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Gulf Economic Monitor

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Staying the Course on Reforms
In Focus: Water for Prosperity and Development



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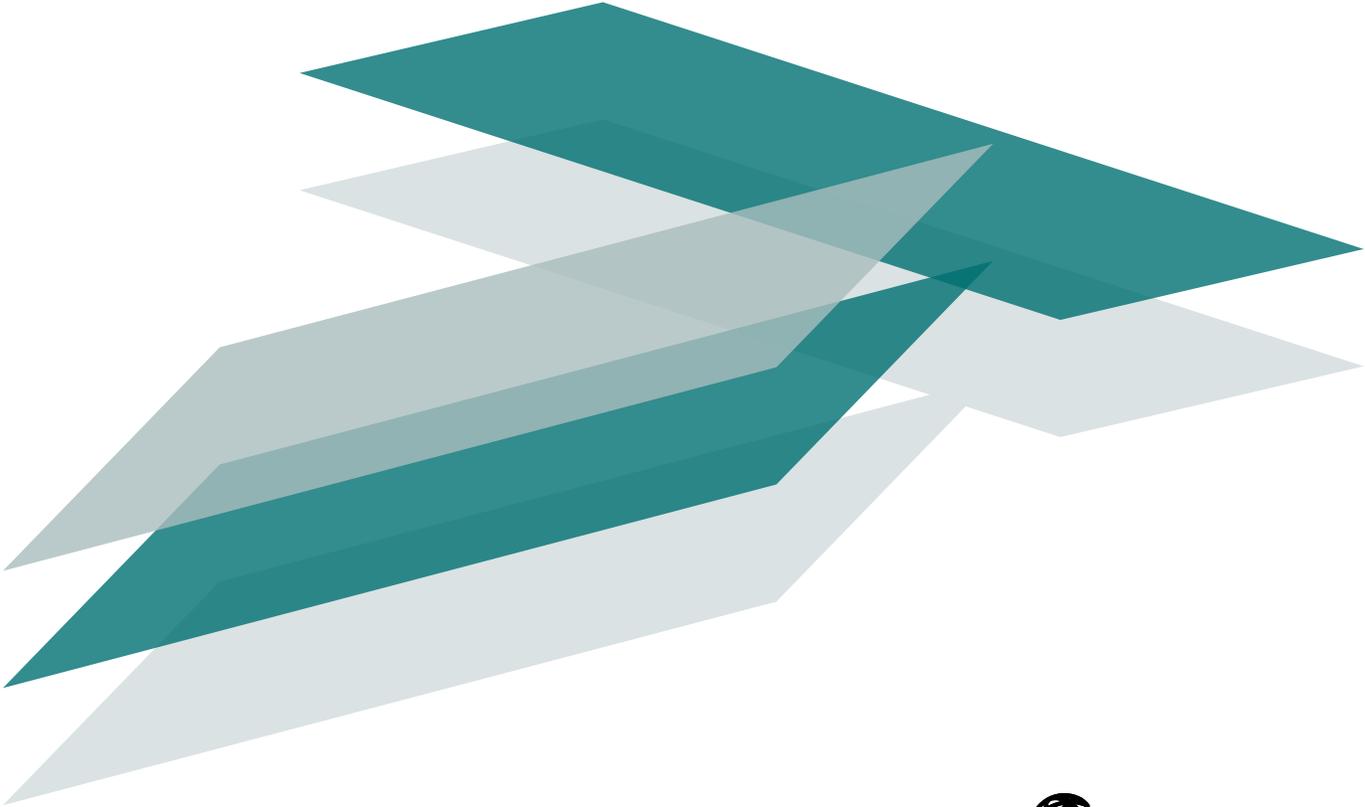
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ACRONYMS

BOT	Build-operate-transfer	MENA	Middle East and North Africa
AED	United Arab Emirates Dirham	MSCI	Morgan Stanley Capital International
BBL	Per Crude Oil Barrel	MSF	Multi-stage flash distillation
BP	British Petroleum	O&M	Operations and maintenance
CD	Certificate of Deposit	OECD	Organization for Economic Cooperation and Development
CDS	Credit Default Swap	OMR	Omani Riyal
CPI	Consumer Price Index	OPEC	Organization of the Petroleum Exporting Countries
DBO	Design-build-operate	PIF	Public Investment Fund for Saudi Arabia
EMBI	Emerging Market Bond Index	PMI	Purchasing Managers' Index
FDI	Foreign Direct Investment	PPP	Public-private partnership
FOMC	Federal Open Market Committee	QOQ	Quarter on Quarter
FTSE	Financial Times Stock Exchange	RO	Reverse osmosis
FY	Fiscal Year	SAAR	Seasonally Adjusted Annualized Rate
GCC	Gulf Cooperation Council	SAGIA	Saudi Arabia General Investment Authority
GDP	Gross Domestic Product	SAR	Saudi Riyal
GNFS	Goods and Non-Factor Imports	SME	Small to Medium Sized Enterprise
GRE	Government Related Entity	SOE	State Owned Enterprise
IEA	International Energy Agency	TDS	Total dissolved solids
ILO	International Labor Organization	UAE	United Arab Emirates
IMF	International Monetary Fund	UNCTAD	United Nations Conference on Trade and Development
IPO	Initial Public Offering	US	United States
KD	Kuwaiti Dinar	VAT	Value Added Tax
LNG	Liquefied Natural Gas	WEF	World Economic Forum
LPG	Liquefied Petroleum Gas	WTI	West Texas Intermediate
MBD	Million Barrels per Day	YOY	Year on Year

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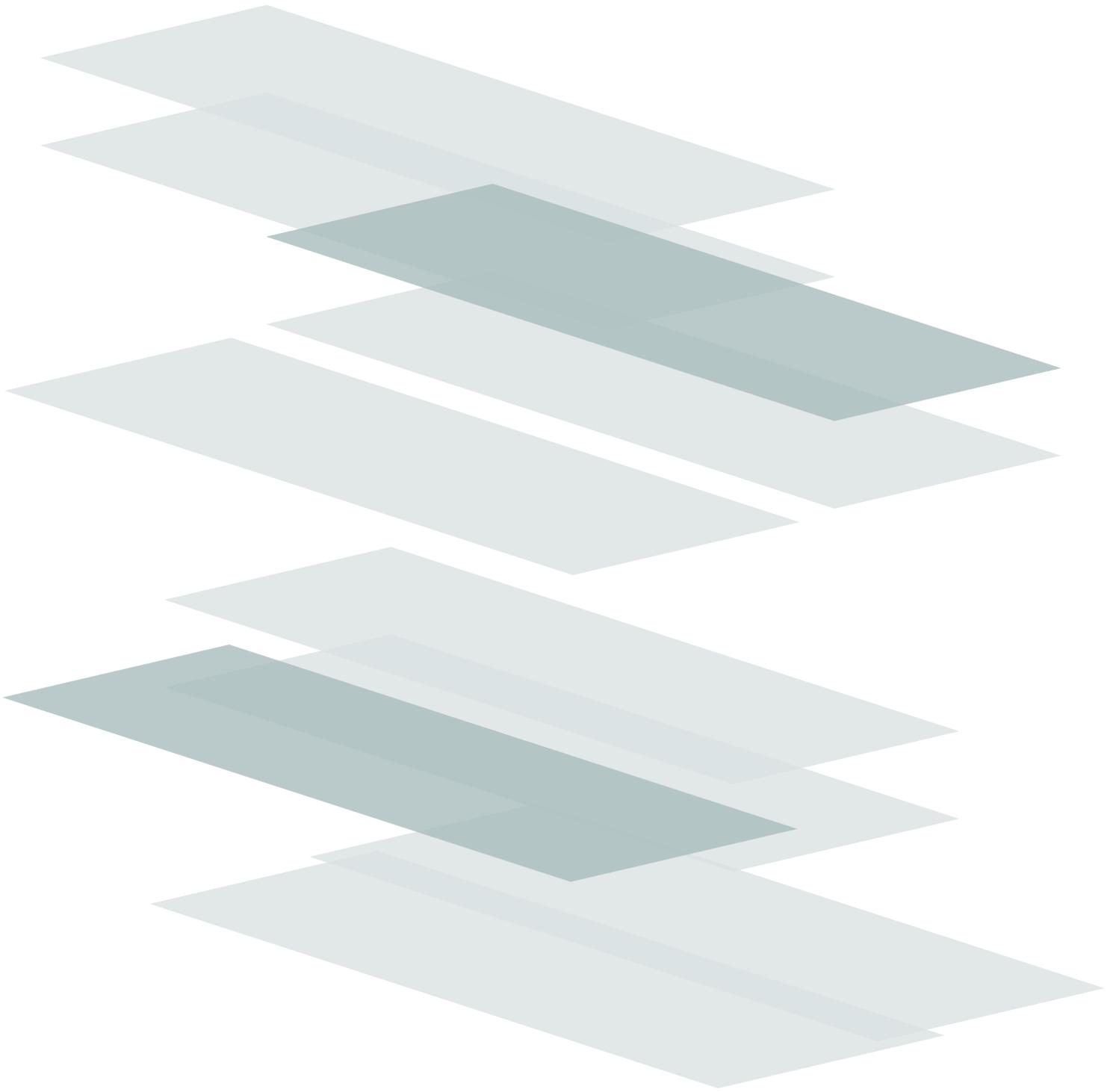
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TABLE OF CONTENTS

5	From the Director
6	Executive Summary
8	The Pulse of the Region
8	The global backdrop
10	Global outlook and risks
11	Regional developments
	<i>Growth, economic activity, and sentiment in the GCC</i>
	<i>Public finances and fiscal reforms</i>
	<i>Trade and external balances</i>
	<i>Prices and credit</i>
	<i>Monetary policy</i>
21	Near-term prospects and key risks
27	Risks and long-term challenges
38	Key Economic Indicators
38	Country summaries
44	Commodity prices tables
45	Oil production table
46	Spotlight: Interview with Carmen Nonay
48	In Focus: Water for prosperity and development
48	The GCC countries' water challenges
52	Taking the water security agenda forward
56	References



From the Country Director for the GCC Countries Middle East and North Africa Region, World Bank Group

ISSAM ABOUSLEIMAN



FOREWORD

The 2014 oil price collapse represented a major shock, and an opportunity, for the Gulf Cooperation Council (GCC) countries. While it exposed fundamental weaknesses in their “growth model,” it also made clear the conditions necessary for long term economic sustainability – namely, diversified economies, propelled by dynamic private sectors and an innovative and productive workforce rather than an oil-based, public-spending driven growth.

Policy makers in the GCC have been quick to seize this opportunity to transform their economies. Initially the adjustment took the form of spending restraint and active management of migrant labor to alleviate domestic labor market pressures. More recent efforts have tackled deeper reforms such as rolling back costly and highly distortionary subsidies, increasing revenues from the non-oil sector, and implementing business environment and labor reforms to revitalize domestic economies and generate economic opportunities for all citizens.

This shift in direction marks a radical turn for the GCC. It needs to be sustained if the desired transformation is to be achieved, especially in the presence of a growing risk that, in the face of recent buoyant energy prices, the forward momentum on reforms is lost. Reforms already implemented so far provide a sound platform upon which more progress can be built.

Yet it is precisely *now*, when energy prices are high, that GCC countries are best positioned to forge ahead with difficult reforms. First, the current period of economic recovery provides breathing room so that concerns about the impact of reforms on growth, employment and welfare will be less pressing. Second, while short-term prospects are undoubtedly looking better due to higher oil prices and the reforms implemented thus far, GCC countries continue to face substantial risks and challenges. These primarily stem from the continued heavy dependency on the oil sector when oil prices are inherently volatile and the long-term demand for the region’s hydrocarbon exports remains clouded by global efforts to combat climate change. Finally, the exodus of capital from emerging market economies this past summer is indicative of the kind of risks present in global financial markets. While the GCC has escaped this volatility thus far, ensuring continued confidence requires that they remain committed to credible policy reform agendas. Indeed, slippage in reforms could signal to the markets that governments in the region are not sufficiently strongly committed to the reforms needed to draw in long-term investors, which are a key part of diversification efforts.

In this context, this third edition of the *Gulf Economic Monitor* focuses the reforms lens on four key areas where further progress on reforms is needed. These include reducing the public-sector wage bill in GCC countries, which is among the highest in the world, creating business environments that support foreign and domestic investment, and reforming labor markets to foster job creation and ensure that Gulf nationals have the skills required by the private sector. Finally, governments should note that spending better (rather than spending more) will likely be the key to unlocking productivity gains from infrastructure spending.

The *In Focus* section of this report, as was the case in previous editions, draws attention to a separate, but equally crucial, aspect of long term economic prosperity: water security and sustainability. This is a tremendous challenge for GCC countries, which are already among the most water stressed in the world and face further pressures from climate change and demographics. Further increases in water stress could significantly impact social, economic and environmental well-being. Because water management touches many sectors, governments will need to ensure that decisions and strategies are integrated and applied consistently across these sectors, be they water conservation, management of aquifers, recycling, agricultural use, desalination, and coastal management. With increasing private sector participation in water management and delivery, well-developed government oversight and regulatory frameworks are needed to ensure accountability and high quality of service delivery.

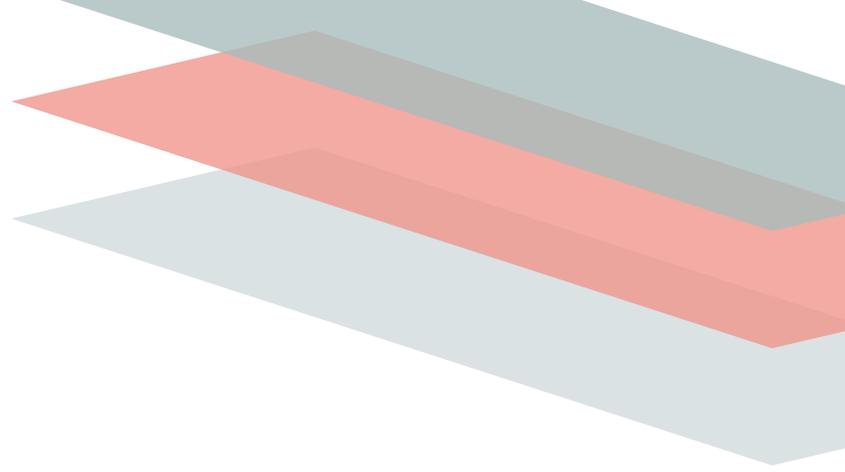
Executive Summary

The near-tripling of oil prices from their trough in January 2016, to nearly \$80 per barrel in early October 2018, has spurred a recovery in the GCC economies, following three years of persistent weakness. Additional support has come from rising oil production, and a slower pace of fiscal consolidation as government revenues have increased. Saudi Arabia emerged from recession in the first quarter of 2018 and Kuwait, in the second quarter. The United Arab Emirates, Qatar, Oman and Bahrain posted positive economic growth rates in the first half of the year. Higher energy prices and rising oil production are also helping the GCC countries to narrow large fiscal and external deficits, which had emerged in the wake of the 2014 oil shock.

On aggregate, the region is expected to post growth of 2.0 percent in 2018, following a contraction of 0.3 percent in 2017 (the first such contraction in over a decade). Looking further ahead, growth is expected to reach 2.7 percent in 2020, as high energy prices and the expiration of the OPEC+ agreement bolster government revenues, support higher government spending and lift domestic sentiment and activity. External and fiscal imbalances are also expected to narrow, with Saudi Arabia and the UAE achieving near fiscal balance by 2020 and, along with Qatar and Kuwait, returning to current account surpluses during 2018-20. This positive outlook is underpinned by an upward revision of our oil price forecasts from US\$60 a barrel for 2019-20 (in the February 2018 issue of the *Gulf Economic Monitor*) to US\$72 a barrel for that time period. Projections also assume that GCC countries will persevere with important structural reforms initiated in recent years.

Nevertheless, risks remain, and these are, on balance, tilted to the downside. At the global level, these include growing trade protectionism, global financial volatility as advanced economies tighten monetary policy, and heightened geopolitical tensions that could depress global demand and trade, affect access to and cost of financing, and weigh down global energy prices. Even the potential upside risk of higher oil prices if larger-than-expected supply shortages emerge is in fact a negative, since a key domestic risk for the GCC region is a slowing in the pace of reforms. This is because higher-than-anticipated oil and gas revenues could reduce the pressure for governments to reform.

It is critical, however, that the GCC governments stay the course with the structural reforms launched after the 2014 oil price shock. First, GCC economies are still heavily dependent on oil and gas production, exports, and fiscal revenues, and continue to face long term challenges vis-a-vis sluggish domestic economies, demographic pressures and long-term risks related to the transition to a low carbon global economy. Second, although oil prices have recovered from their 2016 trough, they are unlikely to return to their pre-2014 peak as the fundamentals of the oil market have changed and there remain significant downside risks. Third, the forecast period of higher oil prices affords the GCC countries the opportunity to advance reforms under less stressful conditions even as evidence suggests— as we discuss in the *Monitor*—that fiscal adjustment in the GCC is less costly, in terms of its adverse effects on non-oil growth, than previously thought. Finally, recent global financial volatility and capital outflows from emerging market economies underscores the importance of anchoring the confidence of global financial markets via credible reform agendas.



Fiscal consolidation, economic diversification and social development are central to the vision statements, development strategies, and structural reform programs drafted by the GCC countries since mid-2014.

On the fiscal front, previous editions of the *Gulf Economic Monitor* have explored measures to mobilize revenues from the non-oil sector (including VAT and key excises) as well as energy subsidy reforms. This report takes a deeper look at the challenges posed by an extremely large public sector that acts as an “employer of first and last resort” for GCC nationals, and the costs that this imposes, both fiscally and in terms of distortions in the labor market.

This report argues that public wage bill and employment reforms will benefit the GCC in several ways: reducing expenditure rigidities imposed by the wage bill will generate fiscal savings and free resources for growth-enhancing spending on infrastructure and human capital; removing labor market distortions favoring government employment will boost private sector development; and improving the delivery of public services. The *Monitor* also notes that, except for the UAE and Qatar, other GCC countries do not rank high in global rankings of infrastructure quality. Given substantial infrastructure plans in the pipeline across the region, it argues that it is critical for governments to improve the efficiency of investment, which in turn will require a strengthening of public investment management institutions.

Previous issues of the *Monitor* have explored privatization and the use of public private partnerships (PPPs) as diversification and private sector development initiatives. This issue shifts attention to reforms aimed at improving the business environment. The UAE, Saudi Arabia and Qatar have joined Kuwait and Bahrain in allowing 100 percent foreign ownership of firms in select, if not all, business sectors. The UAE, Bahrain and Qatar are also granting 10-year, if not permanent, residency to foreign investors. While these reforms are important steps in attracting foreign investors, the region needs to widen these efforts. The latest World Bank Doing Business report revealed many areas where policy makers could reform business regulation and boost private activity. At least one of these—resolving insolvency—is central to the link between regulatory quality and efficient business outcomes. Saudi Arabia drafted an

insolvency law in 2018, and the UAE, in 2016. These laws will support the business environment for both foreign investors looking to earn returns on their investments, and for domestic firms and entrepreneurs.

With respect to social development and labor market reforms, this issue considers reforms related to the nationalization of GCC workforces. In this context, countries have stepped up efforts to nationalize their workforces in a bid to reduce their dependence on foreign labor, which accounts for 80 percent of private sector jobs in the region, mostly non-skilled. For instance, Saudi Arabia doubled the levy on expatriate labor in 2018, Oman banned the recruitment of expatriate workers in 90 job categories in ten industries for a year, and Kuwait plans to restrict employment in government contracts to local workers. The authorities must be mindful of the business continuity issues attendant to these workforce nationalization programs and must do more to ensure that their nationals can assume and perform the work of expatriates in key industries. Governments must strengthen educational systems and training programs to address private industry’s need for suitably skilled nationals for technical jobs.

