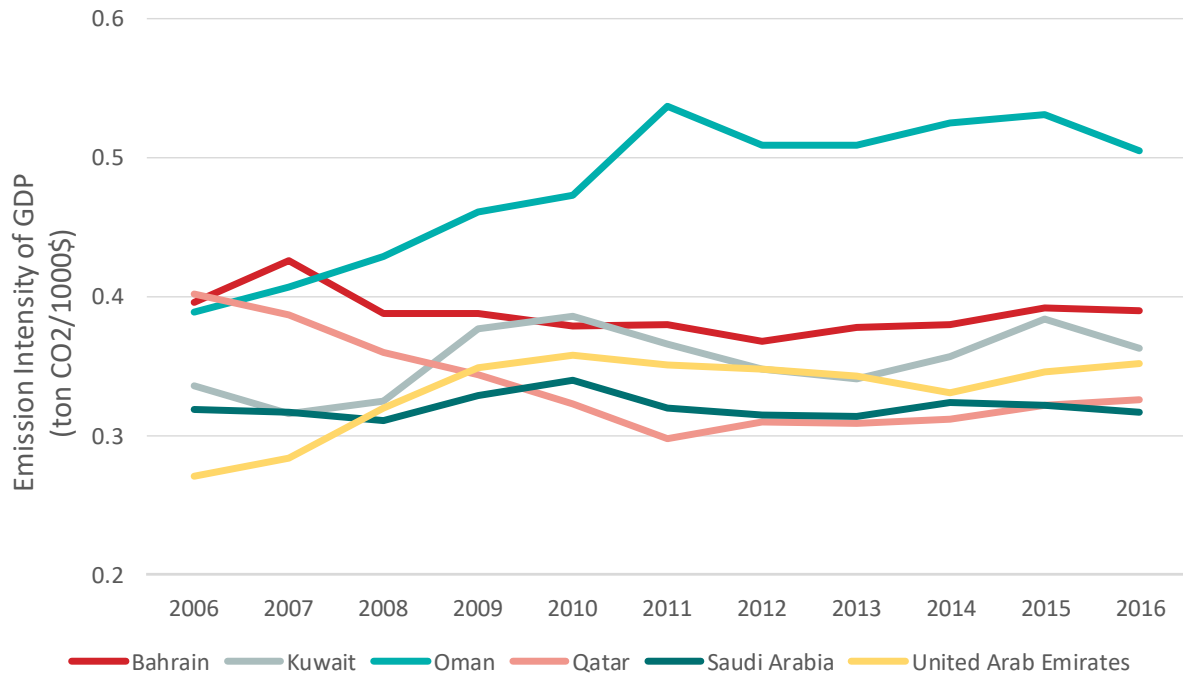


FIGURE 41

GCC export shares by product category, 2013 and 2017

Source: World Bank, based on data from <https://oec.world/en/resources/data/>



27/ Janssens-Maenhout et al. 2017.

FIGURE 42

Relative vulnerability to the low-carbon transition by country, GCC and comparators, 2019

Source: Peszko et al., 2019 (forthcoming).

Note: Bahrain is missing because data were incomplete.



climate should not be discounted.²⁸

High and increasing domestic carbon emissions double down on the vulnerability of GCC countries to the impacts of the global low-carbon transition

The World Bank's comprehensive index of vulnerability to the low-carbon transition suggests that GCC economies, except the UAE, are among the most exposed in the world but are also comparatively resilient to its impacts (Figure 42). The exposure index captures the historical and expected importance of hydrocarbons and emission-intensive industries in the economy.²⁹ All GCC countries, except UAE are among top 10 most exposed countries to the low-carbon transition impact. However, they are also relatively resilient to external shocks, hence are well-positioned to manage the risks of low-carbon transition and take advantage of the opportunities it offers.³⁰ They owe resilience to the low production costs of oil and gas, but also to the region's record of macroeconomic and financial stability, well-developed infrastructure, and generally strong business climate. The key areas in which resilience could be strengthened include governance (i.e., institutional quality, stability, and accountability) and economic complexity³¹, economic diversification may not necessarily lead to better preparedness for the low-carbon transition.

Asset diversification offers a resilient path toward sustainable growth in the GCC

The structural impacts of the global low-carbon transition underscore the importance of adopting a consistently broader approach to diversification. Beyond diversifying products and exports, a broader approach focuses on diversifying the composition of national wealth – the portfolio of the

28/ Nordhaus, 2015.

29/ Exposure index includes four indicators: (i) Current reliance on fossil fuels export revenues as a percentage of GDP; (ii) Future reliance on expected resources rents from known fossil fuel reserves as a percentage of current GNI; (iii) Current carbon intensity of manufactured exports is an indicator of current dependency on carbon-intensive manufacturing goods and services; and, (iv) Committed (future) emissions from electricity generation divided by the current annual power generation is a forward-looking indicator of exposure of electricity-intensive industries as a function of the age and emissions intensity of power plants.

30/ The index of economic resilience to low-carbon transition is composed of 11 indicators capturing a country's capacity to adjust to the impacts of a low-carbon transition and to tap some of the opportunities that such a transformation would offer. Countries whose economies can rely on a broader portfolio of assets, flexible economic structures, and good governance are more resilient.

31/ Peszko et al., 2019.

FIGURE 43

Composition of the wealth of nations

Source: World Bank based on Lange, et al., 2018



assets utilized by a country's economy to generate income.³² In addition to subsoil resources, the national asset base includes human capital (i.e., the health, skills, and creativity of the workforce), produced assets (e.g., factories, infrastructure, and intangible intellectual property), net foreign assets (i.e., equity holdings of domestic financial institutions and foreign direct investments of domestic firms), and renewable natural assets (e.g., ecosystems, water, and renewable energy resources), which are often underpriced and misused (Figure 43).³³ Investments in governance, social capital, and inclusive political systems boost the productivity of the national assets' portfolio.³⁴ A broader base of productive assets allows greater flexibility and complexity of products and capabilities, including innovative, new ones that are further away from inherited comparative advantage. It unleashes productivity drivers of long-term growth, its resilience to external shocks and capabilities of economic agents to harness opportunities of emerging trends.

All GCC countries, except Oman, have been growing without depleting their stocks of wealth, but adjusted net savings were much lower than officially reported wealth accumulation. The adjusted net savings indicator (ANS)³⁵ captures

investments in human capital, depletion of natural resources, and damage from pollution, indicating whether a country accumulates or depletes its total wealth from year to year. Figure 44 shows that, for almost all GCC countries, the ANS as a percentage of GNI was positive in the period 2011-2015, with the highest, at 41 percent (Qatar), suggesting that these countries have been saving more wealth than they were losing. Oman is the only GCC country where ANS is negative, averaging about minus 10 percent of GNI in this period. It suggests that the important source of the country's current income is consumption of the asset base for the future income. The World Bank ANS data³⁶ shows that, in all GCC countries, ANS is significantly below gross savings because of natural resource depletion, capital depreciation, and environmental damage (air pollution; over-extraction of natural resources such as water, fish and land; and, global damage of unabated carbon emissions). The ANS trends closely follow gross savings rates, and the latter fluctuate in line with world oil and gas prices. Therefore, such wealth accumulation driven by hydrocarbon rents is vulnerable to the external factors affecting oil prices, which will be much more difficult to control during the low-carbon transition.

During the transition, traditional "brown" assets need to be managed and hedged to prevent environmental risks and disruptions to their resource mobilization capacity

Before new greener assets reach the scale of commercial potential, the traditional fossil-fuel related assets will need to generate short-term resources, enabling long-term investments in asset diversification. Traditional diversification

32/ Gil et al, 2014; and, Peszko et al., 2019.

33/ Helm, 2015; Hamilton and Hepburn, 2014; Hamilton and Hepburn, 2017; and, Lange et al., 2018.

34/ IMF, 2012; and, Ossowski and Halland, 2016.