Finally, in the *In Focus* section, the *Monitor* turns its attention toward water, a topic that has implications for long-term economic and environmental sustainability—water. The central challenge for the region is how to better manage water resources and deliver water services in the presence of acute water stress, consumption levels that are the highest in the world, and when dependence on energy-intensive water desalination is extreme. Developing national water sector strategies that address these challenges, and that coordinate decisions and water management across a range of sectors—be they energy, water conservation, coastal management, or agriculture—will be critical. This report argues that obtaining data on water-related variables, such as availability and use, and economic-related variables, such as cost of option, is a first step toward developing such a strategy. Additional steps include coordinating the actions and decisions of government agencies that need to work together to achieve long-term sustainability and accountability objectives; moving toward stronger private sector-led service delivery under effective public-sector oversight; and strengthening the management of water supply and sanitation services (including recycling).

The Pulse of the Region

The Global Backdrop

Global economic growth remains robust, but is uneven and appears to be slowing ...

Global economic growth remained robust in the first half of 2018 (Figure 1). However, indications are that global industrial activity and goods trade momentum have slowed in recent months (Figure 2), with a particularly pronounced deceleration in the trade-intensive capital and intermediate-goods sectors. Moreover, growth has become more uneven, accelerating in the United States on the back of fiscal stimulus, and moderating in many other parts of the world.

Among emerging market and developing economies, growth has become more heterogeneous, reflecting country-specific challenges. In addition, a strengthening U.S. dollar, trade tensions, deteriorating growth prospects, concerns about external vulnerabilities, and domestic challenges have all contributed to substantial currency declines and capital outflows in some emerging markets and developing economies. Commodity markets have also diverged, with crude oil prices rising on supply deficits and metal and most agricultural commodity prices declining on demand concerns (World Bank, 2018d).

... while global goods trade has weakened, and financial market conditions have tightened in developing countries

Following the strong gains at the start of the year, global goods trade slid for the first time in the second quarter of 2018

(Figure 3), reflecting weakening trade in and out of Asia, decelerating imports from some major advanced economies, and continued trade tensions between the U.S. and China. Although container shipping volumes bounced back at the start of the third quarter of 2018, new export orders have continued to deteriorate. Previously, a cyclical recovery in global manufacturing and investment, following a prolonged period of marked weakness, propelled global goods trade growth to 4.6 percent in 2017, three times the pace observed the previous year. The momentum was sustained in early 2018, despite easing export orders, and services trade growth also gathered strength. However, the acceleration has since weakened, including for industrial production. Meanwhile, trade policy uncertainty has reached record highs in recent months. Since the beginning of the year, the U.S. has imposed tariffs on about US\$300 billion of imports, US\$250 billion of them on imports from China. In response, China, the European Union, Canada, Mexico and other countries have placed retaliatory tariffs on a comparable value of U.S. exports.

Financial market conditions have tightened in emerging markets and developing economies over 2018, reflecting, in part, concerns about reduced U.S. dollar-denominated funding, escalating trade tensions, and rising policy uncertainty. Financial market jitters have been most pronounced in Turkey and Argentina, where external financing needs are particularly large, but other major emerging market and developing economies have also suffered from currency pressures (Figure 4), tighter borrowing costs, and broad-based capital outflows. In response, a growing number of central banks have hiked interest rates or intervened in foreign exchange markets.

FIGURE 1

Global GDP growth
Percent, QOQ seasonally-adjusted annualized rate

Source: World Bank Group.



FIGURE 2

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

Sources: JP Morgan, Markit Economics.

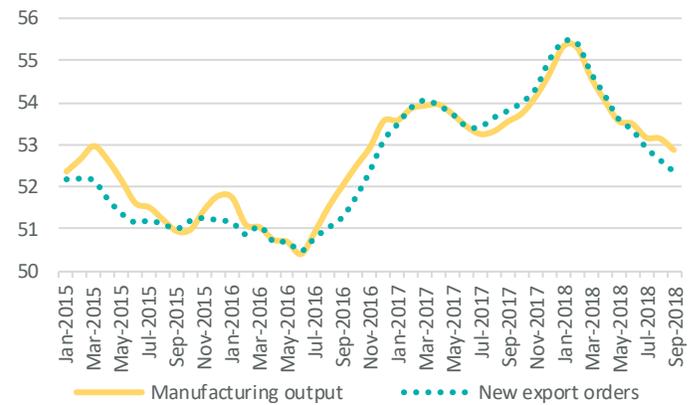


FIGURE 3

Global trade and industrial production growth
Percent, 3-month seasonally adjusted annualized rate

Source: CPB Netherlands Bureau for Economic Policy Analysis.

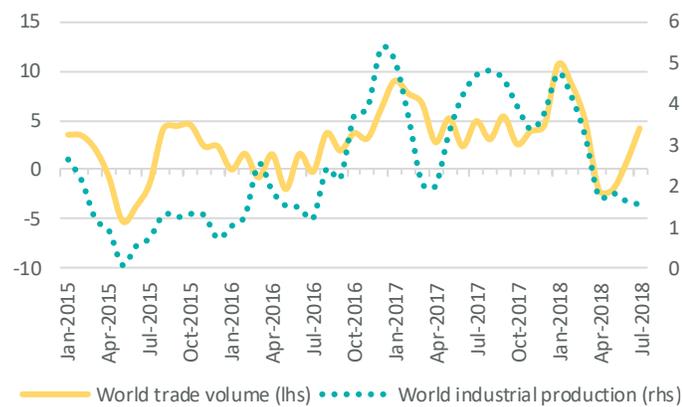
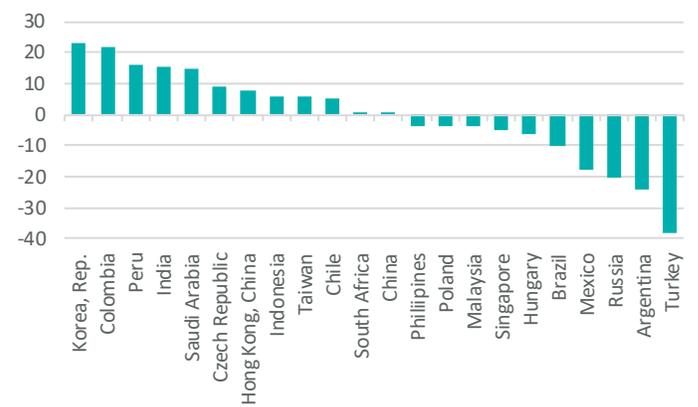


FIGURE 4

Changes in real effective exchange rates
Percent, December 2013 – September 2018

Source: International Monetary Fund and Bank for International Settlements.



Energy prices have risen sharply on robust demand and supply deficits

Global energy prices have almost tripled over the past two years, from US\$30 per barrel (bbl) in January 2016 to US\$80 bbl in October 2018 (Figure 5), supported by a broadly-based global recovery and production restraint by 12 OPEC and 10 non-OPEC producers following the OPEC+ agreement of December 2016. More recently, the Brent price, the benchmark for half of global oil trade, rose to a four-year high of US\$85 per barrel in early October 2018, driven in large part by the prospect of a shortfall in global supply once U.S. economic sanctions against Iran come into force in November 2018. Iran is the OPEC's third largest oil producer, exporting, at its peak in mid-2018, some 2.7 million barrels per day (mbd), about 3 percent of daily global consumption. With the imposition of U.S. sanctions, some 500,000 mbd, or possibly more, are expected to go offline. The fear is that the

FIGURE 5

Energy prices
US\$

Source: World Bank Group.

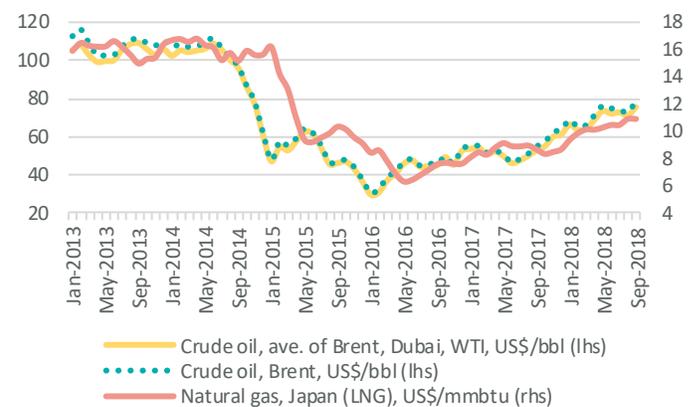
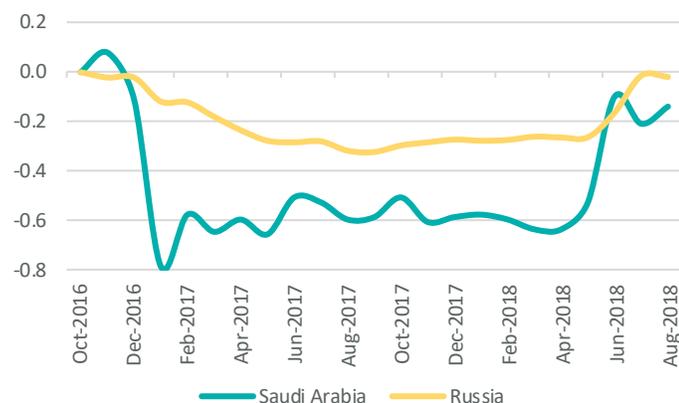


FIGURE 6

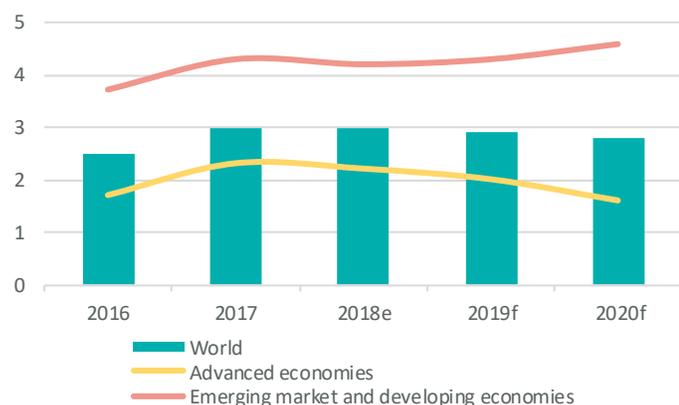
Change in oil production by Saudi Arabia and Russia Million barrels per day, since October 2016

Source: International Energy Agency.

**FIGURE 7**

GDP real growth Percent

Source: World Bank Group.

**FIGURE 8**

World trade volume growth Percent

Source: World Bank Group.



loss of Iranian exports is not going to be completely made up, even with available capacity in, and an expressed willingness by, Saudi Arabia to boost supply, much less with limited spare capacity in other OPEC members (Figure 6).

Global Outlook and Risks

Global economic and trade growth are expected to moderate in the near-term

Global economic growth is expected to remain firm at 3.0 percent in 2018 before slowing slightly to 2.9 percent in 2019 and 2.8 percent in 2020 (Figure 7). Global growth assumptions are above estimates of potential, suggesting that capacity constraints will become more binding in the near term. The advanced economies, which remain constrained by weak productivity trends, will move closer to their long-run potential growth path. Growth in the advanced economies will edge down to an average 1.8 percent in 2019-20 from 2.2 percent in 2018. The emerging market and developing economies offer more robust growth prospects, reflecting a modest acceleration among large commodity exporters, which will offset the anticipated structural slowdown in China. Growth in the aggregate among emerging market and developing economies will pick up from 4.2 percent in 2018 to 4.6 percent in 2020.

After surging to a six-year high of 4.8 percent in 2017 with the cyclical upturn in worldwide manufacturing and investment, the growth rate of global trade in goods and services is anticipated to moderate to 4.3 percent in 2018, before decelerating to 3.8 percent by 2020 (Figure 8). Moderating global economic growth, easing global investment momentum, trade policy uncertainty, and higher tariffs will weigh on global trade prospects. The tariffs are likely to depress bilateral trade, weaken global supply chains, and increase trade diversion.

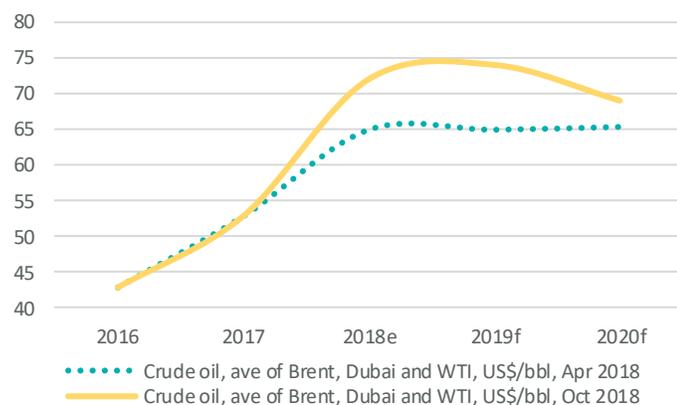
Oil prices are forecast to increase further in 2019, and interest rates may rise faster than previously anticipated

Oil price forecasts have been revised upward since the publication of the Bank's *Commodity Markets Outlook* in April 2018, when crude oil prices were forecast to average US\$65 bbl in 2018. With the recent price ramp-up in spot and futures markets, crude oil prices are expected to average US\$72 bbl in 2018, up by 35 percent from US\$53 bbl in 2017, and to pick up to US\$74 bbl in 2019 (Figure 9). The upward price pressures reflect robust global oil demand despite rising trade tensions, the continuing decline in production by Venezuela, and any larger-than-anticipated reduction in exports by Iran as economic sanctions by the U.S. come into effect beginning in November 2018 (the supply deficits may not be fully offset by OPEC due to limited spare capacity in most members other than Saudi Arabia). The average crude oil price is then expected to settle lower at US\$69 in 2020, with the upside limited in the medium term by the ability of non-conventional oil producers in North America to enter and exit the market.

FIGURE 9

Energy price forecasts US\$

Source: World Bank Group.



Looking forward, global interest rates are expected to rise at a faster pace than previously projected, as upward revisions to the U.S. growth outlook lead to expectations of a somewhat faster pace of U.S. interest rate hikes in 2019-20. U.S. bond yields hit multi-year or multi-decade highs across the curve in early October, with the yield on the benchmark 10-year note jumping from 2.4 percent in end-2017 to 3.15 percent, its highest level since 2011 (Figure 10). The lift in U.S. yields helped fuel strong gains in the U.S. dollar, with the U.S. dollar index (measured against six major currencies) hitting 95.78 in early October. Above-trend growth and narrowing economic slack will also lead to further monetary policy normalization in other advanced economies. While the U.S. Federal Reserve is on track to shrink its balance sheet by 4 percent of GDP by the end of 2020, the European Central Bank is expected to bring its asset purchase program to a close by the end of 2018 (World Bank, 2018c). Due to the prospect of faster monetary policy normalization in the major advanced economies, financing conditions are expected to tighten more rapidly than previously anticipated in emerging market and developing economies.

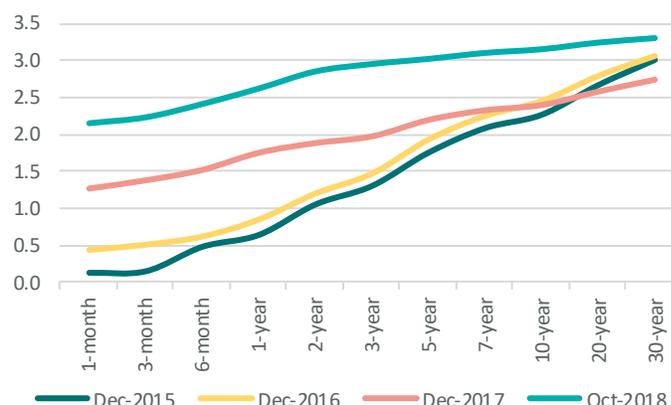
Risks to the global outlook are on the downside

Global risks are tilted to the downside and they include escalating trade protectionism, disorderly financial market movements, and heightened geopolitical tensions. Escalating trade protectionism triggered by tariff increases by the United States and retaliatory measures by China and other trading partners could depress medium-term growth prospects globally by raising trade costs along global value chains and exacting negative spillovers in commodity and financial markets. An abrupt tightening of global financing conditions reflecting reassessments of inflation risk, stretched asset valuations, higher debt, and possible further U.S. dollar appreciation could raise borrowing costs and have severe consequences in emerging market and developing economies facing substantial refinancing needs. Heightened geopolitical tensions including intensifying strains in the Middle East,

FIGURE 10

U.S. Treasury yield curve Percent

Source: U.S. Department of the Treasury.



precarious security situations in Sub-Saharan Africa, and diplomatic tensions among the major powers could severely impact growth and development prospects in the affected regions and hinder activity at the global level (World Bank, 2018c).

Regional Developments

GROWTH, ECONOMIC ACTIVITY, AND SENTIMENT IN THE GCC

Growth picked up in the region in the first half of 2018 ...

Economic activity and sentiment have begun to recover in the GCC region following an extremely weak 2017 when aggregate regional GDP contracted by 0.3 percent, the first downturn since the global financial crisis of 2008-09. The weakness in 2017, visible in decelerated or negative growth in all GCC economies except Bahrain, reflected the impact of lower oil prices, the associated fiscal retrenchment and its impact on non-oil activity, and compliance with oil production cuts agreed to among OPEC and non-OPEC countries. However, both output and sentiment have gradually recovered as global energy prices have risen, and more recently, as oil production curbs were lifted in June 2018. With fiscal and external imbalances also narrowing, the region has remained largely immune to the financial volatility that has beset other emerging market economies in mid-2018. At the same time, the pace of recovery has been slow, reflecting the impact of new taxes, subsidy cuts, and labor market measures.

The **Kingdom of Saudi Arabia**—the region's largest economy and OPEC's biggest producer—emerged from recession with a 1.2 percent year-on-year (yoy) and a 1.1 percent quarter-on-quarter seasonally-adjusted annualized (qoq saar) growth in the

FIGURE 11

GDP growth, quarterly
Percent year-on-year

Source: Haver Analytics.

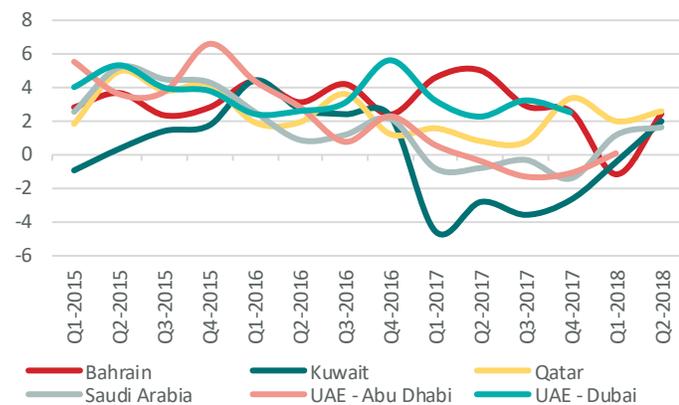


FIGURE 12

GDP growth, quarterly
Percent QOQ seasonally-adjusted annualized rate

Source: Haver Analytics.

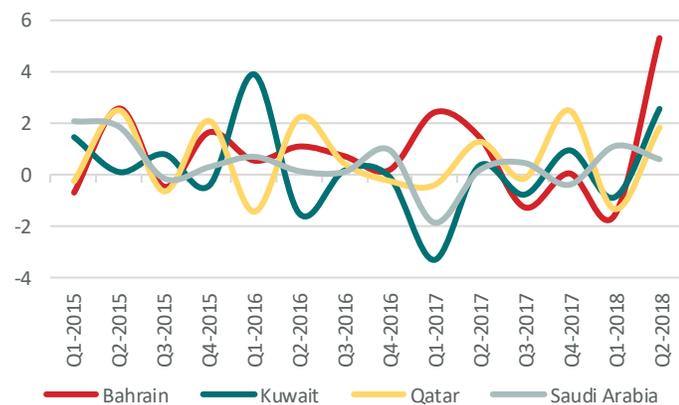
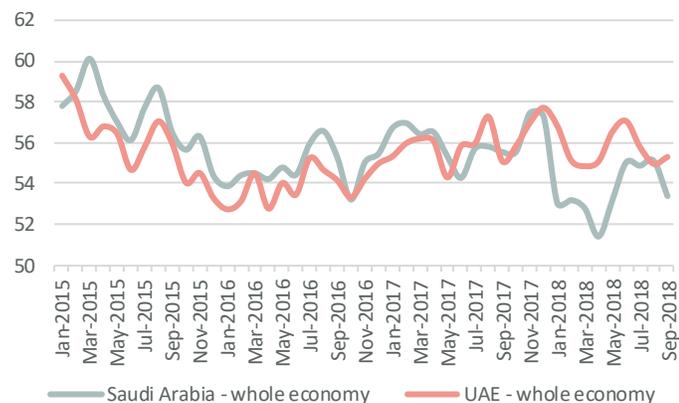


FIGURE 13

Purchasing Managers Surveys (PMI)
Index values seasonally adjusted, 50+ = expansion

Source: Markit Economics.



first quarter of 2018 (Figure 11 and Figure 12). Growth continued at positive rates of 1.6 percent yoy and 0.6 percent qoq saar in the second quarter of 2018. Previously, the economy had contracted 0.9 percent yoy in 2017, with four consecutive quarters of negative growth, as oil production and exports declined from OPEC-agreed cuts and non-oil output growth remained tepid. Both outturns have since been reversed.

Oil output expanded 0.6 percent yoy in the first quarter and 1.3 percent yoy in the second quarter. Saudi Arabia raised output in June before a revision to the OPEC+ agreement was finalized that allowed the OPEC+ partners to offset production shortfalls by some members. The non-oil sector grew 1.6 percent yoy in the first quarter and 2.4 percent yoy in the second quarter. Fiscal measures, including spending on salaries, bonuses and social benefits, supported stronger non-oil activity. A robust performance by the financial, real estate and business services sectors and a slower contraction in the transport sector offset continuing weakness in the construction sector, which contracted for a tenth consecutive quarter.

High-frequency numbers suggest the recovery remained robust in the third quarter. Oil production likely increased by more than 2 percent to an estimated 10.7 mbl in September from 10.46 mbl in June. The whole economy Purchasing Managers Index (PMI), which covers the entire non-oil private sector, jumped to 55.1 in August, its highest reading for the year (Figure 13). However, the government’s “Saudization” measures may have offsetting contractionary effects on the non-oil economy going forward. Employment quotas for nationals, mandated under the Nitaqat system, and levies on expatriate labor, introduced in 2018, have pushed out a quarter of a million foreign workers in the first quarter of 2018. Most of the foreign workers were employed in construction (some 126,000 workers) and in trade (about 53,000). The departing foreign workers have not yet been replaced by Saudi nationals.

The UAE appears to be recovering from slow growth in 2017. The non-oil sector expanded 3.3 percent yoy in the first quarter of 2018, supported by positive economic sentiment from higher oil prices and improved global economic conditions, according to the index of non-oil activity constructed by the central bank (the index tracks GDP growth using economic activity variables including the PMI, consumer prices, and oil prices). Abu Dhabi, the largest of the seven emirates, posted a modest pick-up in growth to 0.1 percent yoy in the first quarter of 2018, from -1.1 in the fourth quarter of 2017. That said, the whole economy PMI for the UAE, which covers the non-oil private sector for the national economy, appears to largely reflect softer external, rather than domestic, demand. New export orders dropped to a four-month low of 54.6 in August, and the whole economy PMI slid for the second consecutive month to 55.0 in August.

Qatar’s economy has fully adjusted to the impact of a severance of trade and diplomatic ties with some GCC neighbors in June 2017. The economy grew 2.0 percent yoy in the first quarter of 2018 and 2.5 percent yoy in the second quarter. Growth in the non-hydrocarbon sector was strong, helping

offset a small contraction in the hydrocarbon sector. Qatar has opened a new port, re-routed international trade, diversified import sources, and increased domestic food processing, while liquidity pressures that emerged last year have waned. With economic conditions improving and uncertainty diminishing, consumer confidence rose to its highest level in nearly two years in the first quarter of 2018.

Kuwait also pulled out of recession, growing 1.95 percent yoy in the second quarter of 2018, the first positive print in six quarters, following contractions of 0.4 percent yoy in the first quarter of 2018 and 3.5 percent in 2017. Weakness in 2017 was due to a sizable 7.2 percent downturn in the oil sector, which was only partially offset by a 2.2 percent expansion in non-oil activity, the latter aided by steady growth in household spending and higher government consumption spending. Non-oil sector growth has strengthened further in 2018, rising to 4.1 and 6.9 percent yoy in first and second quarters respectively, led by robust growth in the transportation, communications and financial sectors. Retail spending was buoyant in the first half of 2018, bolstered by higher oil prices, rising public sector employment, and positive household sentiment. Kuwait is the fifth-largest OPEC oil producer, and one of the few OPEC members with spare oil production capacity. Oil output has risen to 2.8 mbd, a daily increase of 90,000 barrels since June, following the revision of the OPEC+ production cuts.

Oman does not report quarterly national accounts in real terms, although the government announced that GDP grew 6.5 percent yoy in the first quarter of 2018 in nominal terms. Quarterly oil and gas production data indicate a pick-up in the hydrocarbon sector. Oil production increased 0.2 percent yoy in the eight-month period January-August 2018 after contracting 3.9 percent yoy during the same period in 2017. Gas production expanded 6.8 percent yoy in the first quarter of 2018 on higher output from the Khazzan gas field.

Bahrain bounced back from a 1.2 percent yoy (1.3 percent qoq saar) contraction in the first quarter of 2018 to a 2.4 percent yoy (5.3 percent qoq saar) expansion in the second quarter. The oil and gas sector, which contracted 14.7 percent yoy in the first quarter because of oil field maintenance, grew 0.8 percent yoy in the second quarter due to higher natural gas production. Non-hydrocarbon growth was positive at 1.9 percent yoy in the first quarter of 2018, driven by the construction of large scale GCC-funded infrastructure projects and associated domestic demand, an important development for an economy that is the least dependent on hydrocarbon GDP in the GCC. Non-hydrocarbon growth picked up to 2.8 percent yoy in the second quarter as the construction sector continued to perform strongly, with ongoing infrastructure projects along with some private real estate developments, and the manufacturing sector grew on the back of strong aluminum output.

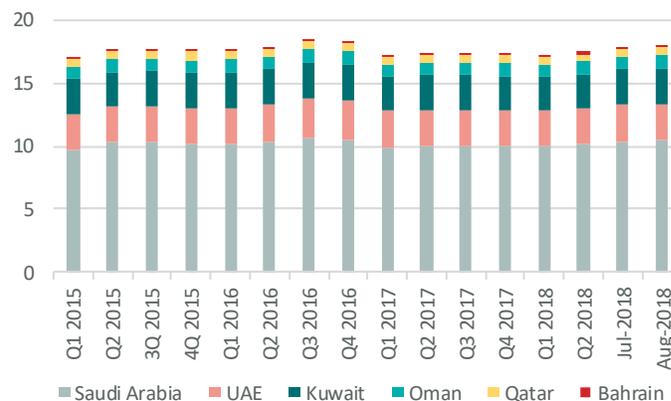
... buoyed by rising oil and gas prices

With hydrocarbons accounting for a large part of GDP across the GCC countries (from a fifth of GDP in Bahrain to half in

FIGURE 14

Crude oil production Million barrels per day

Sources: International Energy Agency, Oil Market Report, September 2018, and OPEC, Monthly Oil Market Report, September 2018.



Qatar), the growth performance in first half of 2018 was largely driven by oil and gas production and exports, supported by higher oil and gas prices.

Crude oil production by Saudi Arabia and the GCC was 17.1 mbd in the first quarter of 2018 and 17.3 mbd in the second quarter, compared to 17.2 mbd in 2017 (Figure 14). Higher output in the first half of 2018 by Saudi Arabia, of around 90,000 barrels per day over 2017 levels, covered for lower output, mainly by the UAE, of around 70,000 barrels per day.

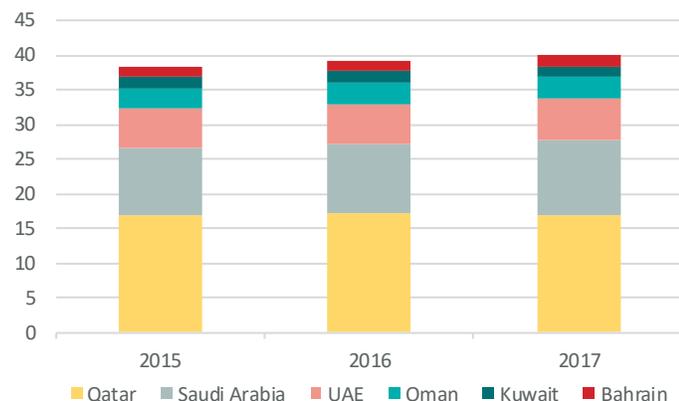
Following the OPEC+ agreement first struck in December 2016 among the 12 OPEC and 10 non-OPEC suppliers to cut global production by 1.8 mbd beginning in January 2017, crude oil production by the GCC slid to 17.2 mbd in 2017, some 4.4 percent lower than in 2016. Compliance with the agreement had been 95 percent in 2017 by OPEC members and 82 percent by non-OPEC producers, according to the International Energy Agency. The cutbacks have helped rebalance the global crude oil market in the past 21 months and lifted international oil prices to around US\$80 per barrel (the average of the Brent, Dubai and West Texas Intermediate prices) in October 2018 from as low as US\$30 per barrel in January 2016.

However, unexpected production outages in 2018 in Venezuela, Libya, and Angola, all OPEC members, had effectively brought supply cuts to around 2.8 mbd by mid-2018, overshooting the cutback target by some 55 percent. The United States, China and India have since urged oil producers to release more supply to prevent an oil deficit that would undermine global growth. In June 2018, OPEC made a pledge in Vienna to 100 percent compliance with the OPEC+ agreement. The commitment implies an increase in production by around 0.7-1.0 mbd, although the communique does not specify how the production increases would be allocated among the parties. Indications are that OPEC members are still over-shooting

FIGURE 15

Natural gas production
Billion cubic meters

Source: British Petroleum, BP Statistical Review of World Energy, June 2018.



production cuts while non-OPEC producers are underperforming. The International Energy Agency reports compliance rates in August 2018 at 115 percent of the target by OPEC and 75 percent by non-OPEC suppliers, although competing estimates place these rates higher, at 129 percent by OPEC members, and lower, at 69 percent, by non-OPEC partners.¹ Among the OPEC members, Saudi Arabia, the UAE, Kuwait and Iraq have boosted output; however, total OPEC production remains lower than targeted because of underinvestment in Angola and falling output in Venezuela and Iran, partly a reflection of U.S. sanctions.

Recent data show higher production by the GCC of 0.51 mbd, from 17.53 mbd in the second quarter of 2018 to 18.04 mbd in August 2018, including an incremental output by Saudi Arabia of 0.28 mbd over the same period to 10.42 mbd in August. Preliminary numbers for September indicate that production by Saudi Arabia likely topped 10.7 mbd in the month and may reach 11.0 mbd by end-2018. Having spare capacity and acting as a key swing producer, Saudi Arabia will likely lead in offsetting deficits with the OPEC+ production targets. Saudi Arabia and Russia reportedly agreed to another output boost ahead of a meeting among the OPEC+ partners in Algiers in September.

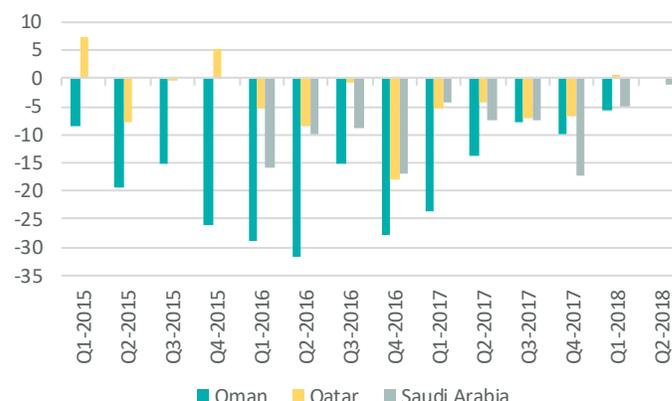
Meanwhile, the GCC's natural gas producers, which raised output last year (Figure 15), stand to benefit from the surge in natural gas prices, driven by extreme weather-related demand, in the near-term, and China's drive to replace coal with cleaner burning natural gas, in the medium to long term. China, which overtook South Korea as the world's second biggest buyer of natural gas with 38 million tons of imports in 2017 (46 percent higher than in 2016), is seeking long-term supply commitments of 65 million tons per year through 2022. China

1/ <https://www.bloomberg.com/graphics/opec-production-targets/>

FIGURE 16

Fiscal deficit, quarterly
Percent of GDP

Source: Haver Analytics.



has also added natural gas from the U.S. to its list of goods under tariffs as its trade conflict with the U.S. has escalated. Qatar, the world's biggest natural gas exporter (and a competitive supplier with sizable output and low costs), is seeking to expand its production capacity from 77 to 100 million tons a year and is well-positioned to help meet higher future global demand for natural gas.

PUBLIC FINANCES AND FISCAL REFORMS

Governments continued with fiscal adjustment, albeit at a more gradual pace ...

Budgets approved for fiscal year 2018 for the GCC countries, or for fiscal year 2018-19 (April-March) in the case of Kuwait and Qatar, generally envisage a narrowing of deficits in 2018 from 2017. Countries reporting quarterly fiscal data—Saudi Arabia, Qatar, and Oman—indicate that deficits were cut in the first or second quarter of 2018, from the fourth quarter of 2017 (Figure 16). Oil price assumptions in budget projections are generally more conservative than actual outturns for the year thus far, so that final budget outturns are on track to be better than projected across the GCC.

Overall, the GCC governments are continuing with fiscal consolidation plans launched after oil prices collapsed in mid-2014, albeit at a more gradual pace in 2018 as several adjustment measures were front-loaded in 2015-16. Two countries—Saudi Arabia and the UAE—have already introduced the 5 percent value-added tax (VAT) on goods and services planned by the GCC governments as a region-wide harmonized tax to be implemented starting in 2018. Four countries—Oman and Bahrain in 2018, and Saudi Arabia and UAE earlier in 2017—have implemented the 100 percent excise tax on tobacco products and energy drinks and the 50 percent excise tax on soft drinks, similarly covered by a GCC unified tax agreement.

Saudi Arabia reduced its fiscal deficit from 17.2 percent of GDP in the fourth quarter of 2017 to 5 percent in the first quarter of 2018. Oil revenue remained nearly flat despite significantly higher crude prices because of an over-shooting of output cuts in the first quarter. Non-oil revenue jumped 63 percent yoy, driven by an almost 300 percent yoy increase in receipts from taxes on goods and services following the implementation of the VAT in January 2018. Purchases of goods and services were down 39 percent yoy and capital expenditures, 11 percent yoy, but salaries rose 20 percent yoy following the rollback of salary cuts introduced in 2016 and an even bigger increase in social benefits.

Apart from implementing the VAT, Saudi Arabia also substantially increased gasoline and electricity prices in January 2018. Gasoline prices rose from Saudi riyal (SAR) 0.8 (US\$0.21) per liter to SAR 2.04 (US\$0.55) for Octane 95 and to SAR 1.37 (US\$0.37) for Octane 91, equivalent to price increases of 127 and 83 percent respectively. The price increases effectively eliminated consumer price subsidies on Octane 95. The government also increased electricity tariffs and simplified tariff tiers for residential and commercial consumers. The new tariffs are supposed to reflect the average supply cost of electricity, but still generate subsidies because electricity producers continue to receive their oil supply at subsidized prices.

The government is also reporting its smallest quarterly fiscal deficit since the first quarter of 2016, at US\$2.0 billion in the second quarter of 2018. Compared to the first quarter, oil revenue was higher in the second quarter. Non-oil revenue increased 42 percent yoy due to VAT and excise tax collections. Zakat taxes and income from sovereign assets held by the Saudi Arabia Monetary Authority and the sovereign wealth fund, the Public Investment Fund for Saudi Arabia (PIF), were also higher.

In the **UAE**, Dubai and Abu Dhabi announced separate economic stimulus packages in April and June 2018, respectively. The Dubai plan consists of supply-side measures, including allocating around 20 percent of public tenders to small and medium enterprises (SMEs), offering incentives to some 1,000 emerging market start-ups to locate in Dubai, and attracting international investment funds to invest in real estate projects. The Abu Dhabi plan proposes spending United Arab Emirates dirham (AED) 50.0 billion (US\$13.6 billion) over three years to boost the economy through infrastructure, industrial, SME and social projects, and to provide 10,000 jobs to nationals.

These twin moves partly ease, but do not completely reverse, the fiscal adjustments made in 2015-16. The stimulus plans come after the two emirates raised infrastructure spending in the second half of 2017: Abu Dhabi to increase crude output from its offshore Upper Zakum and onshore Bab oil fields, and Dubai to upgrade infrastructure for the World Expo 2020. The higher expenditures will be funded by higher oil revenues and non-oil revenues. The UAE launched the 5 percent VAT on January 2018 but pledged not to increase federal fees for government services for the next three years.

LNG revenue boosted **Qatar's** public finances to a small surplus of 0.6 percent of GDP in the first quarter of 2018, the first positive outturn since the first quarter of 2016, following a larger-than-expected production in the North Field. Qatar had planned a modest budget for FY2018-19, with capital expenditures, already high at half of total expenditures, remaining flat for the year. The boost to spending would come from salaries, a fourth of total expenditures, which were budgeted to rise by around 9 percent from 2017, with increases in salaries for nationals and an easing in cuts for expatriates. Overall, spending would increase 2.4 percent in the fiscal year; however, on a general government basis, the fiscal balance is anticipated to shift into a small surplus of over 2 percent following a deficit of under 2 percent in 2017. The fiscal surplus may eventually be higher in 2018 than the current oil and LNG production and revenue data suggest, considering that Qatar records hydrocarbon revenue from two streams: a steady receipt of taxes and royalties throughout the year, plus a lump-sum dividend from the state-owned Qatar Petroleum at the end of the year.

Kuwait approved a separate Kuwaiti dinar (KD) 3.3 million (US\$10.6 billion) capital budget for fiscal year 2018-19 (April-March) after passing the KD 21.5 million (US\$69.1 billion) main budget earlier in the year (the National Assembly considers the capital budget separately). The authorities are reorienting spending from expenditure toward investment. The budget for FY2018-19 envisages a deficit of KD6.5 billion (US\$21.7 billion), lower than the KD7.9 billion (US\$25.4 billion) shortfall in FY2017-18.

Earlier this year, the government announced the postponement of the implementation of the VAT, originally scheduled for 2018, to 2021. It will move forward, however, with the implementation of the excise tax on tobacco and soft drinks. Kuwait is also proceeding more gradually with subsidy reform. The government began to rationalize electricity and water subsidies in September, but recent tariff increases have been implemented more slowly than originally proposed. There has been strong opposition in Parliament to the subsidy reductions and there appears to be limited support for the VAT as well.

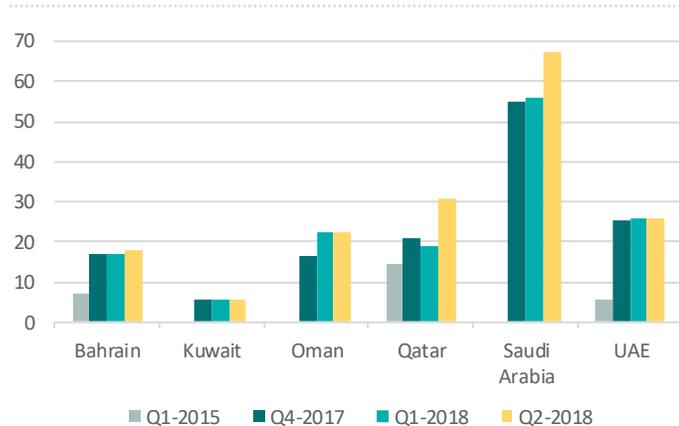
Oman reduced its fiscal deficit from 10 percent of GDP in the fourth quarter of 2017 to 5.8 percent in the first quarter of 2018. LNG revenue rose by some 17 percent, boosted by both higher global LNG prices and larger production volumes, including from the Khazzan gas field. Higher fiscal revenues encouraged the government to relax the salary threshold—from Omari rial (OMR) 600 (US\$1,560) to OMR 950 (US\$2,470)—of eligibility for the fuel subsidy scheme that was first announced in December 2017. The registration-based National Subsidy System provides eligible households 200 liters of petrol a month at a subsidized rate of US\$0.47 per liter, a 47 percent discount from the retail price. The higher threshold allows the subsidy scheme to cover two-thirds of Omani households.