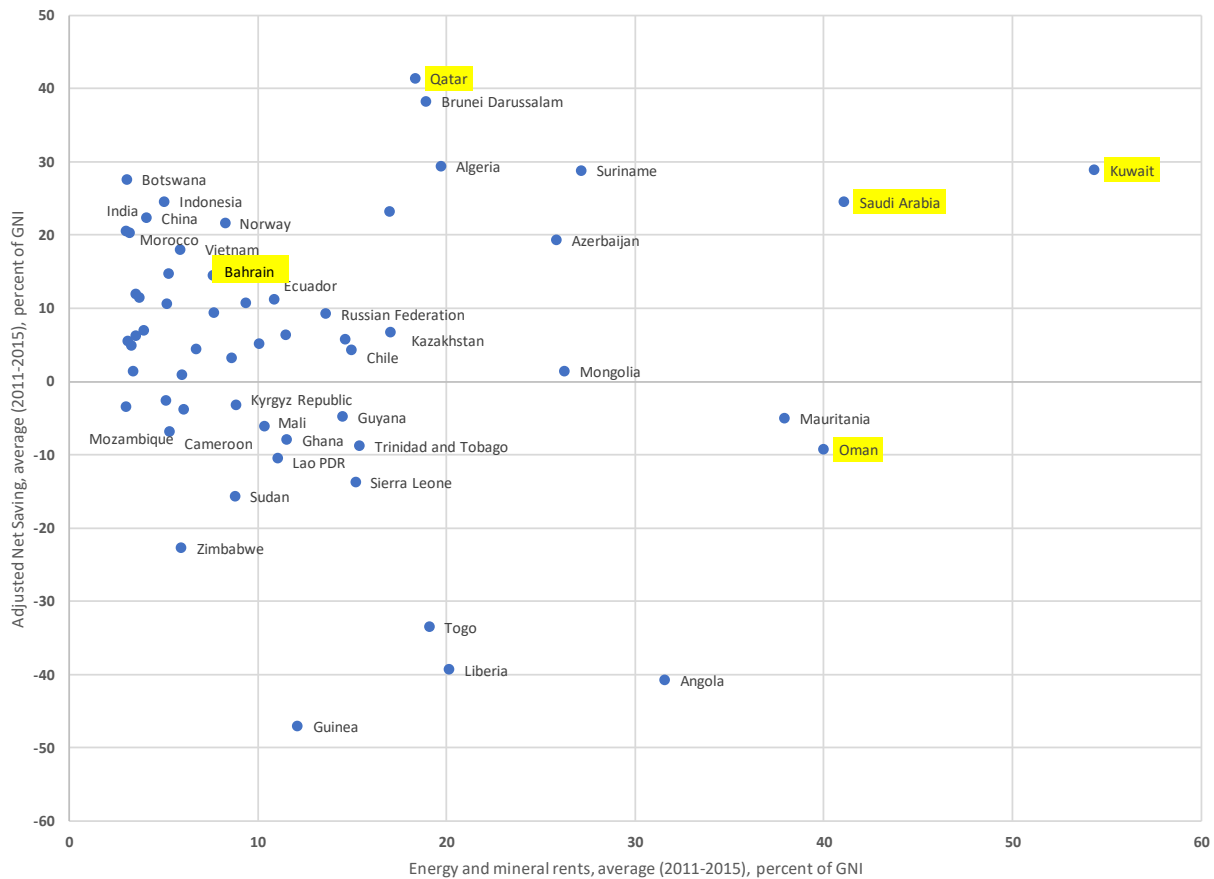
35/ Adjusted net saving is equal to gross savings minus consumption of fixed capital, plus education expenditure, minus energy depletion, mineral depletion, net forest depletion, carbon dioxide damages, and particulate matter (PM) damages. Detailed methodology in: Lange et al. 2018.

36/ World Bank, 2019. World Development Indicators and, WAVES (Wealth Accounting and the Valuation of Ecosystem Services), 2019.

FIGURE 44

Adjusted Net Saving in resource-rich countries in percent of Gross National Income, average, 2011–15

Source: Lange, Glenn-Marie, Quentin Wodon, and Kevin Carey, eds. 2018. *The Changing Wealth of Nations 2018: Building a Sustainable Future*. Washington, DC: World Bank.



into downstream oil and gas products builds on current strengths and capabilities and generate reliable medium-term rents and profits. It can also shelter the economy from the oil-price volatility risk, especially when supported by an effective countercyclical macro-fiscal and institutional framework.

The environmental sustainability risks to traditional assets need to be managed. In the near term, GCC countries have access to multiple policy tools that can lessen the environmental impact of energy-intensive industries and enable them to survive in societies that demand better quality of life, as well as in a global market space marked by increased environmental regulations and consumer awareness. Building state of the art and transparent environmental information and environmental management systems (EIS and EMS) would improve quality of life and reduce pressure on water and ecosystems services, while also encouraging innovation and international competitiveness of domestic firms. Establishing an enabling policy environment for scaling-up investment in renewable energy, carbon capture and storage (CCS), and carbon capture and use (CCU) technologies can reduce or offset the carbon footprint of heavy industry. The three technologies are aligned with

GCC endowments and skills, and they represent environmentally sustainable avenues to create new skilled jobs, capabilities, and comparative advantages in new, complex product spaces away from hydrocarbons. Investment in renewable energy, CCS, and CCU technologies also provide significant climate mitigation co-benefits and contribute to national commitments under the Paris Agreement. By reducing their carbon footprint with increasing renewable energy sources, or by offsetting it with CCS or CCU, the GCC exporters could acquire a competitive edge and a “clean” price premium for their industrial products in export markets that are willing to pay more for low-carbon goods. Some countries implement product standards based on life-cycle environmental impact, and this will be a pre-requisite for gaining market access. Over the long term, GCC-based firms are also well positioned to become foreign investors in projects that utilize these technologies abroad.

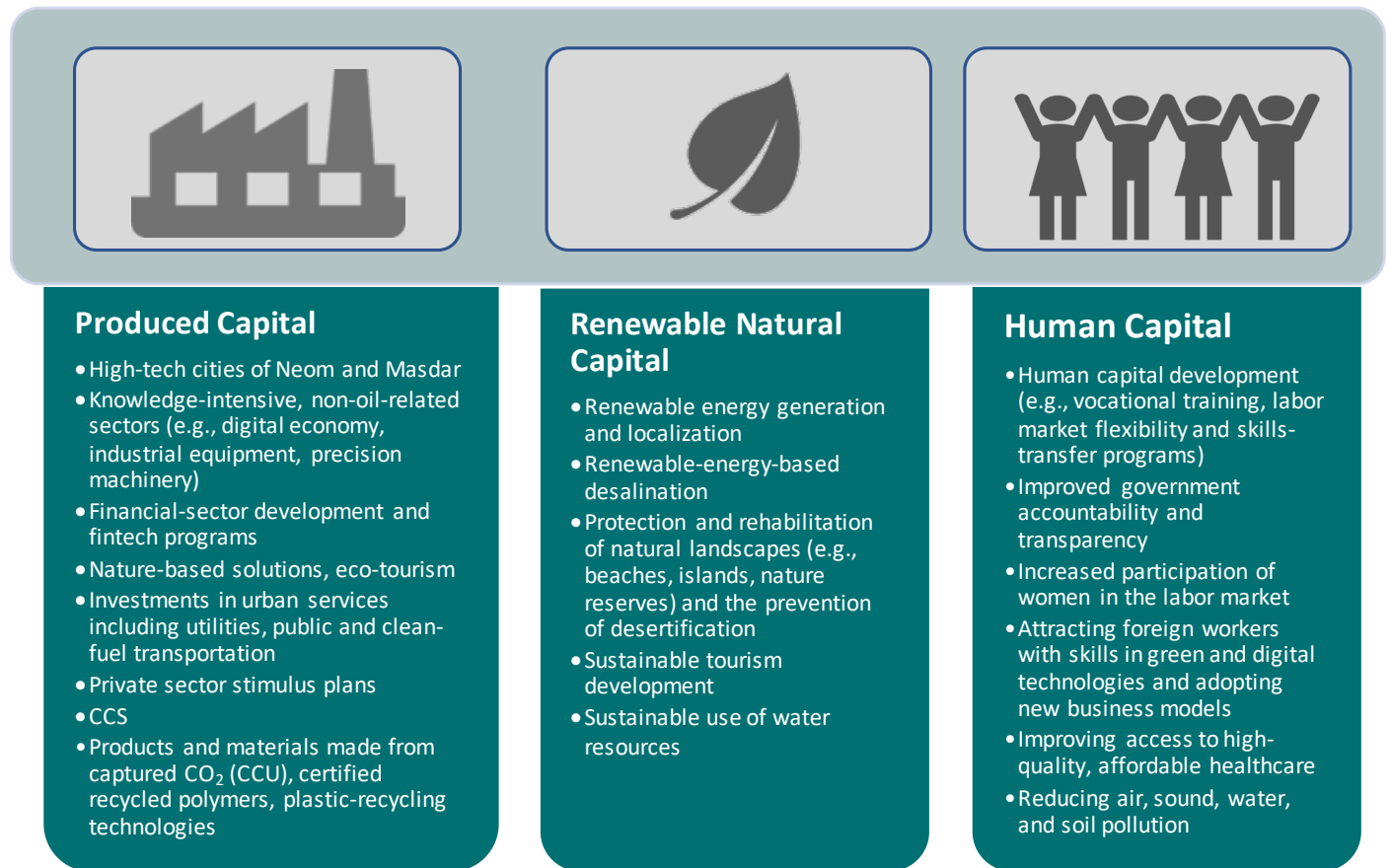
Policy incentives should focus new investments on asset diversification

Most GCC countries are already pursuing several elements of asset diversification, albeit inconsistently, which sends

FIGURE 45

GCC initiatives to promote asset diversification

Source: World Bank



confusing signals to markets. Ambitious renewable energy projects and impressive high-tech research and development initiatives coexist with programs to localize the traditional energy, refining, petrochemical, and metals industries and their supply chains. For example, one of the goals of Saudi Arabia’s Vision 2030 is to increase the local content of the oil and gas sectors from 40 to 75 percent via initiatives such as the King Salman Energy Park and the In-Kingdom Total Value Add program managed by Saudi Aramco. Similarly, the Hassya coal power plant in the UAE further locks the country into traditional diversification patterns.

Ambitious initiatives to diversify beyond hydrocarbon value chains do exist and facilitate the growth of the digital sector, knowledge-intensive services, and other elements of the “green” economy (Figure 45). Large public investments go into new technologies, renewable energy, and futuristic cities such as Masdar and Neom. Impressive public transportation infrastructure, including urban metro systems and high-speed railways, are being built in the UAE, Saudi Arabia, and Qatar. Generously-funded research and development facilities and business incubators, such as Masdar City in the UAE,

King Abdulaziz City for Science and Technology (KACST) in Saudi Arabia, and Qatar Business Innovation Center, support innovation and encourage startups in several key economic segments, including environmental sciences and low-carbon technologies. It is difficult to estimate how the balance tilts, because time series data on the break-down of public and private investments between polluting and clean industries are not readily available across GCC countries.

Current policies and investment decisions remain skewed toward maintaining comparative advantage in the traditional, unsustainable industries and products. This may partly explain why, despite large-scale investments in “clean” technology research and development, the national firms have thus far commercialized relatively few products and business lines in the GCC markets (Box 2). The GCC countries have made several ambitious announcements and commitments towards increasing investments in renewable energy, but in some cases implementation has stalled. For example the much heralded \$200 billion, 200-gigawatt solar plant planned by Soft-Bank and the Saudi Public Investment Fund was cancelled 6 months after it was announced in 2018. The GCC would benefit from a closer alignment of policy incentives and new invest-

ment decisions with a broad strategic vision of environmentally sustainable asset diversification.

Regulated low energy prices appear to have played a critical role in structuring GCC economies around energy-intensive activities. Most Gulf countries maintain low domestic fuel prices, especially for industrial users and power plants. The precise magnitude of fossil-fuel subsidies is difficult to determine due to lack of data and the many benchmarks that could be used to estimate the opportunity cost of the domestic use of oil and gas.³⁷ However, low energy prices encourage energy-intensive patterns of production and consumption, hamper firms' long-term competitiveness,³⁸ and divert scarce fiscal resources away from investments in new skills and infrastructure that could support a low-carbon, knowledge-intensive economy. Subsidies also favor incumbent industries over new entrants, especially efficiency- and innovation-seeking private firms that are not related to hydrocarbons. Energy subsidies increase market concentration around traditional heavy industries while weakening incentives to improve their operational efficiency. They also obscure the commercial performance of national oil and gas companies, which often partly absorb the burden of subsidies through low margins on domestic sales. Windfall profits earned by oil-related downstream industries due to the low, regulated fuel prices can crowd out more productive and knowledge-intensive economic activities.

Due to a legacy of market and policy failures, asset diversification requires more than just horizontal macro-fiscal enabling conditions.³⁹ As industrial policies that support traditional sectors are gradually phased out, the vertical industrial policies and innovation clusters for new post-hydrocarbon sectors can be phased in.⁴⁰ Mission-oriented vertical industrial policies can support the creation of new product spaces and value chains, and help discover new sources of comparative advantage away from hydrocarbons. The risk of picking the

losers can be managed.⁴¹

A successful transition to asset diversification will require changing public attitudes toward the true cost of the domestic use of oil. The expectation of low domestic energy prices reflects the historically entrenched perception of the low domestic opportunity cost of oil and gas. However, GCC's diversification ambitions are underpinned by a growing awareness among regional political leaders that the opportunity cost of domestic oil and gas use is much higher than current domestic prices. Yet, social and political support for the transformation will be essential. Deepening and extending coverage of the existing social protection programs, reducing income and wealth inequality, broadening access to finance, jobs, markets, and education, making engagement of urban populations, youth, and women inclusive, as well as maintaining dialogue with the major industrial players will be important to ensure key stakeholders can cope with changes in the domestic energy costs and deep structural changes in the economy.

International climate cooperation mitigates the risk of external policy shocks and leverages global opportunities for GCC firms exploring new, greener products and business models

37/ Estimates of the domestic opportunity cost of oil consumption can range from production cost to fiscal break-even prices to foregone alternative development opportunities.

38/ Cali et al, World Bank 2019.

39/ Cherif and Hasanov, 2014, Cherif & Hasanov 2016 and Cherif et al. 2017.

40/ Greenwald and Stiglitz, 2006.

41/ Hallegatte et al., 2013.

BOX 2

The complex task of developing sustainable industries in the GCC: the case of waste recycling

The UAE is the regional leader in waste-management investments. While the government is commissioning one of the world's largest waste-incineration plants in Warsan, Dubai, it has also launched pioneering investments in sustainable recycling, such as the Recycling Hub for electronic waste opened by the Dubai-based company Enviro-Serve or the Center for Waste Management at Tadweer, which plans to collaborate with Etihad Airways on a waste-to-fuels project. Similarly, the Saudi Investment Recycling Company was established in 2017 to develop waste treatment and recycling facilities and waste-to-energy solutions. However, European lawmakers are increasingly moving away from waste-to-energy and waste-to-fuels technologies, which many have come to regard as environmentally unsustainable and nonrenewable. The revised EU waste legislation states that plastic waste can be considered as "recycled" only if it is reprocessed into new materials or transformed back into basic chemicals and is not subject to energy recovery. In 2018, the Saudi Basic Industries

Corporation (SABIC), a leading international chemicals company, launched an initiative to produce certified recycled polymers, but SABIC is introducing this alternative feedstock into its production site in the Netherlands, not in the GCC. The certified circular polymers are to be supplied to European companies to use in the development of innovative, high-quality, and safe consumer goods, as well as food packaging and personal care products. This experience shows that even when GCC companies are at the cutting edge of sustainable technology and market trends, they often create profits and jobs abroad, as government-led investments, regulations, and energy-pricing policies in domestic markets systematically favor traditional industries with a large environmental footprint. The GCC countries still have major opportunities to remove barriers and create effective demand for sustainable value chains, which could enable GCC firms to become global market leaders in sustainable technology while commercializing innovations and creating new jobs at home.

Climate policy cooperation involves the strategic coordination of national policy instruments and trade provisions between the GCC countries and their trading partners to align their long-term economic interests while providing the global public good of reduced GHG emissions. The GCC countries should take a lead role in shaping the cooperative mechanisms under the Paris Agreement, which will enable them to leverage additional resources and technologies to enhance the climate co-benefits of economic diversification. Failure to proactively engage with international trading partners on climate issues increases the risk of policy shocks.

Climate cooperation can also increase financial flows, accelerate technology transfer, and expand the international market access for the GCC firms engaged in knowledge-intensive, environmentally sustainable activities. GCC countries could use carbon markets to monetize the domestic climate co-benefits of diversification, energy transition, and CCS. Moreover, GCC countries can also be effective buyers of climate benefits from projects implemented by GCC firms abroad, such as investments in solar energy, desalination, and CCU/CCS across the MENA and Africa regions. This process could facilitate access to new markets while rebranding GCC countries as vital contributors to international efforts to stabilize the climate. The GCC countries could seek to harmonize low-carbon product and fuel standards with those of major oil and gas importers to create incentives to commercially scale up CCS, CCU, and renewable energy technologies. The proliferation of multinational regulatory and labeling regimes, informing consumers about the life-cycle environmental footprint of products can give GCC exports a future competitive edge due to the vast potential of decarbonizing oil and heavy industry products in the region through CCS, CCU, and renewable energy. GCC countries can also develop services for other large emitters, including storing their CO₂ in the region's vast geological formations. Finally, the GCC countries should be prepared to negotiate the international coordination of carbon taxes with oil importers to retain some of the resource rents that would otherwise be solely collected by importers via carbon-tax revenue. Carbon taxes or other forms of carbon pricing can serve as a natural complement to energy-pricing reform by promoting efficiency, structural change, and innovation to discover new sources of comparative advantage in environmentally sustainable economy. The Minister of Energy of Saudi Arabia has already announced the intention to introduce carbon price in the form of an emissions trading system, although details are yet to be determined.

Strengthening effective environmental institutions is vital to achieve the region's sustainability objectives

The GCC countries have already made considerable progress in managing their environmental resources and building the capacity of environmental institutions. The GCC countries have established environment agencies responsible for environmental protection and adopted related legislation. They are signatories to major international environmental agreements, including the main conventions on the conservation of biological diversity, combatting desertification, and mitigating climate change, as well as regional agreements to protect their environment. The GCC countries have also prepared Nationally Determined Contributions (NDCs) under the Paris Agreement that, while varying in terms of their ambition, clearly signal the commitment of regional policymakers to addressing issues around environmental sustainability and climate change.

To meet the environmental challenges that GCC member states currently face, effective environmental institutions incorporating international best practices are urgently needed. Addressing the region's ongoing environmental degradation would deliver substantial benefits across numerous sectors. Improved air and water quality and cleaner marine and coastal environments could enhance health outcomes, increase quality of life, improve competitiveness of GCC's cities, and promote the development of tourism and other sectors that depend on a positive ambient environment.