Meanwhile, Oman introduced the region-wide excise taxes on tobacco products, energy drinks and soft drinks in August 2018. Earlier in January, Oman received US\$210 million in financing from Saudi Arabia, part of the US\$10 billion that the

FIGURE 17

General government international debt securities outstanding, US\$ billion, end-of-period

Source: Bank for International Settlements.



GCC Development Fund had allocated to Oman in 2011. The aid will be coursed through the Saudi Fund for Development and will be used for infrastructure development in the Duqm Special Economic Zone, where Oman is building a port, a ship repair yard and drydock, and a fishery harbor.

Bahrain also introduced the excise taxes on tobacco products, energy drinks and soft drinks and, in addition, raised petroleum prices for the second time in two years, both in January 2018. Following the two measures, the government announced that no new taxes or subsidy cuts would be pursued before compensatory measures for low-income citizens are implemented. Bahrain had previously taken small steps at fiscal adjustment. The government cut subsidies on fuel in January 2016, raised import tariffs on alcohol and tobacco in February 2016, and increased electricity and water prices in March 2016. The measures were criticized roundly in Parliament and by the public.

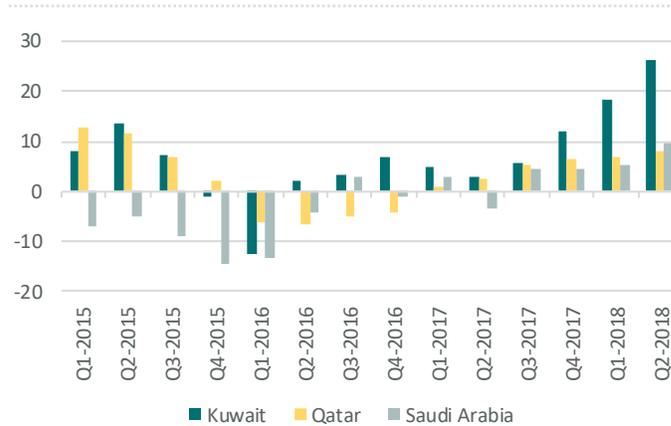
The smallest of the six GCC economies, Bahrain has suffered persistent fiscal deficits since 2009, even before oil prices collapsed in 2014-16, and posted the region’s largest deficit, at 15.1 percent of GDP, in 2017. General government debt is also the highest in the region and has doubled in the last four years to 90 percent of GDP in end-2017. Foreign assets of the central bank barely cover two months of imports of goods.

Bahrain received an offer of economic support from three GCC partners—Saudi Arabia, the UAE, and Kuwait—in mid-2018. The offer was relayed as CDS spreads (the cost of insuring Bahraini debt against default for five years) spiked above 600 basis points in June, their highest since 2008, from 240 basis points in March. The one-year forward premium on the Bahraini dinar also climbed nearly 40 percent to 192.50 in June, reflecting speculation about the peg to the U.S. dollar. The three countries disclosed in August that they were reviewing a fiscal adjustment program for Bahrain that would focus on revenue measures, including the introduction of the VAT, and expenditure

FIGURE 18

**Current account balance, quarterly
Percent of GDP**

Sources: Haver Analytics and IMF.



measures, including a restraint on capital spending. The economic support would be tied to the achievement of fiscal targets monitored by the Arab Monetary Fund. In October, the three pledged to give US\$10 billion to support the country’s funding requirements in relation with a fiscal reform package aiming to eliminate its budget deficit by 2022.

... and continued to access international debt markets

GCC government international debt stock rose in the first half of 2018 from 2017, from new international bond sales through April 2018 (Figure 17).

Saudi Arabia sold US\$11.0 billion also in April 2018 in three tranches (US\$4.5 billion with a 4 percent coupon maturing in 2025; US\$3.0 billion with a 4.5 percent coupon maturing in 2030; and US\$3.5 billion with a 5 percent coupon maturing in 2049). The sovereign wealth fund, the Public Investment Fund (PIF), is looking to raise US\$5-8 billion in a syndicated loan, following the later timeline for the initial public offering (IPO) by the Saudi Arabian Oil Company (Saudi Aramco), which would have generated a flow into the PIF. Saudi Aramco was itself considering an inaugural bond to help finance its acquisition of SABIC, the state majority-owned petrochemical company.

Qatar issued US\$12 billion in April 2018 in three tranches (US\$3.0 billion with 3.875 coupon maturing in 2023 in April 2018; US\$3.0 billion with a 4.5 coupon maturing in 2028; and US\$6.0 billion with a 5.103 percent coupon maturing in 2048). The issue was the government’s first Eurobond sale after its diplomatic rift with some GCC neighbors erupted in June 2017. Qatar attracted US\$53 billion in orders on the US\$12 billion sale, and the 30-year tranche commanded a 205-basis point spread over U.S. treasuries, lower than the 210-basis point spread on its May 2016 sale, suggesting that the diplomatic dispute has not increased Qatar’s international borrowing cost.

Oman sold a record US\$6.5 billion in January 2018 in three tranches (US\$1.25 billion with a 4.125 coupon maturing in 2023; US\$2.5 billion bond with a 5.625 coupon maturing in 2028; and US\$2.75 billion with a 6.75 coupon maturing in 2048). The government issue added to expanding international borrowing by Oman's SOEs in 2018. Nama Holding Company approached banks to raise US\$1.2 billion for the country's electricity transmission and distribution network and Oman Gas Company discussed a US\$1.0 billion bridge loan to fund work on the Salalah LPG extraction plant and the 22-km gas pipeline to the Duqm Special Economic Zone. Previously, Oman Oil Company secured a US\$1.0 billion pre-export financing loan in 2017 and Petroleum Development Oman, a US\$4.0 billion bank loan in 2016.

Bahrain issued a 7.5 year US\$1.0 billion sukuk (Islamic bond) yielding 6.875 percent (4.2 percentage points above equivalent U.S. treasuries) in March 2018. The government had earlier cancelled a conventional bond offering before the sukuk sale because of high yields demanded by investors. Bahrain has increasingly turned to the international debt market for deficit financing since 2015 and the National Assembly, the lower house of Parliament, raised the debt ceiling to 107 percent of GDP in June 2017.

TRADE AND EXTERNAL BALANCES

Higher oil prices supported an improvement in current account balances

Saudi Arabia, Qatar and Kuwait reported current account surpluses in the first quarter of 2018 (Figure 18), continuing with quarterly surpluses beginning in the second quarter of 2016 for Kuwait, first quarter of 2017 for Qatar, and the third quarter of 2017 for Saudi Arabia. Saudi Arabia also posted a current account surplus in the second quarter. Quarterly current account data are not reported by the three other GCC countries. However, quarterly trade numbers indicate that **Oman** posted trade surpluses in the first half of 2018, while **Bahrain** continued to record deficits (Figure 19).

The GCC's trade performance is invariably driven by energy exports, which account for more than half of all merchandise exports by the region. Saudi Arabia hiked oil export volumes by 0.5 mbd between the third quarter of 2017 and the first quarter of 2018, taking GCC overall oil exports volumes up from 11.7 mbd to 12.1 mbd over the same period. Supported by higher global crude oil prices, oil exports by **Saudi Arabia** grew at a nominal rate of 16 percent yoy in the first quarter and 54 percent yoy in the second quarter of 2018 (Figure 20). The quarterly nominal value growth rates were no less notable for **Qatar**, at 36 percent yoy in the second quarter of 2018, and **Oman**, at 46 percent.

Non-oil exports posted growth rates of over 20 percent yoy in **Saudi Arabia** in the second quarter of 2018 and almost 10 percent yoy in **Qatar**, where they make up a fifth of all exports in each country (Figure 21). A growth rate of almost 170 percent

FIGURE 19

Trade balance, quarterly US\$ billion

Sources: Haver Analytics and IMF.



FIGURE 20

Oil exports, nominal value growth rate Percent year-on-year

Source: Haver Analytics.

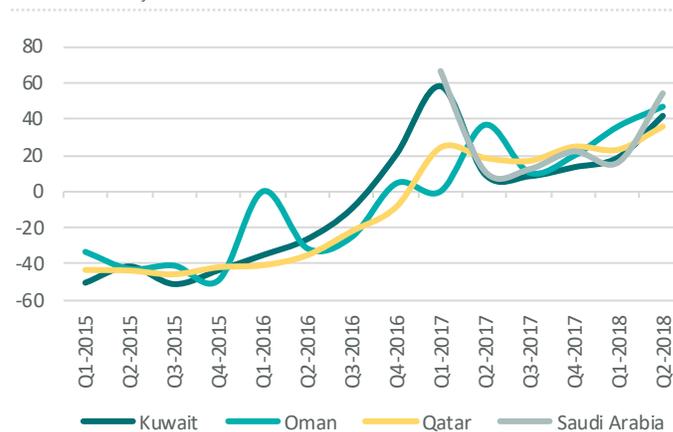


FIGURE 21

Non-oil exports, nominal value growth rate Percent year-on-year

Source: Haver Analytics.

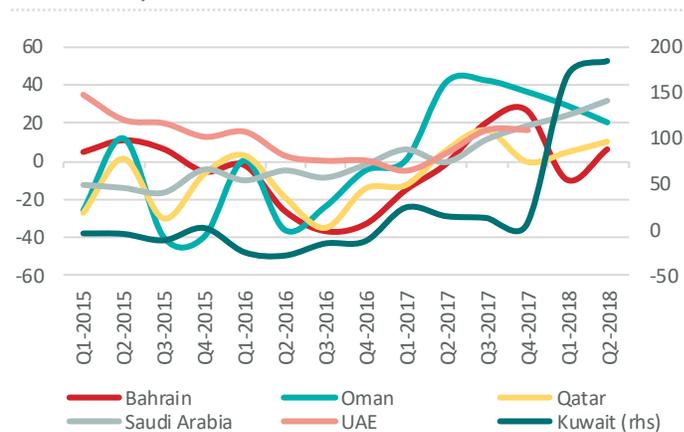


FIGURE 22

Imports, nominal value growth rate growth
Percent year-on-year

Sources: Haver Analytics and IMF.

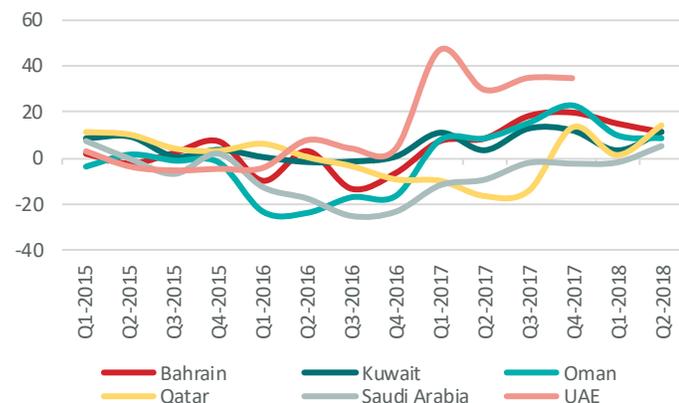


FIGURE 23

Saudi Arabia international reserves, excluding gold
US\$ billion

Source: IMF.

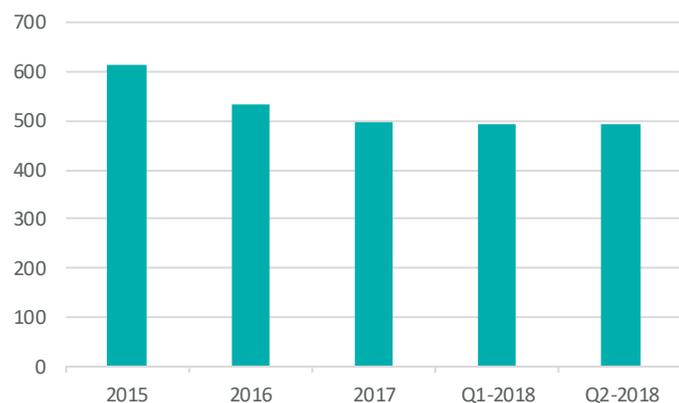
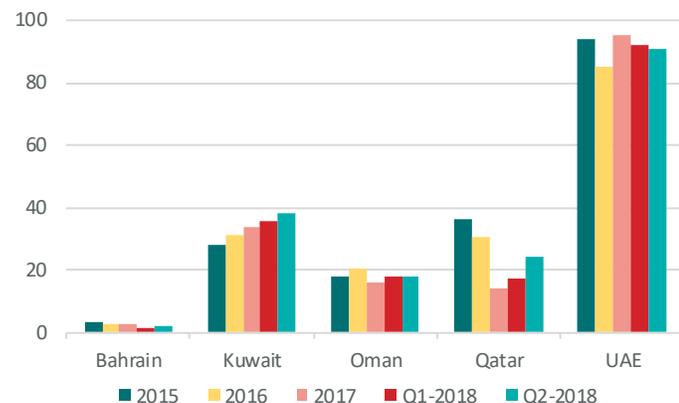


FIGURE 24

International reserves, excluding gold
US\$ billion

Source: IMF.

Note: Data for Bahrain refer to foreign assets held by the Central Bank of Bahrain.



yoy in the first quarter of 2018 in **Kuwait** would be remarkable, except that non-oil exports account for only a tenth of all exports. Non-oil exports increased over 5 percent yoy in the second quarter of 2018 in **Bahrain**, where they account for slightly over two-fifths of all exports.

Import growth, which remained negative in **Saudi Arabia** in the first quarter of 2018, for the ninth consecutive quarter since the first quarter of 2016, swung around to a 5.5 percent yoy growth in the second quarter of 2018 (Figure 22). Import growth strengthened in **Qatar** and **Kuwait** but compressed in **Oman** and **Bahrain** in the second quarter of 2018.

... and helped build reserves or contain reserve drawdowns, except in Bahrain

Saudi Arabia (Figure 23) and the **UAE** lost reserves in the first half of 2018 from end-2017, on capital account deficits. Reserves were US\$3.0 billion less in Saudi Arabia, at US\$493 billion at the end of the first quarter, and US\$4.5 billion less in the UAE, at US\$90.5 billion at the end of the second quarter. UAE reserves remained close to their level in end-2015, US\$93.7 billion, but Saudi reserves were a third off their level in end-2014, US\$907.6 billion. Still, reserves provide ample import cover for Saudi Arabia, at 49 months of imports of goods, although much less so for the UAE, at only 4 months imports of goods.

Qatar added US\$10.5 billion to reserves at the end of 2017, **Kuwait**, US\$4.4 billion, and **Oman**, US\$2.0 billion (Figure 24). Qatar's reserves stood at US\$24.3 billion at the end of the second quarter of 2018, covering 9.5 months of imports of goods and Kuwait's reserves were US\$38 billion at the end of the second quarter, or 12.7 months of imports. Oman's reserves stood at US\$18.1 billion at the end of the first quarter of 2018, covering 8.5 months of imports of goods.

Bahrain, which reported its third straight annual current account deficit in 2017, lost US\$400 million of international reserves in the first half of 2018. The Central Bank of Bahrain's foreign assets of US\$2.2 billion at the end of the second quarter of 2018 are a third of their level of US\$6.1 billion at the end of 2014, and cover barely 2 months of imports of goods, down from almost 7 months of imports at the end of 2014. The depleted reserves reduce buffers for the dollar peg and the ability to fund maturing bonds.

PRICES AND CREDIT

Headline inflation increased in Saudi Arabia and the UAE with the implementation of the VAT, but has eased since then

Consumer price inflation rose in Saudi Arabia and the UAE in January 2018, as the GCC's two largest economies introduced a 5 percent VAT at the beginning of the year. Inflation rose to 3 percent yoy in January in Saudi Arabia, from -1.7 percent the previous November 2017, before settling lower at 2.3 percent

in August (Figure 25). Inflation also jumped to 4.5 percent yoy in January in the UAE, from 1.7 percent in November, before moderating to 3.8 percent in July. The month-on-month rates were 3.5 percent in Saudi Arabia in January (Figure 26), and 2.6 percent in the UAE.

The sharp rise in the CPI in **Saudi Arabia** to its highest monthly rate since September 2016 followed a full year of deflation in 2017. The sectors that saw a major impact from the VAT were food, household furnishings, and recreation, where prices jumped between 5.0 to 5.6 percent month-on-month (mom). Housing, which is exempt from VAT, rose only 1.8 percent mom, while education, also exempt, declined 0.8 percent mom. The VAT was not the only driver of inflation in January, however, as domestic fuel prices also rose sharply, between 82 and 126 percent yoy for various products, reducing, if not eliminating, long-standing fuel subsidies.

The **UAE** had expected a higher inflation rate in January than the 4.5 percent yoy posted, considering that energy prices had also risen and, with subsidies removed, that price rise should have been reflected in local costs. A soft property market in Dubai helped contain the UAE-wide inflation, with residential property prices dropping 4.6 percent yoy on average in 2017, rents falling 1.7 percent yoy in January 2018, and housing and utility costs declining 0.7 percent yoy, also in January.

Credit growth remains weak, and deposit growth, mixed

Except in Qatar and Bahrain, where it appears to be recovering in the second quarter of 2018, credit growth to the private sector remains weak in the rest of the GCC (Figure 27). Credit contracted in **Saudi Arabia** for the fifth consecutive quarter, by 0.5 percent yoy in the first quarter of 2018 before recovering slightly by 0.6 percent in the second quarter. The long stretch of private credit contraction began after oil prices collapsed in mid-2014, as bank liquidity dried up and business confidence tanked. In addition, borrowing by the government may have reduced credit to the private sector.

Credit growth has been subdued in the **UAE** since the third quarter of 2017, growing 1.9 percent yoy in the first quarter of 2018 and 3.4 percent in the second quarter. Credit to firms was poor, with government-related entities de-leveraging and the property market softening. Credit to consumers was weak, as poor consumer sentiment and price pressures from the introduction of the VAT weighed on demand for personal loans. Credit growth has been sluggish in **Kuwait** since the beginning of 2018, flattening at 1.7 percent yoy in the first quarter and 1.6 percent in the second quarter.

Growth in banking sector deposits had weakened in the GCC in the wake of the 2014 oil shock and as fiscal pressures contributed to governments drawing down deposits held with the banking sector. The exception is Qatar, where rapid withdrawal by foreign clients of deposits at Qatari banks forced the government to bring in cash from abroad

FIGURE 25

CPI inflation, monthly Percent year-on-year

Source: Haver Analytics.

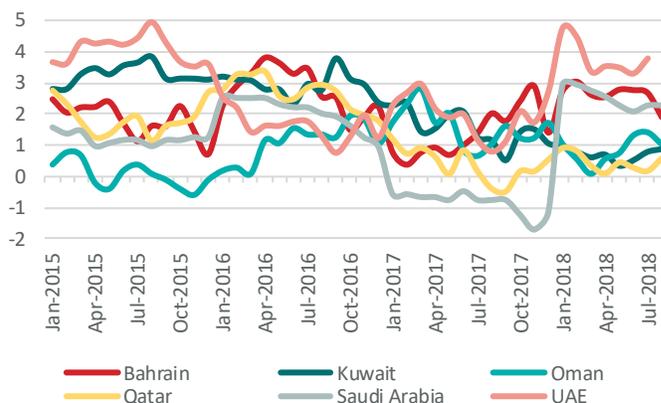


FIGURE 26

CPI inflation, monthly Percent month-on-month seasonally-adjusted

Source: Haver Analytics.