Focusing diversification strategies towards environmentally sustainable economic activities needs to be clearly communicated to citizens, investors and the international community and operationalized through consistent and investment-grade regulatory and financial incentives. Key elements of the framework to promote environmentally sustainable diversification include:

1. Anticipatory risk identification and assessment

- *Monitoring the exposure and resilience of macro-fiscal systems, the real economy, and the financial sector to the possible impacts of climate change and low-carbon transition.* Conducting stress tests to gauge the performance of the exposed sectors under various low-carbon transition scenarios and domestic diversification strategies would inform the development of flexible, adaptive policies to manage risks and harness emerging opportunities in a more environmentally sustainable economy.
- *Comprehensive wealth-accounting systems.* Measuring changes in total wealth (including natural, human, produced capital and foreign assets), in the composition of the wealth stock, and in adjusted net saving would enable policymakers to monitor the sustainability of economic growth and better integrate wealth portfolio management into the national economic policies. Performance of structural and sectoral policies should be evaluated with systematic monitoring of their impact on air pollution, energy and resource efficiency, water efficiency and water quality, waste management and recycling, and the value of benefits provided by critical ecosystem services.
- *Strengthening regional capacity for environmental research and development, bridging data gaps and relying on evidence-based decision making.* The GCC countries collect some environmental data; however, there is a pressing need to standardize monitoring protocols for key variables across the region, strengthen data analysis, and facilitate accessibility of environmental information to the decision makers and the general public.

2. Strengthening environmental management institutions

- *Developing comprehensive air-quality management plans and systems.* The GCC countries are expanding the networks of air-quality monitoring stations in major cities and publishing online air-quality indexes for Kuwait City, Doha, Jeddah, Riyadh, Abu Dhabi, and other major cities. However, comprehensive monitoring of emission sources and their impact on air-quality are needed to develop air quality improvement programs and address the air pollution hot-spots. Increasing ground and tree cover around major cities would help buffer the impact of dust storms.

- *Modernizing environmental institutions and regulatory frameworks, and strengthening implementation and enforcement.* The environmental management institutions and regulatory frameworks of GCC countries need to be brought into conformity with international best practices. Environmental institutions in the GCC face several key challenges, including the fragmentation of responsibilities for environmental and natural-resource management, weak implementation and enforcement capacity, and limited public engagement. The application of the “polluter pays” principle could complement and alleviate some of the administrative burden of command-and-control instruments, which are costly to apply and difficult to enforce. Strategic environmental assessment as a planning tool for upstream decisions on economic development of coastal and other environmentally fragile regions would enhance environmental sustainability of growth.

3. Aligning economic, financial and regulatory incentives with goals of environmentally sustainable asset diversification

- *Accelerating the liberalization of energy and water pricing.* Market-based resource pricing is critical to incentivize efficiency and create the conditions necessary to enable innovation and market penetration by environmentally sustainable technologies and businesses. Tax and subsidy policies should be reformed to align energy prices with their internal and external costs, while targeted policies should protect vulnerable groups from adverse social impacts. Efficient water pricing would help manage water demand for human needs and for environmental flows to ensure that the economic activities in sensitive coastal and oasis habitats will be sustained under conditions of increasing water stress and temperature.
- *Fiscal policy to support asset diversification.* On the tax revenue side it would be important to: (i) continue improving transparency of oil and gas rent collection through explicit taxes; (ii) add fuel excise taxes to the menu of fiscal instruments of rent collection and differentiate tax rates by the social and environmental cost of a fuel use; and, (iii) explore carbon taxes or other forms of carbon pricing harmonized within the broader trade and technology agreement with oil and gas importers.
- *Key expenditure policies include:* (i) While liberalizing domestic fuel prices, move from nontransparent producers’ energy subsidies to transparent consumers’ subsidies (e.g., through block tariffs or income transfers targeted at vulnerable groups; (ii) Focus expenditure policies on adding new capabilities to economy, rather than adding value to hydrocarbons, and prioritize non-oil-related produced assets, human capital, and renewable natural assets over the oil-related products and services; and, (iii) Among vertical industrial policies remove preferences to industries within hydrocarbon value chain and prioritize those that can discover new greener sources of comparative advantage, and shelter the oil and oil-dependent exports from external policy shocks.
- *Economic regulatory incentives to support circular economy, resource efficiency and integration of GCC economies into the greening global markets.* This can be achieved by implementing emission, efficiency, and product standards in line with international best practices. The reciprocal adoption of environmental standards for fuel efficiency that prevail in major consumer markets, such as California and the EU, can help GCC oil and gas exports maintain robust access amid increasing consumer preferences for green products. GCC hydrocarbons could be branded as having low environmental footprint because their emissions in upstream activities are already relatively low, and in addition they can use CCS to offset emissions embedded in the exported fuels. Similarly, the harmonization of environmental product standards for plastics and other industrial products with consumer countries could help GCC exporters scale up and localize production of innovative, environmentally sustainable products such as certified recycled polymers or materials produced from captured CO₂ with high inputs of renewable energy. Adopting these standards can align private-sector incentives with sustainable economic diversification and encourage the exploitation of niche markets in which the region has a potential comparative advantage.
- *Protecting critical coastal and marine habitats.* The blue economy has significant potential to support diversification through integrated and sustainable economic activities in a healthy coastal and marine environment. Governments in the region must build their capacity for marine spatial planning, which is a key instrument to reconcile multiple ecological, economic, and social objectives for the use of coastal and marine resources, including setting aside biodiversity hotspots or areas of unique cultural and environmental importance for conservation, as well as enhancing and restoring fisheries productivity, promoting sustainable aquaculture, controlling marine pollution, and implementing the Ballast Water Convention. Similarly, it is essential to strengthen sustainable land management to promote the conservation of biodiversity, combat desertification, and enhance climate resilience.
- *Enhancing resilience to the impacts of climate change.* The GCC countries are threatened by rising sea-levels, ocean acidification, rising temperatures, and the increasing frequency of dust storms. An integrated approach that uses analytical tools to inform climate adaptation strategies and action plans can build on regional good practices, such as the climate change vulnerability assessment prepared by the Abu Dhabi Environment Agency and the Abu Dhabi Global Environmental Data Initiative.

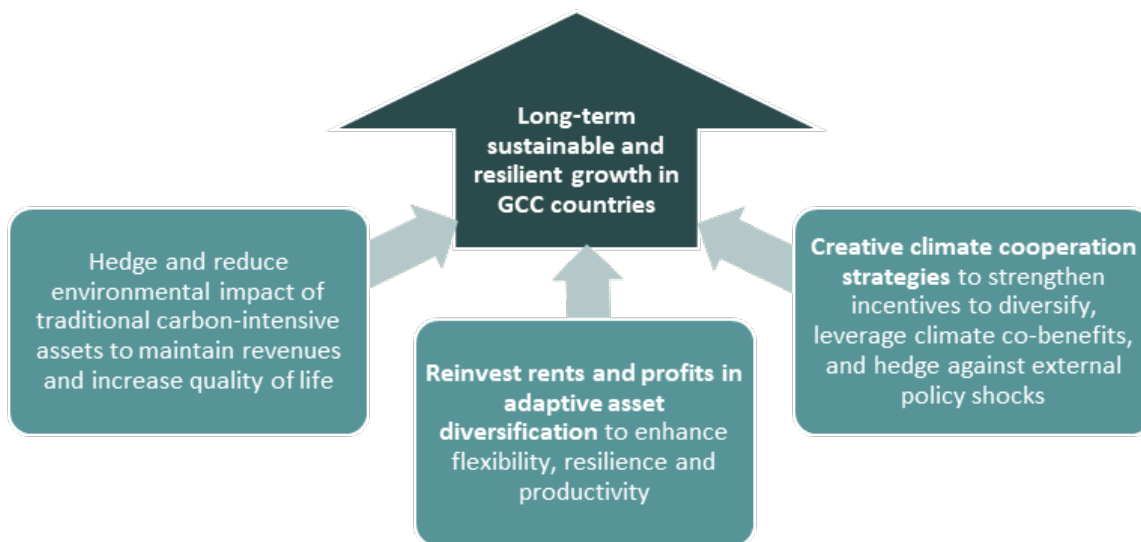
Conclusions

This chapter outlined the framework for the alignment between what the GCC countries are trying to achieve, i.e., increasing growth, productivity and quality jobs, but also the resilience to external shocks including the arrival of low-carbon technologies fueled by behavioral and policy changes in importing countries, with what is needed to make their economy more environmentally sustainable and livable.

This alignment takes the form of incentives and investment to (i) diversify the economy toward activities that are more environmentally friendly (e.g., renewable energy, clean transport, green industries, eco-, and cultural tourism), (ii) hedge exist-

Three-pronged strategy to support environmentally sustainable diversification

Source: World Bank, adapted from Peszko et al., 2019 (forthcoming).



ing risks of polluting industries that currently dominate the non-oil economy by lowering their environmental footprint for example through modern environmental management systems, CCS and CCU, and (iii) engage in a more proactive international climate policies to access support (technology, finance, and access to market) for asset diversification and rebrand GCC countries as global leaders in environmental sustainability (Figure 46).