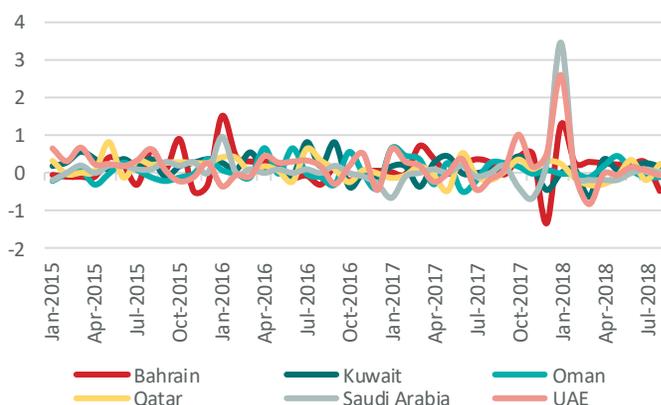


FIGURE 27

Bank credit to the private sector, growth Percent year-on-year

Source: Haver Analytics.

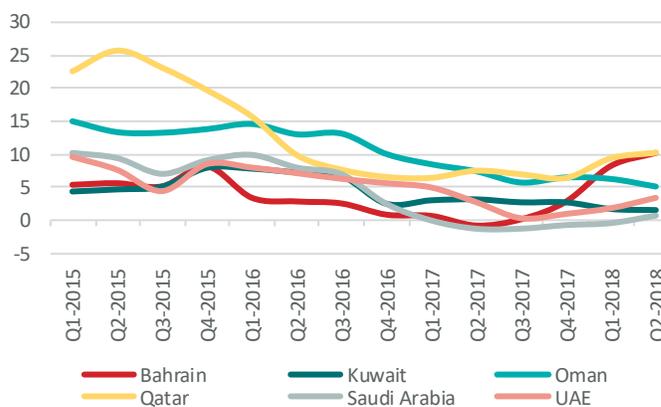
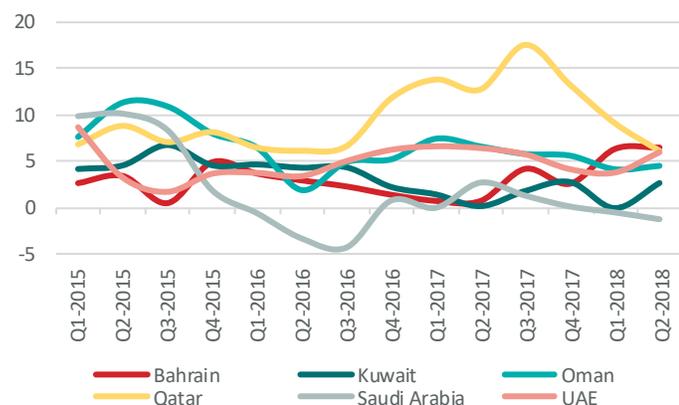


FIGURE 28

Deposits at banks, growth
Percent year-on-year

Source: Haver Analytics.



to stabilize bank balance sheets (Figure 28). Over the past two years, as fiscal pressures have eased, and as economic activity has begun to revive, deposit growth has begun to improve, albeit modestly. Government deposit growth has been particularly strong in the UAE at 24 percent yoy in the first half of 2018. Local savings rates increased with the monetary policy tightening, encouraging savings at local banks. In Qatar, the much slower growth rate of government deposits in the second quarter of 2018 indicates that private deposit outflows may have abated, allowing the government to reduce its support.

MONETARY POLICY

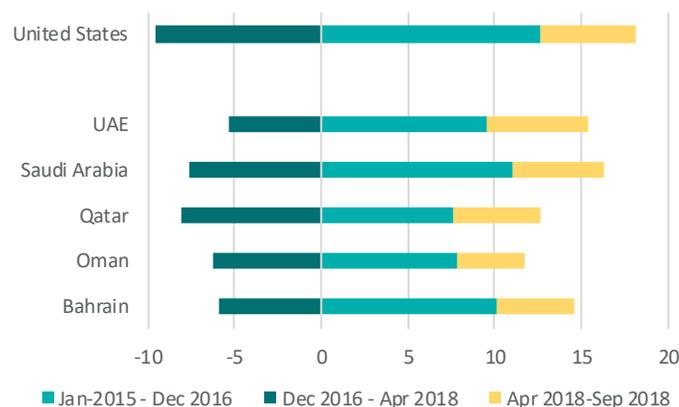
Regional currencies appreciated with the U.S. dollar ...

As the U.S. dollar depreciated 9.5 percent in broad nominal effective terms between December 2016 and April 2018, the GCC currencies similarly depreciated against the currencies of their trading partners, although by varying amounts (Figure 29). Since then, the U.S. dollar has strengthened by 5.5 percent between April and September 2018 on stronger economic performance in the first and second quarters of 2018 and three policy rate hikes since the start of the year. The GCC currencies have appreciated, in tandem, in nominal effective as well as real effective terms, although real rates are still lower than in January 2017 and are only moderately higher than in January 2015 (Figure 30).

FIGURE 29

Nominal effective exchange rates
Change, + = appreciation

Source: IMF.



... and interest rates rose with U.S. policy rates

Most GCC central banks matched policy rate hikes by the U.S. Federal Reserve during 2018. The U.S. central bank raised the Federal Funds target rate to 1.625 percent in March, 1.875 percent in June and 2.125 percent in September (Figure 31). In response, the **Saudi Arabia Monetary Authority** increased the repo rate to 2.25 percent in March, 2.5 percent in June and 2.75 percent in September, and the **Central Bank of the United Arab Emirates**, the CD rate to 2.5 percent in March, 2.75 percent in June and 3.0 percent in September. The **Qatar Central Bank**, which maintains an interest rate framework with three rates, kept the repo rate unchanged since December 2017 at 2.5 percent, but raised the central bank deposit rate to 2.25 percent in September. The **Central Bank of Kuwait** raised its discount rate to 3.0 percent in March, but paused in June and September, citing economic concerns. Meanwhile, the **Central Bank of Oman** raised rates gradually each month, taking the repo rate from 2.06 percent in January to 2.57 percent in September. Finally, the **Central Bank of Bahrain** increased the one-week deposit rate to 2.0 percent in March, 2.25 percent in June and 2.5 percent in September.

FIGURE 30

Real effective exchange rate index
2010 = 100, increase = appreciation

Sources: IMF, BIS.



The policy rate hikes beginning in December 2016 have led to higher bank real lending rates in the region. (Figure 32). In Kuwait, the real lending rate has increased steadily since end-2016, topping nearly 5 percent in the second quarter of 2018.

Near-Term Prospects and Key Risks

The recovery of global oil prices from their trough in 2016, following the OPEC+ strategy to restrict supply to revive prices, underpins the forecast for a steady recovery of the GCC economies in the near-term. The sources of growth will be roughly balanced, with the contribution of private consumption to GDP growth doubling from 2016 to 2019 and that from fixed investment nearing a percentage point by 2020 (Table 1). Higher oil revenues will enable governments to revive investment spending in support of economic diversification objectives and sustain social spending in response to tax measures and energy subsidy reform. Fiscal deficits will gradually narrow or shift into surplus, slowing the recent debt buildup, while current account balances, mostly in surplus since 2017, will expand, augmenting international reserves.

Economic growth is expected to rebound

Growth is expected to recover across the GCC over the forecast period, 2018-20. Saudi Arabia, Kuwait, and Oman emerged from recession in 2017 and resumed growth in 2018 (Figure 33). Thereafter, economic growth will strengthen in most countries through 2019 and 2020. Bahrain will continue to post positive GDP growth numbers during the period, although the economy will slow by more than a percentage point from 2017 to 2019.

Growth is projected to average 2.1 percent in **Saudi Arabia** in 2018-20, driven by higher oil production particularly after the expiration of the OPEC+ agreement in end-2018, greater non-oil exports, and brisk domestic demand through 2020. As the world's third largest crude oil producer with a self-declared capacity of 12 million barrels a day, Saudi Arabia is well positioned to raise output after the expiry of the supply reduction agreement and to help offset an expected decline in Iranian supply after the U.S. reimposes sanctions on OPEC's third largest oil producer. Saudi Arabia has also moved to boost gas production to supply feedstock for the petrochemical industry, with Saudi Aramco awarding tenders to add capacity at the Hawiyah and Haradh plants that will double gas output to 23 billion standard cubic feet per day by 2021.

While the economy will continue to be driven by oil during the forecast period, Saudi Arabia will realize gains in the non-oil sector, particularly manufacturing and services, where investor and business confidence is recovering and hiring has picked up. Services is projected to grow an annual average 3.0 percent in 2018-20. On the demand side, private consumption growth will be positive as the government restores some of the benefits for public sector workers that were cut in 2016-17 (Figure 34). Progress on several constructions projects will add to growth.

The **UAE** is projected to grow at an annual average 3.1 percent in 2019-20, from an estimated 2.0 percent in 2018, supported by higher oil production from the unwinding of the OPEC+

FIGURE 31

Central bank policy rates Percent

Source: Haver Analytics.

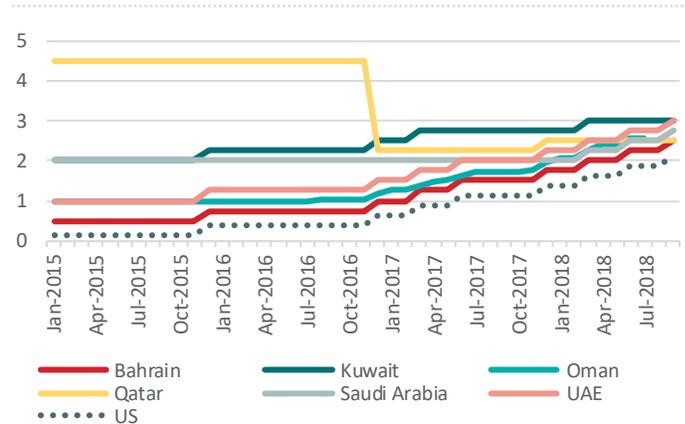


FIGURE 32

Lending rates, adjusted for CPI inflation Percent

Source: Haver Analytics.

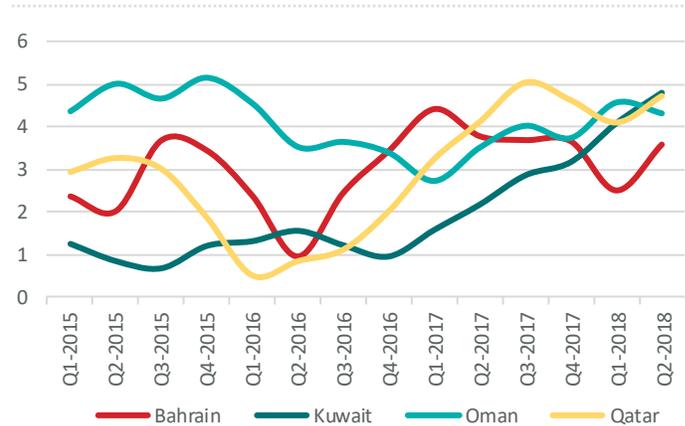


FIGURE 33

GDP growth Percent

Sources: Haver Analytics and World Bank Group.

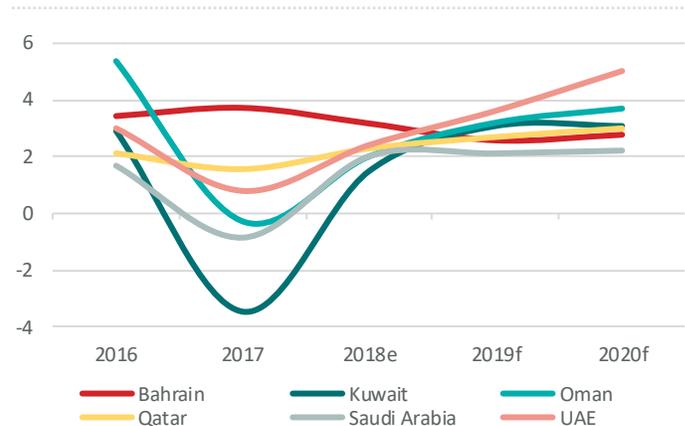


TABLE 1

MENA GCC forecast summary

(annual percent change,
unless otherwise specified)

	2016	2017	2018e	2019f	2020f
AGGREGATE GCC COUNTRIES					
GDP at market prices	2.4	-0.3	2.0	2.6	2.7
<i>Contributions to growth</i>					
Private consumption	0.4	0.6	0.7	0.8	0.8
Government consumption	-2.4	0.4	0.5	0.5	0.6
Fixed investment	-0.8	-0.5	0.7	0.8	0.9
Net exports, GNFS ¹	5.5	0.5	0.3	0.6	0.7
Current account balance (% of GDP)	-3.1	1.2	7.9	7.9	7.9
Fiscal balance (% of GDP)	-10.8	-6.5	-3.3	-1.8	-0.9
Terms of trade	11.6	-0.7	-0.5	-0.1	0.0
INDIVIDUAL GCC COUNTRIES					
GDP at market prices					
Bahrain	3.2	3.9	3.2	2.6	2.8
Kuwait	2.9	-3.5	1.5	3.1	3.1
Oman	5.0	-0.9	1.9	3.4	2.8
Qatar	2.1	1.6	2.3	2.7	3.0
Saudi Arabia	1.7	-0.9	2.0	2.1	2.2
United Arab Emirates	3.0	0.8	2.0	3.0	3.2

Source: World Bank Group.

Notes: e = estimate, f = forecast. GDP at market prices is measured in constant 2010 U.S. Dollars.

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

agreement, the implementation of the Abu Dhabi and Dubai economic stimulus plans, and the impetus from hosting the World Expo in 2020.

The stimulus initiatives support the UAE's broad diversification strategy. Dubai, a more diversified economy, is stepping up efforts to pioneer technology entrepreneurship, aiming to draw the interest of international investors and start-ups. Abu Dhabi, more reliant on oil, is focusing on industrial and SME projects. Meanwhile, the UAE is spending heavily on infrastructure, with US\$7 billion (around 2 percent of 2017 GDP) allocated for new construction and upgrading related to hosting the World Expo, the international exhibition designed to showcase the achievements of nations. The event, the first to be held in the Middle East and North Africa region in the exposition's almost 170-year history, will feature international and corporate organizations from 132 countries and is expected to draw huge numbers of visitors, boosting private consumption and services.

Economic growth in **Qatar** is expected to steadily increase to 2.3 percent in 2018, 2.7 percent in 2019 and 3.0 percent in 2020. The US\$10 billion (6 percent of 2017 GDP) Barzan natural gas project, the joint venture between Qatar Petroleum and Exxon Mobil that will be operated by Qatar Liquefied Gas Company (Qatargas), the world's largest LNG company, will come onstream in 2020, adding 2 billion cubic feet per day, or 12 percent more to the country's current natural gas production of 17 billion cubic feet per day.

The growth of Qatar's gas industry is expected to remain robust during the forecast period. The world's fifth largest natural gas producer (4.8 percent of global production in 2017) and the largest exporter (10.7 percent of world pipeline and LNG exports in 2017) continues to supply LNG to the UAE under existing deals. Meanwhile, Qatargas, the surviving entity from a January 2018 merger with the country's second-largest gas firm RasGas Company Limited (RasGas), is reportedly negotiating a short-term LNG supply deal with PetroChina, which has turned away from U.S. natural gas suppliers following China's trade conflict with the U.S.

Qatar is also implementing a large public investment program for 2014-24, valued at US\$130 billion (77 percent of 2017 GDP), with many projects linked to its hosting of the FIFA World Cup in 2022. Some projects have hit delays, including Qatar Rail's long-distance passenger and freight rail and network project. But, considering the size of the investment plans, construction activity related to the World Cup will continue to support growth during the forecast period. Non-oil growth will average around 3.0 percent in 2018-20.

Kuwait will rebound from recession in 2017 to a 1.5 percent growth in 2018 and 3.0 percent in 2019 and 2020. Plans to invest US\$115 billion (96 percent of 2017 GDP) in the oil sector over the next five years—the target is to boost production capacity by 1 million barrels a day to 4 million barrels a day by 2020—will spur growth during the forecast period.

Kuwait and Saudi Arabia are reportedly making headway towards a political agreement to restart two oil fields in the Partitioned Neutral Zone which have been offline for four years. Restarting the shuttered oil fields—the offshore Khafji deposit and the onshore Wafra field where output is to be shared equally between Kuwait and Saudi Arabia—will bring 500,000 barrels of crude a day onto the market and help meet part of Kuwait’s target.

Implementation of Kuwait’s Northern Gulf Gateway project, unveiled in May at the 2018 Kuwait Investment Forum, could boost growth above the forecast for 2018-20. The megaproject aims to develop the country’s northern region—with a new airport, an industrial hub, and tourism and education zones—and link the area with China’s Belt and Road Initiative. Kuwait announced plans to attract US\$140-200 billion (117-167 percent of 2017 GDP) in FDI for the project, which is also ambitiously projected to create 300-400 thousand jobs.

Oman is forecast to recover from a 0.9 percent contraction in 2017 to 1.9 percent growth in 2018 and 2.8 percent in 2020. Natural gas production from the Khazzan gas field, the British Petroleum development which was commissioned in September 2017, is expected to steadily increase during the forecast period. Meanwhile, British Petroleum and Oman Oil, which own 60 and 40 percent respectively of the Khazzan field, have agreed to the development of the second phase (the Ghazeer) that will boost output from the field by 50 percent to 1.5 billion cubic feet per day by 2021. Total Omani natural gas production was 1.7 billion cubic feet per day in 2017.

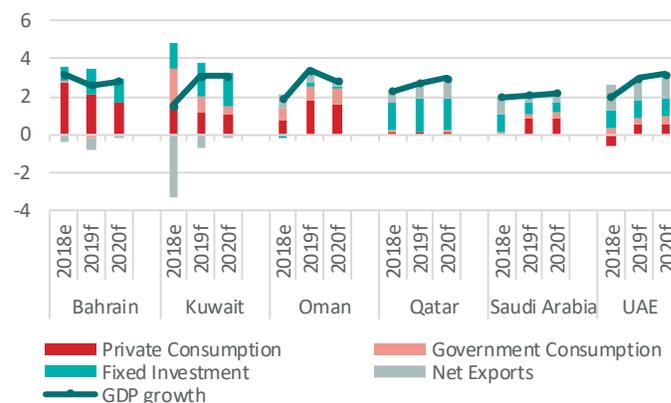
Growth during the forecast period is also expected to benefit from economic diversification initiatives. The opening in May 2018 of the Batinah Expressway, Oman’s 270-kilometer eight-lane highway that connects the Muscat Expressway in the capital at Halbun with Oman’s border with the UAE at Khatmat Malaha, will provide a boost to the country’s logistic sector. The project directly benefits the Khazaen Economic City (formerly called the Khazaen Logistics Hub) in South Al Batinah and the Port of Sohar in Liwa, which has taken over cargo traffic from Port Sultan Qaboos in Muscat. Moreover, the implementation of several business reform measures—liberalizing key sectors, implementing the FDI law, using public private partnerships (PPPs), and allowing 100 percent foreign ownership of companies—will lead to higher investment in the economy.

Bahrain’s economy is expected to slow from 3.9 percent growth in 2017 to 3.2 percent in 2018 following a curtailment in capital spending by the government. However, growth will remain positive and improve slightly from 2.6 percent in 2019 to 2.8 percent in 2020, helped by higher oil production and the expansion of capacity at Aluminum Bahrain (Alba). Production from the Line 6 expansion project at Alba, which will be world’s largest single-site aluminum smelter after the completion of the project, will begin in January 2019, boosting aluminum production by the firm by 50 percent to 1.5 million metric tons per year.

FIGURE 34

Contributions to GDP growth Percentage points

Sources: Haver Analytics and World Bank Group.



Meanwhile, the US\$6.5 billion (19 percent of 2017 GDP) Sitra oil refinery expansion project will not start to boost exports until 2022. Likewise, oil production from Bahrain’s newly discovered 80-billion-barrel shale reserve (the discovery was announced in May 2018)—potentially supplying 200,000 barrels per day, should the reserve be developed—is not expected to commence until five years hence, in 2023 at the earliest.