A pattern of diversification that increases local and global environmental stress carries a risk of undercutting the long-term sustainability of economic growth. Traditional diversification keeps the GCC economies focused on exploiting their current comparative advantages in the hydrocarbon value chain, but it also increases greenhouse gas emissions and intensifies pressure on local environmental resources.

By contrast, asset diversification discovers new areas of comparative advantage through disruptive innovation and increased productivity, improves environmental quality, and is more resilient to the impacts of the global low-carbon transition. Environmentally sustainable asset diversification would also ensure predictable access to foreign markets, which are becoming increasingly sensitive to the environmental footprint of imported goods and services.

Most GCC countries are already pursuing several elements of environmentally sustainable approach to asset diversification, but inconsistent policy frameworks, investment decisions and uneven implementation send mixed signals to markets and the public.

During the transition period asset diversification must be underpinned by sustained access to export revenue, which in the medium term can be generated mainly from traditional “brown” assets. Building completely new innovation and com-

mercialization systems and leapfrogging into global market niches in which other countries have already revealed their comparative advantage requires courage and massive long-term investments in less familiar business models. But, without this bold diversification course, the GCC countries may fall into the vicious circle of low productivity, low quality of life, sluggish and erratic growth, and may lock-in new stocks of polluting assets that can be abruptly stranded by external market and policy shifts. Therefore, while the current production of brown assets requires sheltering from external risks, most of the new investments should seek new, greener assets.

The mixed efforts to diversify into more knowledge-intensive and environmentally sustainable products and assets need to be bolstered by aligning policy and price incentives, and sweeping changes in public perception.

This process of economic transformation also presents an important opportunity to address many of the region’s current environmental challenges, which are the legacy of its rapid hydrocarbon-led economic growth. The GCC will need to shift regulatory and policy incentives and enable the mainstreaming of environmental sustainability and resilience into their growth models. Integrating environmental management systems and institutions into development plans can accelerate job creation in environmentally sustainable sectors, with positive implications for quality of life and the long-term sustainability of economic growth.

Finally, proactive cooperation with major trading partners on issues related to environmental quality and climate-change mitigation will be vital to avoid external policy shocks while leveraging the international expansion of the GCC’s most innovative and competitive new clean technology and service firms to advance into regional and global markets.

Global Developments⁴²

An attack on Saudi Arabia’s Khurais oil field and Abqaiq crude processing plant on September 14 raised questions about the security of the regional oil supply. The attack knocked out more than half of Saudi Arabia’s oil production, approximately 5.7 million barrels per day, or 6 percent of the world’s oil supply. Brent crude futures spiked by 19.5 percent to US\$71.95 per barrel on September 16 before dropping back to US\$64.46 per barrel on September 18. Saudi Arabia reported restoring oil output to its pre-attack level on September 25. The attack followed multiple strikes on oil tankers, pumping stations, and pipelines in and around the Gulf in recent months. Tensions have been high since the U.S. unilaterally withdrew from the 2015 Iranian nuclear pact in May 2018, reestablished economic sanctions on Iran in November 2018, and imposed another round of sanctions on September 20.

This year, global economic growth is set to slow to its lowest level in a decade. Germany posted a negative growth rate in the second quarter of 2019; growth in Italy remained flat following a recession in 2018; the uncertainty surrounding Brexit continues to weigh on growth in the United Kingdom; and Japan faces plummeting consumer confidence. Meanwhile, financial stresses in Argentina, Turkey, Iran, and Venezuela—combined with subdued investment elsewhere—have dampened growth prospects among developing countries and emerging markets. In July 2019, the growth of global industrial production slowed to 0.9 percent (y/y), and global trade contracted by 0.6 percent (Figure A.1). Incoming data suggest that global economic activity will remain subdued over the medium term, and a sustained deterioration in the global PMI⁴³ is anticipated. Services activity, which had until recently remained resilient, has also slowed despite supportive policies. The prospect of a protracted slowdown in global economy and damaging effects of the U.S.-China trade war have substantially lowered oil demand projections for 2019 (Figure A.2).

The U.S. and China have escalated their trade war. Twin moves on September 1, 2019 brought some 69 percent of all U.S. imports from China and 58 percent of all Chinese imports from the U.S. under tariff protection. High-level negotiations are ongoing in November 2019, but should they fail, another round of duties will be triggered on December 15, which will cover 97 percent of U.S. imports from China and 69 percent of Chinese imports from the U.S.. At that point, the average U.S. tariff rate on Chinese goods will have risen from a pre-trade-war level of 3.1 percent to 24.3 percent, and the average Chinese tariff rate on U.S. products will have risen from 8 percent to 25.9 percent (Figure A.3). In the aftermath of higher tariffs, China’s economic growth rate has reached its slowest pace in 27 years, while U.S. manufacturing and capital expenditures are in recession. The trade war is also contributing to the global slowdown by weakening investor confidence.

Following a third rate cut, the Federal Reserve Board is divided over the future of U.S. monetary policy. The Federal Reserve lowered the federal funds rate by 25 basis points in July 2019, the first rate cut in ten years. This was followed by a second 25-basis-point reduction in September and a third in

42/ Accounts of global developments are drawn from World Bank, Global Economic Prospects – Heightened Tensions, Subdued Investment, June 2019, updated in World Bank, “Global Monthly”, July 2019, August 2019, and September 2019; International Monetary Fund, World Economic Outlook Update – Global Manufacturing Downturn, Rising Trade Barriers, October 2019; Peterson Institute for International Economics, “U.S.-China Trade War: The Guns of August”, August 2019.

43/ The PMI indicates the direction of economic trends in manufacturing.

FIGURE A.1

Global trade and industrial production growth
Percent, 3-month seasonally adjusted annualized rate
Global manufacturing PMI
Index value seasonally adjusted, 50+ = expansion

Source: CBP Netherlands Bureau for Economic Policy Analysis and JPMorgan.

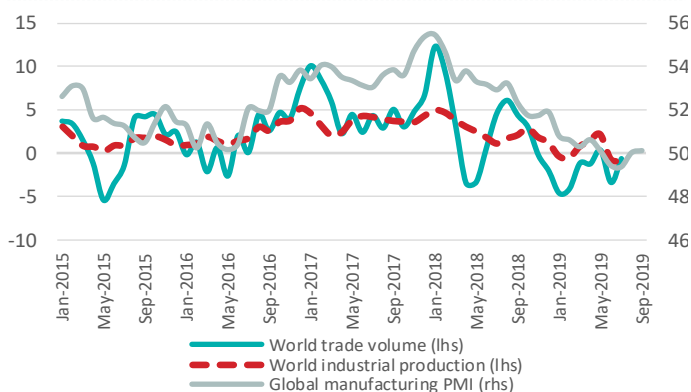


FIGURE A.2

Forecast changes in global oil demand for 2019
Annual change from 2018, million barrels per day

Source: Organization of Petroleum Exporting Countries (OPEC), International Energy Agency (IEA), and U.S. Energy Information Administration (EIA).

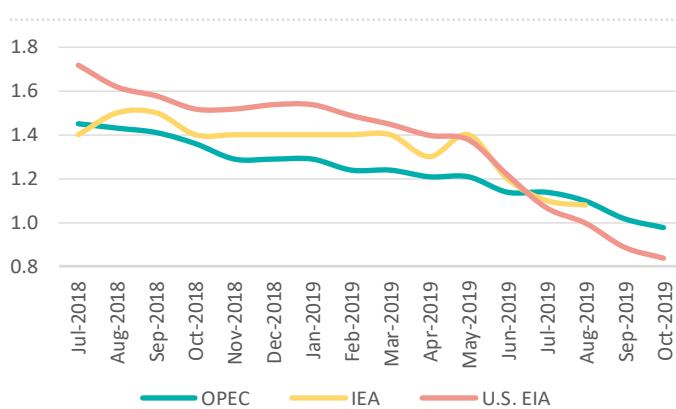


FIGURE A.3

U.S. tariffs on imports from China Percent of imports, and average tariff rate

Source: Peterson Institute of International Economics.

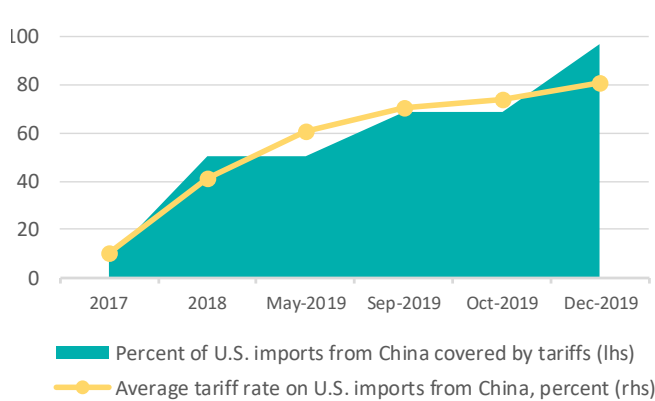
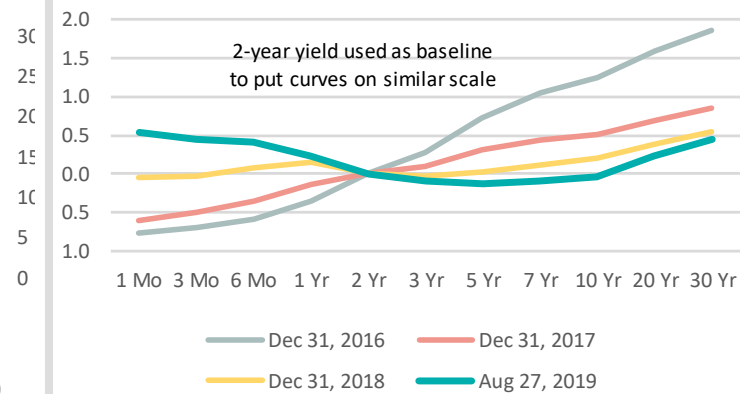


FIGURE A.4

U.S. Treasury yield curve Percentage points

Source: U.S. Department of the Treasury.



October, as inflation remained low and the global economy weakened. Meanwhile, the European Central Bank cut its deposit rate to a record low of -0.5 percent in September and announced that a massive bond-buying program in the amount of €20 billion (US\$22.1 billion) per month will resume in November. The Bank of Japan's policy stance, which is anchored by a short-term rate target of -0.1 percent and a 10-year yield target of 0 percent, remained unchanged in September, but the bank is considering deepening its negative rates. The Federal Reserve has ruled out the use of negative rates.

Policy easing by the major central banks and by central banks in at least 37 other countries has pushed bond yields into negative territory. As of September, US\$17 trillion worth of government bonds were trading at negative yields worldwide. Ten-year yields in the U.S. and Japan fell, inverting the U.S. Treasury yield curve at the end of August (Figure A.4). Historically, an inverted yield curve is a harbinger of recession in the U.S.. In Germany, 10-year yields reached an all-time low of -0.5 percent in September. Borrowing costs in emerging markets and developing economies have mirrored the decline in bond yields in advanced economies, with bond spreads falling to near 12-month lows in early July. In a context of low borrowing costs, excesses have been observed in the U.S. corporate debt market, and a rapidly ballooning leveraged-loan market is likely setting up the next distressed-debt cycle. Meanwhile, debt levels in emerging markets and developing economies reached historic highs in the first quarter of 2019.

Global Outlook and Risks⁴⁴

Global growth is projected to remain subdued in 2020-21 after falling below expectations in 2019. The global economic growth forecast for 2019 was downgraded from 2.9 percent in January to 2.5 percent, reflecting the broad-based weaknesses observed during the first half of the year, including a further deceleration in investment and manufacturing amid rising trade tensions. Global growth is projected to edge up insignificantly to 2.6 percent in 2021 (Figure A.5). Slowing activity in advanced economies and China is expected to be accompanied by a modest and softer-than-envisioned cyclical recovery among major commodity exporters, as well as several emerging markets and developing economies recently affected by varying degrees of financial-market stress or idiosyncratic headwinds such as economic sanctions.

After losing momentum in 2019, global trade growth is expected to stabilize, albeit at rates lower than previously forecast. Global industrial activity and goods trade have weakened considerably in 2019, and global trade growth is projected to slow from 4.1 percent in 2018 to 1.9 percent in 2019—its lowest rate since the global financial crisis of 2008-09, lower than the rate observed during the trade slowdown of 2015-16, and some 1.7 percentage points below the January forecast. Barring a renewed escalation of trade tensions, global trade is expected to recover modestly to 2.2 percent in 2021 (Figure A.6).

Global financing conditions are expected to remain volatile, even if generally more supportive. Faced with worsening global growth prospects and persistently low inflation, major central banks have adopted more accommodative monetary policy stances for the near term. In the U.S., the federal funds rate is forecast to be 45 basis points below the current target by September 2020, implying that the Federal Reserve may cut rates over the next four policy meetings (Figure A.7). Given monetary easing by major central banks, global financing conditions are expected to remain supportive although volatile due

44/ Forecasts on global growth, trade, and oil prices cited in this section are drawn from World Bank, Global Economic Prospects – Heightened Tensions, Subdued Investment, June 2019, updated in October 2019, and World Bank, Commodity Markets Outlook – The Role of Substitution in Commodity Demand, October 2019.

FIGURE A.5

GDP growth projections Percent, (y/y)

Source: World Bank Group.

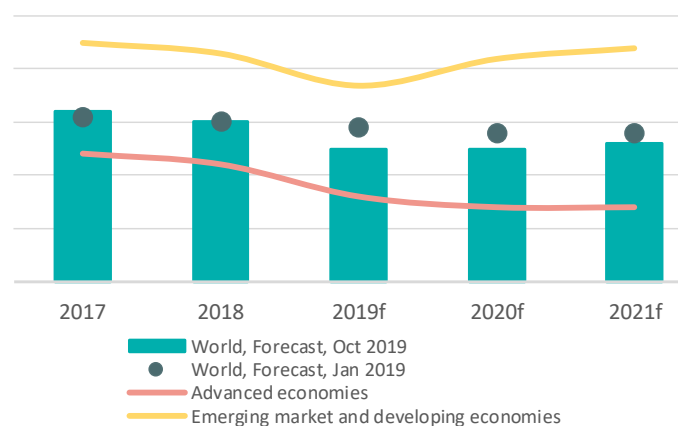


FIGURE A.6

World trade volume growth projections Percent, (y/y)

Source: World Bank Group.

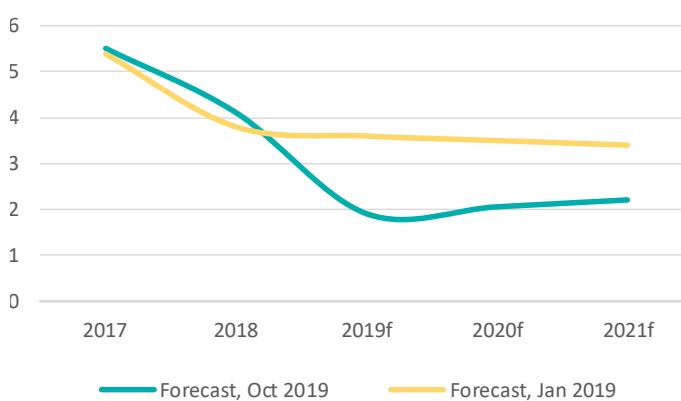


FIGURE A.7

Expected future path of the three-month average U.S. federal funds rate Basis points, from the midpoint (1.625 percent) of the current target range

Source: Federal Reserve Bank of Atlanta, October 31, 2019.

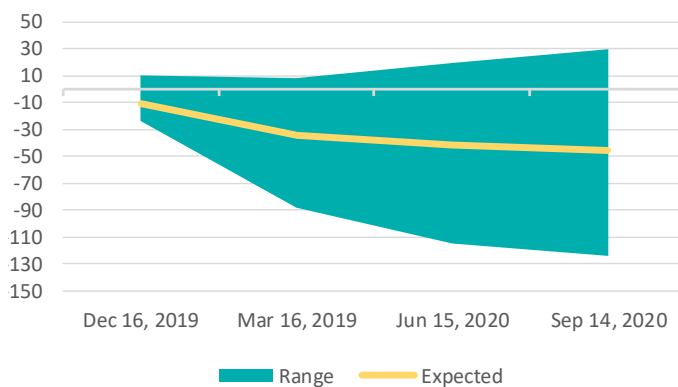
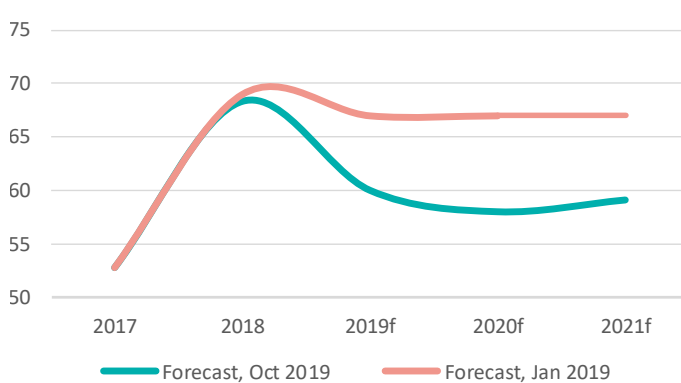


FIGURE A.8

Crude-oil price projections US\$ per barrel, simple average of Brent, Dubai and West Texas Intermediate

Source: World Bank Group, *Commodity Markets Outlook – The Role of Substitution in Commodity Demand*, October 2019.



to global policy uncertainty.

Oil price forecasts have been revised downward. Oil prices are expected to drop to an average US\$59 per barrel in 2020-21, substantially below the average US\$67 per barrel forecast in January, reflecting softening global economic activity (Figure A.8). However, the outlook for oil prices remains highly uncertain and hinges on decisions by the major suppliers, including the U.S., which has ramped up production in 2019 even as OPEC and its partners have cut their output. Nevertheless, OPEC supply cuts have resulted in substantial spare production capacity, which mitigates the risk that oil prices will spike in the near term.