The economic growth projections for Bahrain assume that the country will continue to receive financial assistance from the GCC Development Fund and economic support from Saudi Arabia, the UAE and Kuwait. Of the US\$10 billion pledged by the GCC Development Fund by 2021, around US\$3.2 billion worth of projects has been started. Meanwhile, Saudi Arabia, the UAE, Kuwait and the Arab Monetary Fund are in discussion with Bahrain on the scope and terms of the economic support offered in June 2018.

Current account balances will mostly return to surpluses

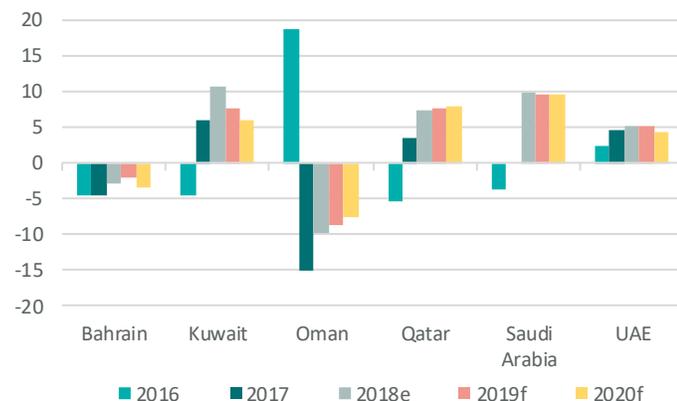
The region’s four largest economies—Saudi Arabia, the UAE, Qatar and Kuwait—are projected to post current account surpluses during the forecast period (Figure 35). Only Oman and Bahrain will continue to incur deficits.

Saudi Arabia’s external accounts are expected to strengthen during the forecast period, and the current account is projected to be in surplus at an average 9.7 percent of GDP in 2018-20. Oil production and exports are expected to rise with the expiry of the OPEC+ agreement, and on the back of anticipated robust global demand for crude. Trade surpluses will be large with rising export shipments of aluminum, phosphates, and petrochemicals, including from the Sadara Chemical Company’s giant 26-plant integrated chemical complex, a joint venture between Saudi Aramco and the Dow Chemical Company. The

FIGURE 35

Current account balance Percent of GDP

Source: World Bank Group.



“Saudization” program and curbs on money transfers will restrain outward remittances. However, interest payments will rise due to the growing external debt stock.

Imports related to infrastructure development are expected to limit the size of current account surpluses in the UAE at an average 4.9 percent of GDP in 2018-20. Oil and gas exports, non-oil merchandise exports, and services credits will all rise during the forecast period, supported by higher oil production and the gains made from economic diversification efforts focused on the UAE’s role as a regional economic hub. Tourism and financial services demand will spur services credits.

Qatar’s current account surpluses should average 7.6 percent of GDP in 2018-20. Global demand for LNG is expected to remain healthy and keep Qatari gas exports buoyant. Services credits should improve with the efforts by the airline SOE, Qatar Airways, and the maritime firm, Milaha, to establish new transport routes. Income credits will fall with the ongoing liquidation of assets by the Qatar Investment Authority, and income debits will rise with payments on the growing external debt stock. Outward worker remittances will keep the transfers account in deficit.

Kuwait is expected to record current account surpluses during the forecast period, but the surplus may moderate from 10.6 percent of GDP in 2018 to 5.9 percent in 2020. Imports related to infrastructure investment will increase during the forecast period. The services account will remain in deficit.

Oman’s current account deficit is projected to gradually narrow during the forecast period from 9.8 percent of GDP in 2018 to 7.6 percent in 2020. Refined oil exports are anticipated to increase from the Sohar refinery improvement project, and gas exports, from the Khazzan gas field. Non-oil exports are also expected to increase with the economic diversification initiatives. However, expanding consumer demand and a pickup in

FIGURE 36

Fiscal balance Percent of GDP

Source: World Bank Group.



investment may raise the import bill. Gains in tourism should narrow the services deficit. But, repatriation of profits by foreign companies will likely keep the primary income deficit high, as will remittances, despite the “Omanization” drive, as the private sector remains dependent on foreign labor.

In **Bahrain**, the current account is expected to remain in deficit during the forecast period, but the deficit may narrow to 2.8 percent of GDP in 2018 and 1.9 percent in 2020, from 4.5 percent in 2017. Merchandise trade should be helped by the rise in oil prices, an increase in aluminum exports from the opening of Alba’s sixth potline in 2019, and a pick-up in refined oil shipments. However, demand for consumer and capital goods imports may also rise with positive economic growth. Meanwhile, services credits have been negatively affected by adverse political developments. Despite the improvement in the current account, reserves may remain within a few months of imports of goods without aid from Bahrain’s GCC partners.

Fiscal deficits are projected to progressively narrow

Fiscal deficits are projected to reverse to surplus in Qatar beginning in 2018, progressively narrow in Bahrain, Kuwait and Oman over 2018-20, and approach near-balance in Saudi Arabia and the UAE by 2020 (Figure 36). The projections are underpinned by a more gradual pace of fiscal adjustment across the GCC, supported by higher oil and gas receipts and additional rounds of revenue enhancement and expenditure reduction.

Saudi Arabia is expected to close its budget deficit from 17.2 percent of GDP in 2017 and 9.0 percent in 2018 to 0.5 percent by 2020, achieving a near fiscal balance ahead of schedule. The government had previously deferred its target date to achieve a balanced budget to 2023 rather than 2019, due to concerns about economic growth. The slower pace of fiscal consolidation has been deemed broadly appropriate considering the availability of

fiscal space in the economy; gross financing needs and the debt-to-GDP ratio remain below thresholds, both under baseline and stress scenarios.

The budget for 2019, released with the government's first ever budget statement in early October, is broadly consistent with the foregoing scenario. Government revenues are forecast to rise to SAR 978 billion (US\$261 billion) in 2019. Total government expenditures are projected to increase by 7.4 percent to SAR 1,106 billion (US\$295 billion) in 2019 from an estimated SAR 1,030 billion (US\$275 billion) in 2018 to cover financing expenses, subsidies and social benefits. The deficit is expected to narrow to SAR 128 billion (US\$34 billion) in 2019 from an estimated SAR 148 billion (US\$40 billion) in 2018. The budget statement also commits the government to strengthen governance, improve transparency, continually reassess spending priorities, and encourage citizens to find jobs.

The near-term projections assume that Saudi Arabia will remain firm on its commitment to raise non-oil sources of revenue. The government is set to revise the mandatory registration threshold for the VAT to a turnover of SAR 1.0 million (US\$267,000) in 2019 to enlarge the tax base from 110,000 to 400,000 mostly small business taxpayers. The threshold was set to a turnover of SAR 375,000 (US\$100,000) when the tax was introduced in January 2018 in a bid to win ready compliance and to ease tax administration. Following plans detailed in the 2018 Update to the Fiscal Balance Program, the government is also set to further rationalize energy and water tariffs over the period 2019-25. The early measures in 2015 raised electricity tariffs for households by an average 35 percent and prices for fuel products by 29-133 percent.

The projections also assume that the government will continue to limit the future growth of current spending, which accounts for three fourths of total public expenditure, while allowing for increases in capital outlays, albeit from a lower base. The Citizens' Account Program, introduced in December 2016 to compensate low- and middle-income households for the price effects of the VAT and the energy subsidy cuts, now benefits half the population and will likely be maintained as a social protection fund directed at low-income Saudi nationals. But, the Royal Decree of January 2018, which provides a monthly allowance to government workers, students, retirees, and social benefit recipients, is set to expire in 2019.

The UAE is on pace to achieve near fiscal balance by 2020, gradually reducing its deficit from 1.4 percent of GDP in 2018 to 0.5 percent in 2020. Revenues will remain robust, with oil revenues boosted by higher oil prices and non-oil revenues supported by collections from the VAT, implemented in January 2018, and the excise taxes on tobacco products, energy drinks and soft drinks, introduced in October 2017.

Investment in infrastructure, focused on enhancing the UAE's role as a regional economic hub, will keep spending buoyant. Abu Dhabi will implement its new US\$13.6 billion (6 percent of the emirate's 2017 GDP) three-year development spending

plan over the forecast period through 2020. Dubai has ramped up capital spending for World Expo 2020, with a 47 percent increase in budgetary spending on infrastructure in 2018 over 2017. Dubai's investment for World Expo 2020 is estimated at US\$7.0 billion (6 percent of the emirate's 2017 GDP, or 2 percent of the UAE's 2017 GDP).

Qatar is projected to improve on an estimated fiscal surplus of 2.3 percent of GDP in 2018 with marginally higher surpluses of 2.9 percent in 2019 and 2020. Revenue is anticipated to increase with the rise in LNG prices, and higher natural gas production, including from the Barzan gas project, by 2020. Qatar is also expected to implement the VAT during the forecast period, presumably in 2019. Capital spending will expand during the forecast period with the implementation of Qatar's US\$130 billion multi-year public investment program. Pared down from an original US\$180 billion (107 percent of 2017 GDP), the investment plan includes upgrades to infrastructure, including for the FIFA World Cup in 2022. Moreover, new capital spending may be expected during the forecast period for the expansion of the North Field, the massive offshore field where the majority of Qatar's natural gas is located, following the lifting of the 2005 moratorium on new export-oriented gas projects announced in early 2017.

In **Kuwait**, the government has postponed the implementation of the VAT for three years, from 2018 to 2021. The delay in the introduction of the VAT and recent increases to budgetary spending are likely to reduce the gains from higher oil prices and keep the deficit large, although declining, at 4-5 percent of GDP in 2019-20 (the fiscal balance excludes investment income and mandatory transfers to the Future Generations Fund). Kuwait has a low fiscal break-even price for oil, providing a less pressing motivation to mobilize non-oil revenues, and a strong populist Parliament, opposing measures, including the VAT, that reputedly impose financial burdens on citizens.

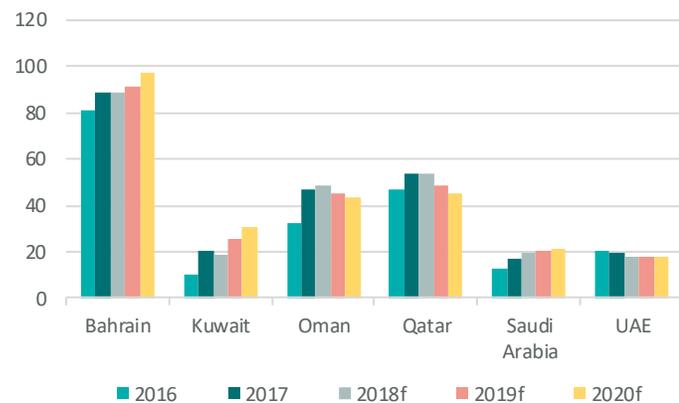
Budget spending in FY2018-19 is 12 percent higher than in the previous year. Proposals to develop the Northern Gulf Gateway project near the border with Iraq suggest that the government remains focused on large-scale projects, consistent with the five-year development plan which seeks to revive stalled infrastructure ventures. Kuwait's large sovereign wealth fund (the Kuwait Investment Authority holds assets valued at US\$592 billion, around 490 percent of 2017 GDP) and large foreign reserves (at US\$38 billion in end-June 2018, around 32 percent of 2017 GDP) provide ample financial resources for large-scale projects.

Oman is expected to cut its fiscal deficit from 6.4 percent of GDP in 2018 to 4.9 percent in 2020. The government plans to introduce the VAT in 2019, according to a Ministry of Finance notice in late 2017, although more firm details have not been issued since. Meanwhile, the government will continue with investment spending during the forecast period for the Duqm Special Economic Zone, the country's flagship economic diversification project and plans to fund the venture with more international borrowing.

FIGURE 37

**General government gross debt
Percent of GDP**

Source: IMF, World Economic Outlook, April 2018.



The forecast for a narrower fiscal deficit in **Bahrain** of 4 percent of GDP in 2020 from 5 percent in 2018 and 12.9 percent in 2017 assumes that Bahrain will accelerate and strengthen its fiscal reform efforts. The government is considering a voluntary separation program for public sector employees, deeper subsidy reforms, and the privatization of selected health and education services. The government is also in discussion with its GCC partners and the Arab Monetary Fund on a broader fiscal consolidation program that can be supported with donor funding. The VAT, anticipated to be implemented in 2019, and the excise taxes will be vital to the country's revenue mobilization effort. Controlling expenditures, including by reforming government agencies and cutting subsidies, will help improve economic efficiency.

Lower deficits should moderate the growth of public debt, except in Bahrain

Public debt ratios are projected to decline in Qatar and flatten in the UAE. They are also projected to rise slowly in Saudi Arabia and Oman but climb more sharply in Kuwait and Bahrain (Figure 37).

Saudi Arabia is expected to continue financing its deficits in 2018-19 with a combination of asset drawdowns and domestic and international borrowing. But, to protect its reserves, the government will likely finance its deficits to a greater degree by issuing debt, both to domestic banks and on the international debt markets. Oman is seeking loans of up to US\$1.2 billion to finance infrastructure development in the Duqm Special Economic Zone.

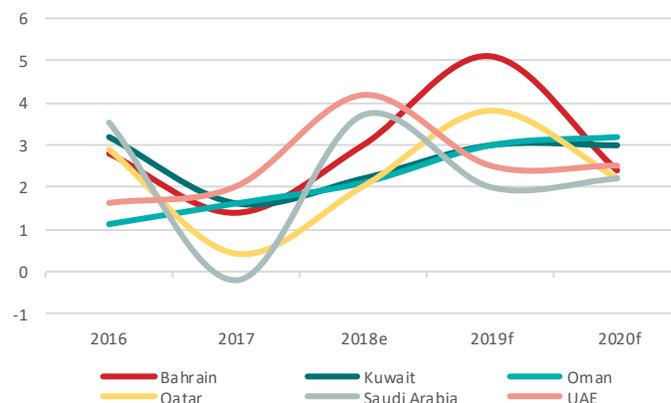
Inflation is anticipated to spike with the VAT, but stabilize quickly

Inflation is anticipated to rise moderately across the GCC during the forecast period following the implementation of the

FIGURE 38

**CPI inflation
Percent**

Source: World Bank Group.



VAT and excise taxes and new cuts to energy price subsidies. Inflation is projected to top 3.7 percent in **Saudi Arabia** and 4.2 percent in the **UAE** and 3.7 in 2018 (Figure 38). Saudi Arabia and the UAE implemented the VAT in January and Saudi Arabia added fresh cuts to electricity and fuel subsidies at the same time. The effects of the VAT are not expected to cascade, however; the maximum direct effect on the price level will not exceed the tax rate of 5 percent. The inflation rate is expected to drop to 2.0 percent in Saudi Arabia and 2.5 percent in the UAE in 2019.

Qatar is expected to implement the VAT in 2019 and inflation is projected to reach 3.8 percent in the year before slowing down to 2.5 percent in 2020 as the impact of the VAT hike falls. In Kuwait, inflation is projected to rise to 3.0 percent in 2020, from 2.2 percent in 2018, from subsidy reform. Kuwait is not set to implement the VAT until 2021.

Inflation is forecast to rise to 3.2 percent in **Oman** in 2020, from 2.1 percent in 2018, from the introduction of indirect taxes. Oman introduced the excise taxes on tobacco products, energy drinks and soft drinks in August 2018, but has not firmed up implementation plans for the VAT. **Bahrain** introduced the excise taxes on tobacco products, energy drinks and soft drinks and raised petroleum prices in January 2018; inflation is expected to average 3.0 percent in the year. Inflation is forecast to accelerate to 5.1 percent in 2019 before easing to 2.4 percent in 2020. Bahrain is expected to implement the VAT in 2019.

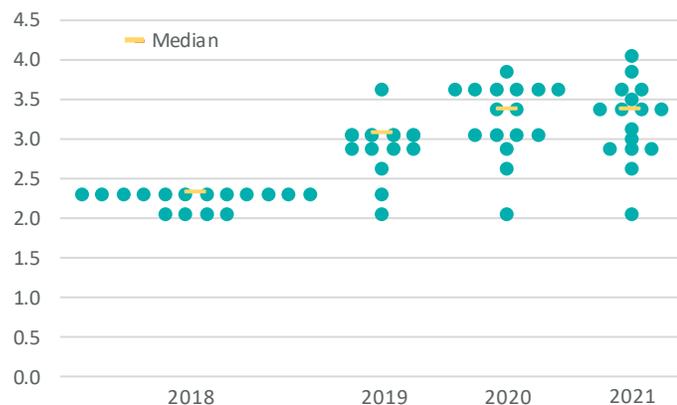
The GCC central banks are expected follow U.S. monetary policy

Monetary policy is constrained in the GCC by the currency pegs. The GCC central banks are expected to broadly follow U.S. monetary policy. At the September 2018 meeting of the Federal Open Market Committee (FOMC), the monetary policy-making body of the Federal Reserve System, the U.S.

FIGURE 39

Target for the Federal Funds rate Percent

Source: U.S. Federal Reserve Board. Note: Each dot corresponds to the expected Federal Funds rate of each Federal Open Market Committee member at the end of the next few years.



central bank signaled that it saw the Federal Funds rate at 2.313 percent (median value) at the end of 2018, and 3.063 percent (median value) at the end of 2019 (Figure 39). The median estimates imply one additional rate increase in 2018 and three rate increases in 2019, from the current target of 2.125 percent set in September 2018.

The GCC central banks will likely tighten monetary policy through 2020 as the U.S. Federal Reserve continues to hike rates to normalize monetary policy. The rate increases will raise domestic concerns across the GCC that tighter monetary policy might constrain economic growth. The concerns will be heightened in countries facing less robust growth prospects.

Risks and Long-Term Challenges

Risks to the regional outlook are tilted to the downside ...

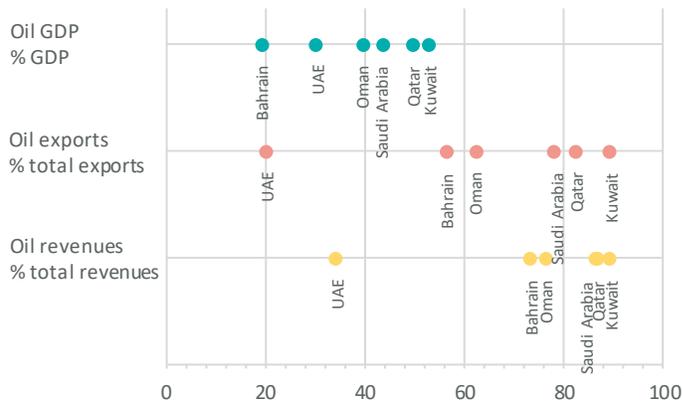
The region faces a number of risks, which are on balance tilted toward the downside. These include steep upward or downward changes to oil and gas prices, geo-political risks and risks from volatility in global financial markets. A key domestic risk is a slowing of the pace of reforms in the region in the face of the increase in oil prices over the past year.

The historical dependence of the GCC economies on oil and gas production, exports, and revenues heightens the sensitivity of regional outturns to oil and gas prices and demand. The hydrocarbon sector accounts for an average 40 percent of GDP in the GCC, and even for the most diversified economy in the regional group, the UAE, the hydrocarbon sector is still 30 percent of GDP (Figure 40). Except in the UAE, hydrocarbon exports are more than roughly 65 percent of total goods exports, and hydrocarbon revenues, more than 75 percent of total fiscal revenues.

FIGURE 40

Oil GDP, exports, and revenues, 2015-17 Percent of GDP, total exports, and total revenues

Sources: World Bank Group, Haver Analytics.



The GCC countries stand to benefit from an improved outlook for oil and gas prices, with higher prices lifting their fiscal revenues and export receipts.

There are both upside and downside risks to oil prices, which topped US\$85 bbl (Brent) in early October. Saudi Arabia, Russia, and their partners in the OPEC+ agreement have committed to boost production following an overshooting of the agreement targets. But markets remain concerned with potential additional losses in Venezuela, which is grappling with field shutdowns from an exodus of workers, and in Iran, which faces economic sanctions from the United States. On the downside, any weakness in global demand (e.g. related to trade tensions, or weakness in major emerging market economies) could also weigh on energy prices.