Risks to the global outlook remain tilted to the downside. A protracted trade war between the U.S. and China, coupled with increasing trade tensions among various bilateral partners in a context of policy uncertainty, could weigh heavily on investment and contribute to financial-market volatility. Renewed financial stress in emerging markets and developing economies could be amplified by rising debt levels, corporate-sector vulnerabilities, and increasing refinancing pressures, while a sharper-than-expected slowdown in the major economies could have important spillover effects. In some regions, these risks are compounded by policy uncertainty and geopolitical tensions.



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COUNTRY SUMMARY TABLES

BAHRAIN

SELECTED ECONOMIC INDICATORS	2012	2013	2014	2015	2016	2017	2018	2019f	2020f	2021f
Nominal GDP, US\$ billion	31	33	34	31	32	35	38	38	39	41
Real GDP, % change	3.7	5.4	4.4	2.9	3.5	3.8	1.8	2.0	2.1	2.4
Hydrocarbon ¹	-8.5	15.3	3.0	-0.1	-0.1	-0.8	-1.3	..	..	..
Non-hydrocarbon ¹	7.1	3.1	4.7	3.6	4.4	4.9	3.0	..	..	..
CPI Inflation Rate, average, %	2.8	3.3	2.6	1.8	2.8	1.4	2.1	3.3	3.2	2.3
Government Revenues, % GDP	26.4	24.6	26.8	18.2	17.5	18.2	21.8	22.4	21.8	21.5
Government Expenditures, % GDP	31.9	34.3	28.4	36.6	35.1	32.4	30.4	33.3	29.6	28.8
Fiscal Balance, % GDP	-5.5	-9.7	-1.6	-18.4	-17.6	-14.2	-8.6	-10.9	-7.8	-7.3
General Government Gross Debt, % GDP ²	36.2	43.9	44.4	66.0	81.3	88.2	94.7	101.7	106.9	111.3
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % nominal change	17.4	10.9	-8.2	-29.6	-22.7	20.3	18.7	-4.9	0.5	0.2
Merchandise Imports, % nominal change	62.8	8.0	-7.0	-20.6	-13.5	18.3	18.9	-4.2	0.4	1.4
Current Account, % GDP	8.4	7.4	4.6	-2.4	-4.6	-4.5	-5.9	-4.3	-4.4	-4.3
Official Reserves, \$ billion ³	5.2	5.3	6.0	3.4	2.4	2.6	2.1	..	..	..
Memorandum Items										
Hydrocarbon sector, % GDP ¹	18.9	20.7	20.4	19.8	19.2	18.3	17.7	..	..	..
Hydrocarbon revenue, % total revenue ¹	87.2	88.3	86.2	78.1	75.7	75.1	82.4	..	..	..
Hydrocarbon exports, % total exports ⁴	50.5	47.8	45.0	33.3	33.3	40.3	47.4	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, *Macro Poverty Outlook, October 2019*, updated November 2019, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, *World Economic Outlook - Global Manufacturing Downturn, Rising Trade Barriers*, October 2019.

3/ IMF, International Financial Statistics.

4/ U.N. COMTRADE.

KUWAIT

SELECTED ECONOMIC INDICATORS	2012	2013	2014	2015	2016	2017	2018	2019f	2020f	2021f
Nominal GDP, US\$ billion	174	174	163	115	109	120	142	142	146	152
Real GDP, % change	6.6	1.1	0.5	0.6	2.9	-3.5	1.2	0.4	2.2	2.0
Hydrocarbon ¹	10.2	-1.8	-2.1	-1.7	4.0	-14.4	1.2	..	..	..
Non-hydrocarbon ¹	0.6	6.5	4.8	4.2	1.4	9.9	1.3	..	..	..
CPI Inflation Rate, average, %	3.3	2.7	2.9	3.3	3.2	2.2	0.6	1.0	1.0	3.2
Government Revenues, % GDP ²	65.7	64.4	53.9	39.5	39.6	44.1	48.0	44.1	45.3	45.6
Government Expenditures, % GDP	39.1	38.3	46.3	52.9	53.6	53.1	51.1	50.6	51.3	51.5
Fiscal Balance, % GDP ²	26.6	26.1	7.6	-13.4	-13.9	-9.0	-3.0	-6.5	-5.9	-5.9
General Government Gross Debt, % GDP ³	3.6	3.1	3.4	4.7	9.9	20.7	14.7	15.2	17.4	25.0
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % nominal change	16.3	-3.3	-9.5	-47.2	-15.8	18.4	29.9	-2.6	3.3	2.3
Merchandise Imports, % nominal change	7.3	5.5	7.1	-0.2	-2.9	11.2	5.9	9.2	5.0	5.0
Current Account, % GDP	45.5	39.9	33.2	7.5	0.6	6.5	15.0	9.1	8.7	9.1
Official Reserves, \$ billion ⁴	28.9	29.4	32.1	28.3	31.0	33.6	37.0	..	..	..
Memorandum Items										
Hydrocarbon sector, % GDP ¹	64.5	62.7	61.0	59.7	60.3	54.2	54.1	..	..	..
Hydrocarbon revenue, % total revenue ¹	93.6	92.1	90.3	88.6	89.2	89.3	89.6	..	..	..
Hydrocarbon exports, % total exports ⁵	95.5	94.7	94.9	92.1	91.9	93.0	93.8	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, *Macro Poverty Outlook, October 2019*, updated November 2019, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ Excluding investment income.

3/ IMF, *World Economic Outlook - Global Manufacturing Downturn, Rising Trade Barriers*, October 2019.

4/ IMF, International Financial Statistics.

5/ U.N. COMTRADE.

OMAN

SELECTED ECONOMIC INDICATORS	2012	2013	2014	2015	2016	2017	2018	2019f	2020f	2021f
Nominal GDP, US\$ billion	77	79	81	69	66	71	79	77	79	82
Real GDP, % change	9.3	4.4	2.8	4.7	5.0	0.3	1.8	0.0	3.7	4.3
Hydrocarbon ¹	3.9	2.5	-1.6	4.4	3.8	3.0	2.8	..	..	..
Non-hydrocarbon ¹	12.4	7.0	4.7	5.6	5.0	3.3	2.0	..	..	..
CPI Inflation Rate, average, %	2.9	1.0	1.0	0.1	1.1	1.6	0.9	1.5	1.8	3.8
Government Revenues, % GDP	48.7	49.5	45.3	34.2	29.7	31.8	37.4	36.5	35.1	36.6
Government Expenditures, % GDP	46.0	46.2	48.7	51.7	50.8	45.8	45.4	43.2	43.4	43.1
Fiscal Balance, % GDP	2.7	3.3	-3.4	-17.5	-21.2	-14.0	-7.9	-6.7	-8.4	-6.5
General Government Gross Debt, % GDP ²	4.9	5.0	4.9	15.5	32.5	46.8	53.4	59.9	63.9	65.0
General Government Net Debt, % GDP ²	-15.6	-28.8	-27.6	-22.8	-1.0	13.4	32.2	39.0	44.9	42.9
Merchandise Exports, % nominal change	10.7	8.2	-5.1	-33.4	-22.9	19.6	6.9	5.1	11.2	15.9
Merchandise Imports, % nominal change	19.2	25.0	-13.0	-4.7	-19.8	13.1	-2.0	2.2	2.8	4.7
Current Account, % GDP	10.2	6.6	5.2	-15.9	-18.7	-15.3	-5.2	-7.2	-8.0	-6.6
Official Reserves, \$ billion ³	14.4	16.0	16.3	17.5	20.3	16.1	17.4	..	..	..
Memorandum Items										
Hydrocarbon sector, % GDP ¹	44.9	43.8	42.5	42.4	41.8	40.4	40.8	..	..	..
Hydrocarbon revenue, % total revenue ¹	84.7	85.7	84.3	78.7	68.2	72.9	78.2	..	..	..
Hydrocarbon exports, % total exports ⁴	83.6	81.7	81.7	74.9	70.5	72.1	74.4	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, *Macro Poverty Outlook, October 2019*, updated November 2019, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, *World Economic Outlook - Global Manufacturing Downturn, Rising Trade Barriers*, October 2019.

3/ IMF, International Financial Statistics.

4/ U.N. COMTRADE.