Other external risks include those related to bouts of turbulence in global financial markets and the associated volatility in capital flows. GCC sovereign wealth funds have investments abroad, some governments in the region have large deficits to finance, and banks have direct and indirect exposure to real estate. Any sharp drop in equity indices, rise in financing costs, or drop in asset values will have implications for governments, households and firms (depending on their exposure). Smaller GCC countries with large financing needs could be particularly exposed to such risks. Other external risks include geo-political tensions within the wider Middle East and North Africa region that affect energy supplies/prices and or weigh on investor sentiment and confidence in the region.

A key domestic risk for the GCC region is a slowing in the pace of reforms if higher-than-anticipated oil and gas revenues reduce pressure on governments to undertake critical spending adjustments and policy shifts. Governments have so far maintained a focus on reform imperatives while striving to be responsive to popular sentiment, often by implementing measures to alleviate cost-of-living concerns (e.g. the freeze on

FIGURE 41

Fiscal break-even price of oil, 2018

US\$ per barrel

Sources: IMF, Middle East, North Africa, Afghanistan and Pakistan Regional Economic Outlook, May 2018, and World Bank Group.

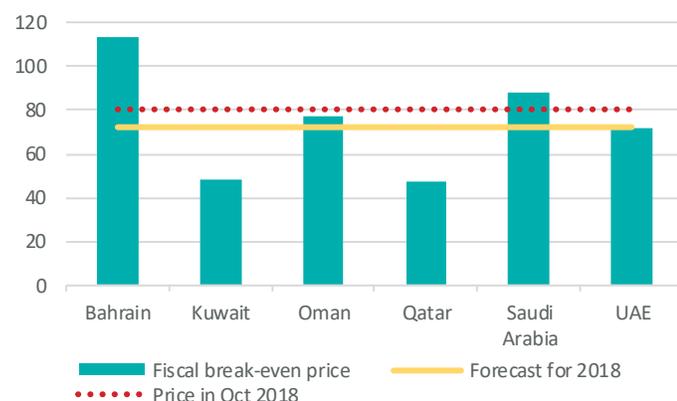
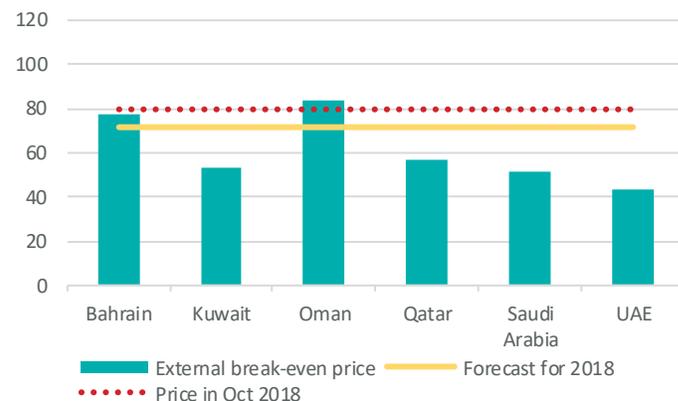


FIGURE 42

External break-even price of oil, 2018

US\$ per barrel

Sources: IMF, Middle East, North Africa, Afghanistan and Pakistan Regional Economic Outlook, May 2018, and World Bank Group.



school tuition fees in Dubai and the introduction of a Citizens Account payment in Saudi Arabia). Given the social contract in the GCC countries, reducing the subsidy bill and restraining public-sector wages will continue to be sensitive. This is especially so for Kuwait, where the executive and legislative branches will likely vigorously debate reform plans.

Higher oil prices also exert less pressure on the GCC countries to advance the revenue enhancement and expenditure reduction measures launched in response to the collapse of oil prices in 2014 and the emergence of large fiscal and current account deficits in 2015-16. The forecast price for oil for 2018 far outstrips the fiscal break-even price of oil (the oil price at which the fiscal balance is zero) for Kuwait and Qatar (Figure 41), while the market price in October 2018 is close to topping the fiscal break-even price for Oman and the UAE (IMF, 2018a). The gaps are even larger between the forecast price for oil for 2018 and the external break-even price (the oil price at which the current account balance is zero) for Kuwait, Qatar, Saudi Arabia and the UAE (Figure 42).

... and argue for continuing with structural reforms

The presence of these risks to the global and the regional outlook underscores the need for pressing ahead with structural reforms initiated by the GCC countries since mid-2014. Although data point to sustained oil prices in the US\$70 per barrel range, fundamental changes in the oil market—shale oil has increased global recoverable oil reserves and turned scarcity into a glut—make a return to the elevated oil prices of the early 2010s unlikely (Stocker et al, 2018). The prospect of oil prices remaining markedly under their pre-2014 levels underscores the urgency for oil exporters to continue with fundamental reforms.

Fiscal consolidation, economic diversification, and social development are central to the vision statements and development

strategies drafted by the GCC countries since mid-2014. Fiscal adjustment remains necessary, on the revenue side, to mobilize non-oil sources of government revenue, and on the expenditure side, to align expenditures with revenues and increase the economic efficiency of government spending. Private sector development is key to each of the countries' economic diversification. And, labor market reforms would mobilize the human capital of the region, whose potential is insufficiently tapped by distortionary policies that currently steer a well-educated population into public sector employment and overly rely on foreign unskilled labor. Sustaining the reform momentum when energy prices are high makes sense because concerns with growth, employment and welfare impacts are less pressing during a period of economic recovery.

Finally, any delay in reforms could serve as a negative signal to investors about the long-term outlook for the region and therefore its ability to attract FDI and external investors, both critical parts of the diversification agenda. A commitment to reforms, in contrast, could help to set in motion a virtuous cycle of positive sentiment, higher investment and higher output.

Updated fiscal multipliers suggest that fiscal adjustment in the GCC is less costly than previously thought

Recent research on fiscal multipliers in the GCC countries offers two findings that may help support ongoing fiscal adjustment programs in the region (Fouejieu et al, 2018). The first is that fiscal multipliers in the GCC have declined in recent years. And the second is that capital expenditure multipliers are larger than current expenditure multipliers.

The weaker relationship between lower government spending and non-oil GDP growth in the recent data is evidenced both by simple correlations and by fiscal multiplier calculations, the latter using linear and non-linear estimation procedures.

FIGURE 43

Public wage bill, 2000-16
Percent of GDP

Source: Tamirisa, Natalia and Christoph Duenwald, 2018, "Public Wage Bills in the Middle East and Central Asia".

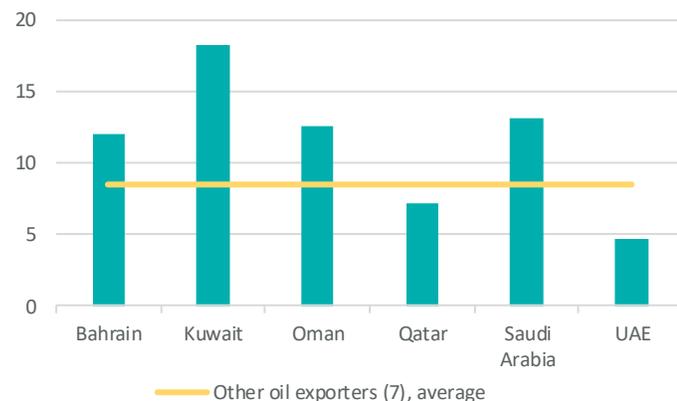
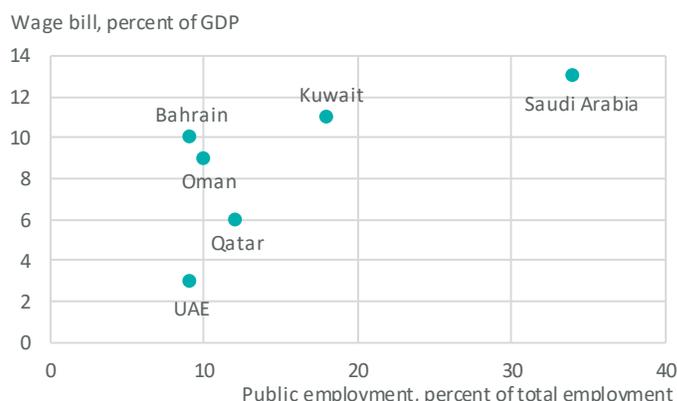


FIGURE 44

Public employment, 2005-16
Percent of total employment

Source: Tamirisa, Natalia and Christoph Duenwald, 2018, "Public Wage Bills in the Middle East and Central Asia".



The correlations are statistically significant for three definitions of spending (total, current, and capital) and show that, whereas a one percentage point growth in total spending was associated with 1.1 percentage point growth in non-oil GDP for the complete period 1990-2016, the ratio fell from 1.4 during 1990-2007 to 0.6 during 2008-16. The fiscal multiplier computations show similar patterns. Over the full sample period 1990-2016, the estimated fiscal multipliers are 0.2 for current spending and 0.4 for capital spending, both in the short term (one-year impact of spending on non-oil growth), and 0.4 for current spending and 1.3 for capital spending, in the long term (three-year impact). Focusing on the most recent period, 2011-16, the fiscal multipliers are insignificant for current spending and 0.4 for capital spending in the short term, and 0.2 for current spending and 0.9 for capital spending in the long term.

Using the actual composition of fiscal consolidation in the region, simulations predict that fiscal adjustment would cut non-oil GDP growth to 4.0 percent in 2017 (trough) if the fiscal multipliers for 1990-2016 were used, but to only 2.7 percent if the updated fiscal multipliers for 2011-16 were used. Moreover, if the adjustment were to fall solely on current expenditure, non-oil GDP growth would be 4.5 percent in 2017 (trough), using the updated fiscal multipliers for 2011-16. However, if the adjustment were to consist entirely of cuts to capital spending, non-oil GDP growth could be as low as -1.0 percent.

The results have two implications for fiscal adjustment programs in the GCC countries. The first is that ongoing fiscal consolidation in the GCC could be less costly than previously thought. This should reassure policymakers in the region who have considered delaying planned revenue enhancement and expenditure reduction measures. It should also help inform opponents of fiscal reform measures of the merits and costs of fiscal adjustment.

The second implication is that reducing less productive current spending and protecting efficient investment expenditures will help limit the adverse impact of fiscal consolidation on economic activity. The crucial distinction is that the investment expenditures must be economically efficient. This report discusses wage bill reform as a current expenditure reduction measure, as well as improvements in capital expenditure efficiency that are needed in light of large public infrastructure plans.

Fiscal adjustment plans could consider reforms to public wage bills ...

Expenditure reduction measures have so far targeted electricity and water tariffs and subsidies for gasoline and other fuel products. Among other potential expenditure measures, the GCC countries have yet to systematically explore reforms to public wage bills as a strategy to contain government spending and address fiscal deficits (Tamirisa and Duenwald, 2018).

Public wage bills are large, as a percentage of GDP, in the GCC economies, compared to other oil producers or the rest of the world. They are especially large in Kuwait, where they have topped 18 percent of GDP, and in Saudi Arabia, where they have exceeded 13 percent of GDP for almost two decades, 2000-16 (Figure 43). The large public wage bills are the result of high levels of public employment and unusually large compensation. In Saudi Arabia, public employment accounted for more than a third of total employment in 2005-16, and in Kuwait, close to a fifth (Figure 44).

In many countries in the Middle East and North Africa (MENA) region, where the public wage bills are larger than in other emerging markets and developing economies, the high wage bills reflect the traditional role of the state as “the employer of first resort”. In the GCC, public payrolls are used to distribute oil income. The availability of fiscal revenues is a

key determinant of wage bills in the long run. In the GCC, where oil revenues were 65-85 percent of fiscal revenues in 2000-16, oil prices were an important driver of wage bills.

The wage bills account for a large share of fiscal expenditures in the GCC. For almost two decades, they have made up for 40 percent of total spending in Saudi Arabia, over 35 percent in Bahrain and Kuwait, and almost 25 percent in Oman (Figure 45). In the UAE, the public wage bill may be under-estimated as wages in some sectors may be classified under other expenditure categories. The large share of wage bills in total government expenditures imply that wage bills have edged out other priorities in the budget, including potentially more productive spending for infrastructure.

Apart from maintaining consistently high levels of public employment, the GCC countries have also offered unusually generous compensation packages to government employees. Public sector pay was over 150 percent of private sector pay for equal competencies in Saudi Arabia and Qatar, over 200 percent in Bahrain, and close to 250 percent in Kuwait (Figure 46). The wide public-private sector wage gaps have distorted labor markets in the GCC, discouraging private employment in favor of government employment, hindering skills development for private industry, and unfairly benefiting insiders in the civil service.

The fiscal deficits across the GCC highlight the need for fiscal reform, as well as labor market reform and education reform, to address the strain that large public wages bills have imposed on public finances and the distortions they have inflicted on labor markets. The measures must progress beyond temporary fixes, including hiring and wage freezes, which may be useful in the short run but will be difficult to sustain in the medium to long term.

Meaningful public wage bill reform will include: (a) anchoring public employment and compensation plans to a medium-term fiscal program; (b) focusing employment and compensation policies on providing quality public services; (c) strengthening the institutions that enable governments to better control employment and link compensation to performance; (d) sequencing reforms and building synergies with other policies, including on labor and education; and, (e) communicating the reform plans firmly to reset public expectations.

The priorities vary by country. In **Saudi Arabia**, which reversed reductions in government employee allowances enacted in October 2016, new allowances and reinstated annual step-pay increases will keep the wage bill high in 2018. In **Qatar**, which has more fiscal space, tightening the eligibility for allowances and reducing staff size by natural attrition will help reduce the wage bill in the first stage of reform. In the medium to long term, a comprehensive assessment of workforce requirements will help deliver stronger results. In **Kuwait**, where the wage bill rose most sharply in the region after the Arab Spring, standardizing the salary structure and keeping wage increases below inflation will limit the increase in

the wage bill to KD3.2 million (US\$10.6 million) in the first year of the reform plan.

Public wage bill reforms will benefit the GCC economies in several ways. Reducing expenditure rigidities arising from high wage bills and enabling, instead, higher investment in infrastructure will promote growth. Removing labor market distortions favoring government employment will boost private sector development. Rationalizing public pay relative to private pay will support efforts to create jobs in the private sector, the more sustainable source of employment for millions of new graduates entering labor markets.

... and upgrades to infrastructure

The quality of infrastructure varies across the GCC. Executive opinion surveys conducted for the World Economic Forum's Global Competitiveness Report for 2017-18 rank the UAE as the fourth best among 137 countries on the overall quality of infrastructure (WEF, 2018). In contrast, Kuwait is ranked 69th (Figure 47). The quality of various classes of infrastructure also varies among the six countries. That of electricity supply is high across the board. However, those of air transport infrastructure and port infrastructure decline sharply as the country rankings fall (Figure 48).

The long-term vision statements and medium-term spending plans of the GCC countries highlight investment in infrastructure as an important driver of economic growth. The **UAE's** Abu Dhabi will spend part of its US\$13.6 billion stimulus plan on infrastructure, while Dubai has allocated US\$7 billion for infrastructure upgrades for World Expo 2020. **Qatar** is implementing a US\$130 billion public investment program for 2014-24, including projects linked to the FIFA World Cup in 2022. **Kuwait's** flagship economic diversification venture, the Northern Gulf Gateway project, and **Oman's** major diversification project, the Duqm Special Economic Zone, are both heavy on infrastructure spending.

In water infrastructure in the region, Oman, which is commissioning three water desalination plants at Sohar, Barka and Quriyat and in 2018, is planning to add 10 more plants to its network by 2023. The expansion aims to supply 90 percent of the population with piped water by 2035.

Overall, rebalancing the composition of public expenditures toward capital spending should help improve infrastructure, support non-oil growth, and spur productivity gains in the GCC economies. But the economic and social impact of public investment depends on its efficiency, and the efficiency of investment, in turn, depends on how it is managed. Countries with more robust public investment management institutions produce more efficient and productive investments.

In **Saudi Arabia**, the authorities have put in place mechanisms to review existing and new capital projects before they are funded. In the **UAE**, the government must carefully monitor capital transfers to government related entities (GREs), many

FIGURE 45

Public wage bill, 2000-16
Percent of total spending

Source: Tamirisa, Natalia and Christoph Duenwald, 2018, "Public Wage Bills in the Middle East and Central Asia".

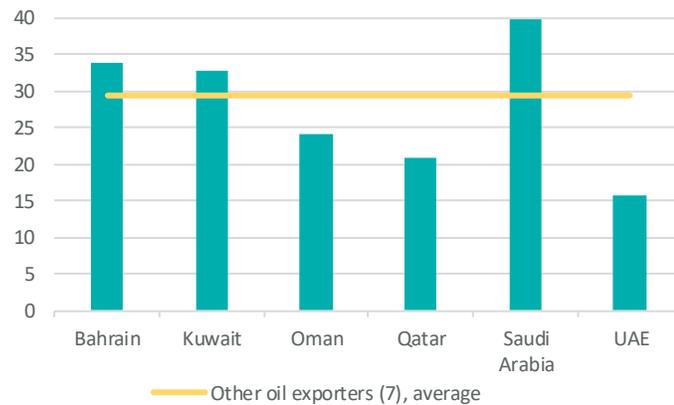


FIGURE 46

Public-private sector wage gaps, 2005-16
Percent

Source: Tamirisa, Natalia and Christoph Duenwald, 2018, "Public Wage Bills in the Middle East and Central Asia".



FIGURE 47

Quality of overall infrastructure

1 = extremely under developed, 7 = extensive & efficient

Source: World Economic Forum, The Arab World Competitiveness Report 2018. Note: numbers in parentheses across the country names refer to the country rank (out of 137 countries).

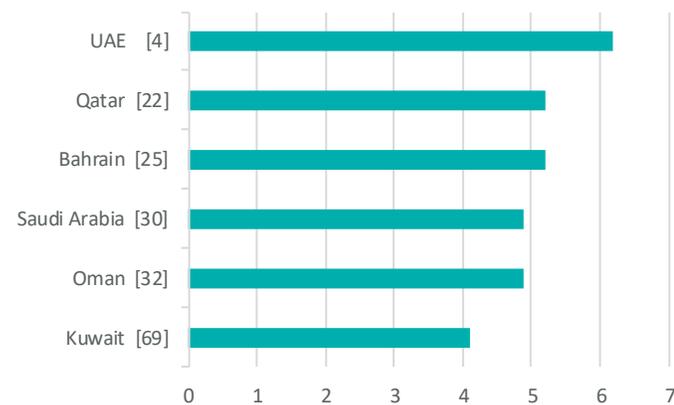
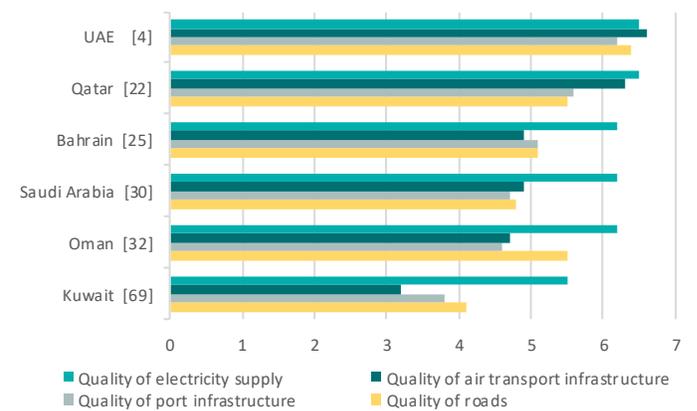


FIGURE 48

Quality of various infrastructure

1 = extremely under developed, 7 = extensive & efficient

Source: World Economic Forum, The Arab World Competitiveness Report 2018. Note: numbers in parentheses across the country names refer to the country rank (out of 137 countries).



of which have developed major infrastructure projects for Abu Dhabi. The UAE must also review future GRE investment plans. Large investment projects, if not implemented prudently, may create additional macro-financial risks. In **Kuwait**, there are potentially large gains from improving public investment management, considering that the country suffers from large infrastructure gaps while lagging its income-group in capital spending.