QATAR

SELECTED ECONOMIC INDICATORS	2012	2013	2014	2015	2016	2017	2018	2019f	2020f	2021f
Nominal GDP, US\$ billion	187	199	206	162	152	167	191	172	176	189
Real GDP, % change	4.7	4.4	4.0	3.7	2.1	1.6	1.5	0.5	1.5	3.2
Hydrocarbon ¹	1.2	0.1	-0.6	-0.6	-0.9	-0.7	-0.6	..	..	..
Non-hydrocarbon ¹	9.9	10.4	9.8	8.5	5.3	3.8	3.6	..	..	..
CPI Inflation Rate, average, %	2.3	3.2	3.4	1.6	2.9	0.4	0.2	0.3	3.5	2.1
Government Revenues, % GDP	41.8	48.2	43.6	31.2	30.9	26.4	31.6	35.2	36.8	36.4
Government Expenditures, % GDP	30.5	33.5	30.0	32.1	40.1	32.2	29.4	34.0	34.7	33.7
Fiscal Balance, % GDP	11.3	14.7	13.6	-1.0	-9.2	-5.8	2.2	1.3	2.1	2.8
General Government Gross Debt, % GDP ²	32.1	30.9	24.9	35.5	46.7	49.8	48.6	53.2	48.0	43.1
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % nominal change	16.2	0.3	-5.0	-39.0	-25.9	17.8	24.9	-8.4	15.2	7.6
Merchandise Imports, % nominal change	14.3	2.2	-1.0	-8.5	12.1	-3.7	8.3	-15.7	-3.4	-10.1
Current Account, % GDP	33.2	30.4	24.0	8.5	-5.5	3.8	8.7	4.4	5.6	5.0
Official Reserves, \$ billion ³	32.5	41.6	42.7	36.5	30.8	13.8	29.1	..	..	..
Memorandum Items										
Hydrocarbon sector, % GDP ¹	58.1	55.7	53.2	51.1	49.5	48.4	47.4	..	..	..
Hydrocarbon revenue, % total revenue ¹	77.1	92.4	82.2	81.9	82.4	81.5	83.3	..	..	..
Hydrocarbon exports, % total exports ⁴	92.5	91.9	90.8	87.5	85.1	85.7	88.2	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, *Macro Poverty Outlook, October 2019*, updated November 2019, unless otherwise indicated.

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SAUDI ARABIA

SELECTED ECONOMIC INDICATORS	2012	2013	2014	2015	2016	2017	2018	2019f	2020f	2021f
Nominal GDP, US\$ billion	736	747	756	654	645	689	787	750	765	790
Real GDP, % change	5.4	2.7	3.7	4.1	1.7	-0.7	2.4	0.4	1.9	2.2
Hydrocarbon ¹	5.1	-1.6	2.1	5.3	3.6	-3.1	3.1	..	..	..
Non-hydrocarbon ¹	5.5	6.4	4.9	3.2	0.2	1.3	2.2	..	..	..
CPI Inflation Rate, average, %	2.9	3.5	2.2	1.3	2.0	-0.9	2.5	-1.2	0.8	1.0
Government Revenues, % GDP	45.2	41.2	36.7	25.0	21.5	26.8	30.7	32.6	34.3	34.5
Government Expenditures, % GDP	33.2	35.5	40.2	40.8	34.3	36.0	36.6	38.7	38.8	38.6
Fiscal Balance, % GDP	11.9	5.6	-3.5	-15.8	-12.9	-9.2	-5.9	-6.1	-4.5	-4.1
General Government Gross Debt, % GDP ²	3.0	2.1	1.6	5.8	13.1	17.2	19.0	23.2	28.4	33.6
General Government Net Debt, % GDP ²	-47.7	-50.9	-47.1	-35.9	-17.1	-7.7	-0.1	6.8	13.7	21.9
Merchandise Exports, % nominal change	6.5	-3.2	-8.9	-40.6	-9.8	20.4	32.3	-5.0	8.0	8.0
Merchandise Imports, % nominal change	18.2	8.1	3.3	0.5	-19.7	-6.7	10.1	10.0	15.0	18.0
Current Account, % GDP	22.4	18.1	9.8	-8.7	-3.7	1.5	9.0	5.9	7.1	7.9
Official Reserves, \$ billion ³	656.5	725.3	731.9	616.0	535.4	496.0	496.2	..	..	..
Memorandum Items										
Hydrocarbon sector, % GDP ¹	45.2	43.3	42.7	43.2	44.0	42.9	43.2	..	..	..
Hydrocarbon revenue, % total revenue ¹	91.8	89.8	87.8	72.9	64.2	63.0	67.5	..	..	..
Hydrocarbon exports, % total exports ⁴	87.4	86.4	84.9	75.1	75.6	77.3	80.2	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, *Macro Poverty Outlook, October 2019*, updated November 2019, unless otherwise indicated.

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4/ U.N. COMTRADE.

UNITED ARAB EMIRATES

SELECTED ECONOMIC INDICATORS	2012	2013	2014	2015	2016	2017	2018	2019f	2020f	2021f
Nominal GDP, US\$ billion	375	390	403	358	357	378	414	411	415	439
Real GDP, % change	4.5	5.1	4.4	5.1	3.0	0.5	1.7	1.8	2.6	3.0
Hydrocarbon ¹	4.8	3.2	0.1	5.2	2.6	-2.8	2.8	..	..	..
Non-hydrocarbon ¹	4.3	6.0	6.2	5.1	3.3	2.0	1.3	..	..	..
CPI Inflation Rate, average, %	0.7	1.1	2.4	4.1	1.6	2.0	3.1	-1.8	1.3	1.5
Government Revenues, % GDP	40.0	40.7	35.0	29.0	28.9	29.2	31.4	31	29.9	28.6
Government Expenditures, % GDP	31.0	32.3	33.1	32.4	30.9	30.8	30.2	32.3	30.9	29.2
Fiscal Balance, % GDP	8.9	8.4	1.9	-3.4	-2.0	-1.6	1.2	-1.3	-1.0	-0.6
General Government Gross Debt, % GDP ²	17.0	15.8	15.5	18.7	20.2	20.0	19.1	20.1	20.3	20.3
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % nominal change	19.1	3.2	-7.6	-12.4	-1.8	6.3	1.1	3.8	1.5	5.2
Merchandise Imports, % nominal change	11.6	5.8	1.6	-4.6	1.2	8.7	-4.5	6.5	5.5	5.6
Current Account, % GDP	19.7	19.0	13.5	4.9	3.7	7.3	9.1	7.4	6.2	5.7
Official Reserves, \$ billion ³	47.0	68.2	78.4	93.7	85.1	95.1	99.2	..	..	..
Memorandum Items										
Hydrocarbon sector, % GDP ¹	32.6	32.0	30.7	30.8	30.6	29.6	30.0	..	..	..
Hydrocarbon revenue, % total revenue ¹	67.7	63.6	62.9	45.3	22.8	36.1	36.1	..	..	..
Hydrocarbon exports, % total exports ⁴	61.0	59.8	61.2	54.4	44.9	48.0	58.4	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, *Macro Poverty Outlook, October 2019*, updated November 2019, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

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COMMODITY PRICES TABLES

NOMINAL U.S. DOLLARS

ENERGY	Unit	2014	2015	2016	2017	2018	2019f	2020f	2021f	2025f	2030f
Coal, Australia	\$/mt	70.1	58.9	66.1	88.5	107.0	79.0	71.0	69.8	65.3	60.0
Crude oil, average	\$/bbl	96.2	50.8	42.8	52.8	68.3	60.0	58.0	59.1	63.7	70.0
Natural gas, Europe	\$/mmbtu	10.1	6.8	4.6	5.7	7.7	4.5	4.5	4.7	5.6	7.0
Natural gas, U.S.	\$/mmbtu	4.4	2.6	2.5	3.0	3.2	2.5	2.7	2.8	3.3	4.0
Natural gas, Japan	\$/mmbtu	16.0	10.9	7.4	8.6	10.7	10.7	10.0	9.8	9.2	8.5

Source: World Bank Group, *Commodity Markets Outlook - The Role of Substitution in Commodity Demand*, October 2019.

Notes: f = forecasts.

CONSTANT U.S. DOLLARS, 2010=100

ENERGY	Unit	2014	2015	2016	2017	2018	2019f	2020f	2021f	2025f	2030f
Coal, Australia	\$/mt	64.8	60.2	70.3	91.0	105.1	76.0	67.2	65.0	56.7	47.7
Crude oil, average	\$/bbl	88.9	51.9	45.5	54.3	67.1	57.8	54.9	55.0	55.5	55.6
Natural gas, Europe	\$/mmbtu	9.3	7.0	4.9	5.9	7.5	4.3	4.3	4.4	4.9	5.6
Natural gas, U.S.	\$/mmbtu	4.0	2.7	2.7	3.0	3.1	2.4	2.6	2.6	2.9	3.2
Natural gas, Japan	\$/mmbtu	14.8	11.2	7.8	8.8	10.5	10.3	9.5	9.2	8.0	6.8

Source: World Bank Group, *Commodity Markets Outlook - The Role of Substitution in Commodity Demand*, October 2019.

Notes: f = forecasts.

OIL PRODUCTION TABLE

CRUDE OIL PRODUCTION

Unit 1000b/d	2012	2013	2014	2015	2016	2017	2018	Q1-2019	Q2-2019	Q3-2019
Bahrain	0.17	0.20	0.20	0.20	0.20	0.20	0.17	0.19	0.20	
Kuwait	2.46	2.55	2.59	2.75	2.88	2.71	2.75	2.71	2.69	2.65
Oman	0.92	0.95	0.95	0.99	1.01	0.98	0.99	0.98	0.98	0.98
Qatar	0.74	0.73	0.70	0.65	0.65	1.97	2.01	2.02	2.01	2.00
Saudi Arabia	9.51	9.40	9.53	10.12	10.42	9.96	10.33	10.06	9.76	9.49
United Arab Emirates	2.65	2.76	2.77	2.93	3.05	2.93	3.00	3.06	3.05	3.07

Source: International Energy Agency, "Oil Market Report", September 2019 and October 2019, and Joint Organizations Data Initiative, Oil World Database.