Apart from working to improve their public investment management systems, the GCC governments should also review the broader set of governance issues related to their infrastructure programs, including, among others, the regulatory framework for infrastructure investment, the institutional implications of scaling-up infrastructure spending, and the options for, and fiscal costs of, public-private partnerships in infrastructure.

In the water sector, the challenges for the GCC countries are to better manage water resources and deliver water services in a region where water stress is acute, water consumption is the highest in the world, and dependence on energy-intensive water desalination is extreme. The GCC countries need to draw up water sector strategies that address these challenges. The **In Focus** section of this report sets out options to manage water resources for security and sustainability objectives and to deliver water services with accountability and financial sustainability.

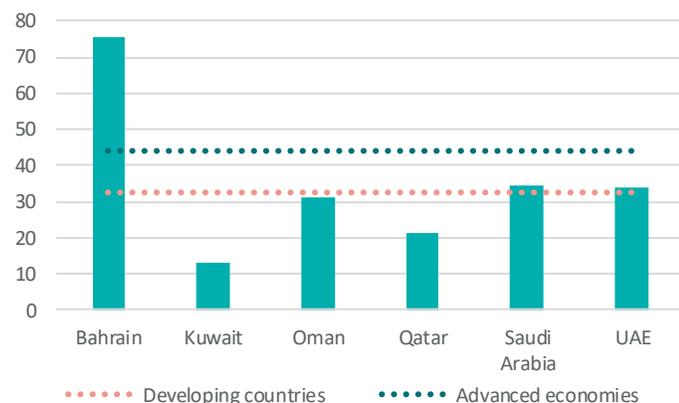
Economic diversification and private sector development initiatives have recently focused on liberalizing foreign investment rules ...

Patterns of foreign direct investment (FDI) vary among the GCC countries. The stock of FDI at the end of 2017, expressed

FIGURE 49

FDI stock
Percent of GDP

Source: UNCTAD, World Investment Report 2018.



as a percentage of GDP, roughly matched the average for developing countries in **Saudi Arabia**, the **UAE** and **Oman** (Figure 49). They stood under the developing country average in **Qatar** and **Kuwait**, and only topped the advanced economy average in **Bahrain** (UNCTAD, 2018). The GCC countries have recently stepped up efforts to liberalize their foreign investment laws, in a bid to attract foreign direct investment (FDI) in their economies, as well as portfolio investment flows into their equity and debt markets.

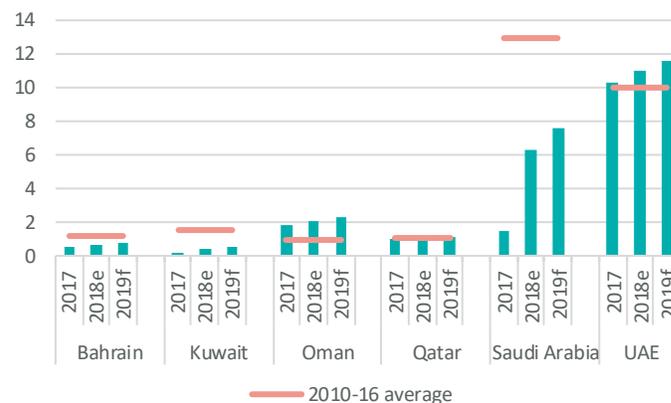
Liberalizing foreign ownership of firms is likely to help raise FDI flows into the GCC. The Institute for International Finance forecasts higher FDI flows in 2019, compared to 2017 and to estimates for 2018 (Figure 50). FDI flows have been declining in recent years, however, and the uptick in 2019 may only exceed the historical average in nominal U.S. dollar values in the UAE and Oman. The drive for higher FDI is motivated by the view that FDI conveys economic advantages to host countries. FDI are traditionally thought to increase the volume and the efficiency of investment and increase the rate of economic growth in the host country through technology transfer, diffusion, and spillover effects.

Openness to FDI is a vital channel by which developing economies gain exposure to the global technological frontier, in addition to participation in international trade and contacts with the diaspora, foreign academia and international organizations (World Bank, 2008). Technology, broadly defined to encompass the techniques by which goods and services are produced and marketed, is central to economic growth and social welfare. But most emerging markets and developing countries lack the ability to generate innovations at the technological frontier, which implies that technological progress must be achieved through the adoption and adaptation of existing or new technologies. Policies encouraging FDI and trade, along with investments in human capital, enable improvements in technological achievement.

FIGURE 50

FDI, non-resident inflows
US\$ billion

Source: Institute for International Finance.



Saudi Arabia disclosed plans to allow full foreign ownership in specific sectors in May 2018. Specifically, the Saudi Arabia General Investment Authority (SAGIA) was considering allowing 100 percent ownership of retail companies and engineering firms. The **UAE** announced plans allowing 100 percent foreign ownership of firms in May 2018, although restricted to sectors to be agreed upon by a committee of the seven emirates. Currently, the UAE allows 100 percent foreign ownership only in the free zones, outside of which foreign ownership is capped at 49 percent. **Qatar**'s Council of Ministers approved a new draft foreign investment law in June 2018, permitting foreign investors to own 100 percent of companies across all sectors, subject to the approval of the Ministry of Economy and Commerce, up from the 49 percent limit for firms outside of free zones.

These three countries joined Kuwait and Bahrain, which had previously allowed a 100 percent foreign ownership in at least some business sectors. **Kuwait** passed the Direct Investment Promotion Law in 2015 to allow foreigners 100 percent ownership of a commercial entity. **Bahrain** allowed 100 percent foreign ownership in several sectors in 2016. Some GCC countries are also considering relaxing residency permits for foreign investors. The UAE and Bahrain announced plans for a ten-year residency for foreign investors in May 2018. Qatar is reportedly mulling permanent residency for foreign investors.

Meanwhile, portfolio investment flows are also expected to rise in the GCC (Figure 51), notwithstanding the decision by Saudi Arabia to postpone the initial public offering for Saudi Aramco. MSCI, which compiles the most widely tracked stock market indices, announced in June 2018 that **Saudi Arabia** will be included in its Emerging Markets benchmark beginning with the reviews of the index in May and September 2019. Earlier in April, FTSE Russell, another index firm, upgraded the Tadawul, the Saudi stock exchange, to emerging market status in a decision that will come into effect in March and

December 2019. The MSCI and FTSE decisions are expected to drive a combined US\$15 billion of passive foreign investment into the Saudi market, around 7 percent of the value of the market's freely-floating shares. Moreover, the investment banking firm JP Morgan Chase announced in October that it will include the U.S. dollar bonds of **Saudi Arabia**, the **UAE**, **Qatar**, **Kuwait** and **Bahrain** in its benchmark EMBI dollar bond index over the course of next year and assign the bonds a combined weight of 11.2 percent. The five GCC countries could benefit from a combined US\$43 billion of portfolio inflows as a result of their inclusion in the EMBI index.

... but must also consider improvements to the domestic business environment

Reforming the regulations that constrain domestic business activity is as beneficial to economic growth and private sector development objectives in the GCC and elsewhere as liberalizing the rules that govern foreign direct and portfolio investment from abroad. Taken together, they improve the operating environment for foreign investors as well as domestic firms and entrepreneurs (Hornberger et al, 2011).

The Bank's Doing Business publication identifies many areas where improvements to the business environment could boost private activity (World Bank, 2018b). Among the 11 areas that are covered by the Bank report, that of resolving insolvency lies central to the link between regulatory quality and efficient business outcomes (Figure 52 - Figure 57). The recovery rate for secured creditors and the extent to which domestic law has incorporated internationally-accepted principles on liquidation and reorganization are indicators of regulatory quality. Efficient outcomes occur when viable businesses are given a chance to survive while inefficient firms exit the market, putting resources to better use elsewhere in the economy.

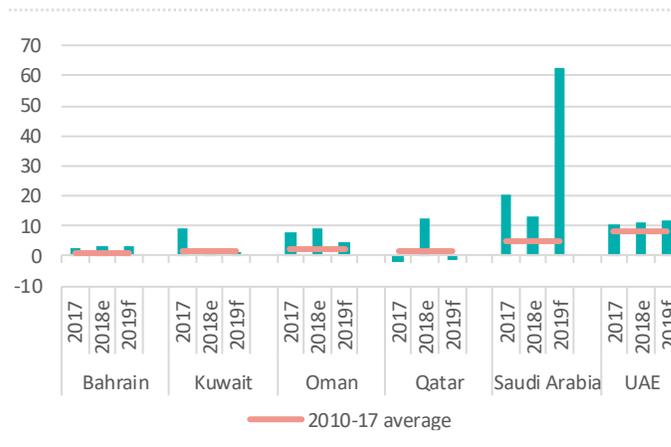
The GCC economies perform poorly on the resolving insolvency indicator, which measures the time, cost, outcome and recovery rate for a commercial insolvency and the strength of the legal framework for insolvency. However, the GCC's two largest economies have recently introduced reforms to improve their commercial bankruptcy and corporate restructuring regimes. **Saudi Arabia** approved a landmark insolvency law in February 2018. Modern bankruptcy legislation did not previously exist in Saudi Arabia and solvency was handled under the 1931 Commercial Court Law and a 1996 royal decree on preventing bankruptcy. The legislation had been under preparation for several years and its implementation should help several large firms currently facing difficulties and seeking to restructure debts with their creditors. The new law also offers protection to creditors.

Earlier, the **UAE** also introduced a new insolvency law in 2016. The Bankruptcy Law allows companies greater opportunities to instigate protective composition procedures and work with creditors in restructuring proceedings, in contrast to the previous regime which placed a greater emphasis on creditor protections and formal bankruptcy proceedings along with

FIGURE 51

Portfolio investment, non-resident inflows US\$ billion

Source: Institute for International Finance.



criminal penalties. Meanwhile, the country's Securities and Commodities Authority has proposed the creation of a secondary exchange for loss-making firms listed in the Abu Dhabi and Dubai exchanges, although the details of the proposal are yet to be fully vetted.

Encouraging strategic investments, both foreign and domestic, in digital services could help the Middle East and North Africa countries create and grow a "new regional digital economy", according to a recent study (World Bank, 2018g). The concept appears attractive and finds an echo in the UAE's plan to pioneer technology entrepreneurship in Dubai. The regional proposal may eventually help the GCC countries advance their national economic diversification efforts in the medium to long term, if carefully planned and efficiently executed. Importantly, the GCC countries must be cognizant of the strategic role that the private sector must play in this and any other economic development initiative.

GCC governments must support workforce nationalization efforts with education reform and pay parity measures

Some GCC governments have recently stepped up efforts to nationalize their workforces in a bid to lessen their economies' dependence on foreign workers, or at least the private sector's dependence on foreign workers. On average, foreign labor accounts for 80 percent of private sector jobs in the GCC, mostly in low-skill categories. Meanwhile, nationals work predominantly in the government sector, where, in the GCC's highly segmented labor markets, they enjoy higher wages and greater job security than do those employed by private industry.

Saudi Arabia doubled the monthly levy on expatriate workers to SAR 400 (US\$107) in January 2018 on firms that fail to meet the 50 percent "Saudization" ratio (the percentage of Saudi nationals in a firm's workforce). The fee is set to rise to

FIGURE 52

Bahrain Doing Business scores

Source: World Bank Group, Doing Business 2018 – Reforming to Create Jobs.



FIGURE 53

Kuwait Doing Business scores

Source: World Bank Group, Doing Business 2018 – Reforming to Create Jobs.

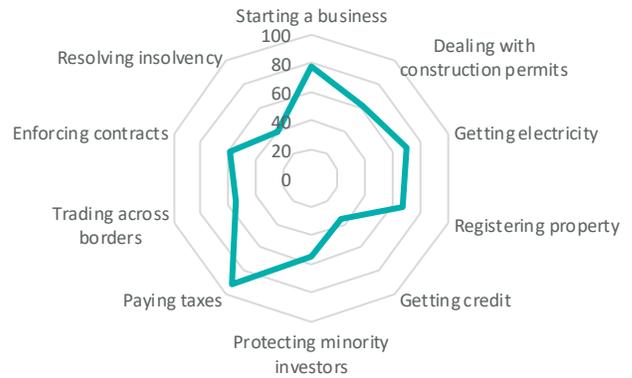


FIGURE 54

Oman Doing Business scores

Source: World Bank Group, Doing Business 2018 – Reforming to Create Jobs.



FIGURE 55

Qatar Doing Business scores

Source: World Bank Group, Doing Business 2018 – Reforming to Create Jobs.

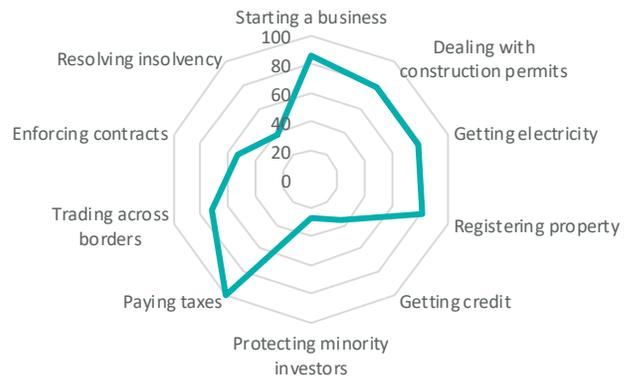


FIGURE 56

Saudi Arabia Doing Business scores

Source: World Bank Group, Doing Business 2018 – Reforming to Create Jobs.

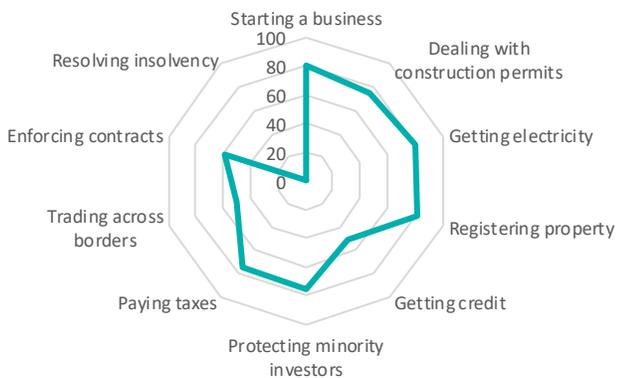
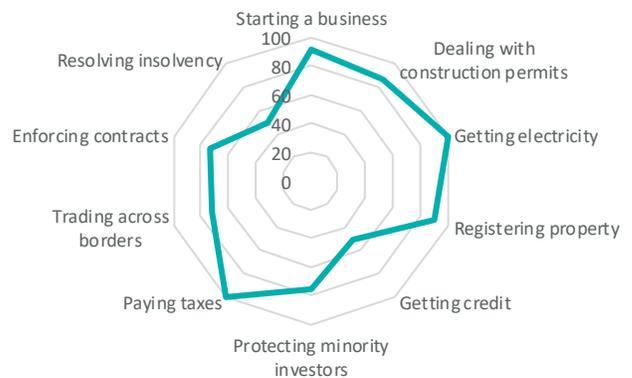


FIGURE 57

UAE Doing Business scores

Source: World Bank Group, Doing Business 2018 – Reforming to Create Jobs.



SAR 700-800 (US\$187-213) per worker by 2020. Earlier, in July 2017, Saudi Arabia imposed a levy on resident expatriate dependents at SAR100 (US\$27) a month, rising to SAR 200 (US\$54) a month in 2018 and SAR 400 (US\$107) a month by 2020. Saudi Arabia subsequently reported a 6 percent decline in the number of expatriate workers in the country in the first quarter of 2018, with the decline concentrated in the construction, trade and manufacturing sectors. These three sectors have performed poorly recently; they are the same sectors where the government had previously imposed other “Saudization” requirements more heavily, raising costs for both employers and workers.

Kuwait planned to implement further controls on the employment of expatriate labor and restrict government contracts to local workers under its “Kuwaitization” program. In May 2018, government agencies announced the termination of some 1,000 expatriate workers in the public sector. Earlier, in January, the government unveiled a plan to provide job opportunities to 17,000 nationals in the private sector in place of expatriates. It also instructed local banks to increase the number of Kuwaiti employees to 70 percent of various positions.

Oman banned the recruitment by the private sector of expatriate workers in 90 job categories in ten sectors in January 2018. The temporary ban was to apply for six months, but the government extended the ban for another six months, in July 2018. The government reported a 0.3 percent month-on-month reduction in the country’s expatriate workforce of around 1.8 million in January 2018. Meanwhile, Oman also amended its part-time employment regulations in April 2018, to allow more flexible working arrangements for retirees and students. The government hopes that its “Omanization” plan significantly raises the percentage of nationals in private sector employment from the current low rate of 14 percent.

The nationalization drives have implications for business continuity, particularly in small and medium enterprises. Saudi Arabia and Oman have been careful to consider these risks. Small businesses with less than nine employees are exempted from expatriate levies in Saudi Arabia, up to the first five expatriate workers. Businesses registered with the Public Authority for Small Business Development and insured with the Public Authority for Social Insurance are exempted from the year-long expatriate ban in Oman.

Yet, more needs to be done by GCC governments to ensure that their nationals can assume and perform the work of expatriates in key industries. In **Kuwait**, where expatriates make up some 70 percent of the local population of 4.4 million and over 80 percent of the labor force, skills mismatches are a binding constraint. Educational systems and training programs must address the need for suitably skilled nationals for technical jobs in private industry. Meanwhile, business owners are likely to resist the quotas on nationals and the fees on expatriates if they are unable to draw qualified and skilled nationals from the labor pool, according to recent reports.

In **Oman**, where 40 percent of 44,000 job seekers in September 2017 had university degrees, the preference remained for public sector employment. And yet, the government will unlikely be able to continue providing additional jobs to nationals given the squeeze on public finances. Achieving pay parity between public and private employment should help the government steer workers toward the private sector under its “Omanization” drive.

In countries where workforce nationalization drives need to be more attuned to economic necessities, including the evident need for foreign workers in construction jobs, governments are taking a more nuanced view of foreign employment.

The **UAE** announced changes to labor regulations in June 2018 but focused on improving the business environment and increasing both domestic private and foreign participation in the economy. The government will replace the mandatory bank guarantee for labor recruitment with a low-cost insurance system, to reduce the cost of recruiting foreign labor for companies. The government also plans to issue temporary six-month visas to expatriates who wish to be reemployed in the country and two-year visas to foreign students who are graduating from university.

Qatar signed bilateral worker protection agreements with a dozen countries in 2017, after which the International Labor Organization (ILO) dropped a complaint against Qatar’s labor practices in November 2017. The case had been originally filed by a group of countries in 2014 against Qatar for violation of ILO conventions on forced labor. The decision helps ensure that Qatar meets its need for foreign labor to work on large infrastructure projects, including for the FIFA World Cup which Qatar is hosting in 2022. The government also proposed additional reforms on foreign employment, including a minimum wage, the details of which are not yet available.

... and do more to advance female employment and protect women’s pay

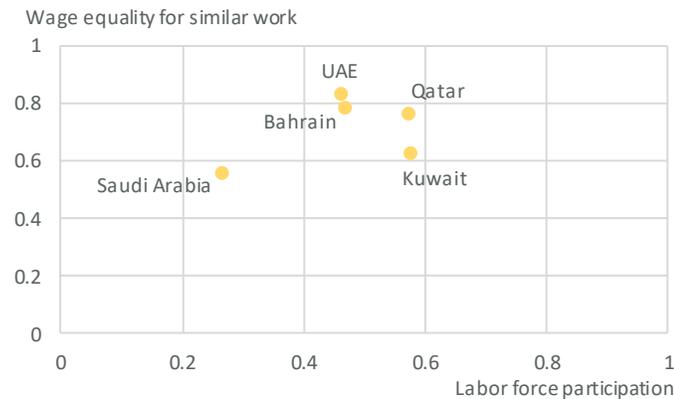
Meanwhile, GCC governments could do more to encourage the participation of women in the workforce. Employment rates are generally low among women across the GCC, ranging from 20 percent of the female population aged 15+ years in Saudi Arabia to 58 percent in Qatar in 2017 (Figure 58). There is also a wide disparity between pay for female and male workers in the region.

Saudi Arabia’s royal decree in September 2017 lifting the world’s only ban on women drivers went into effect in June 2018, with some 120,000 women reportedly applying for driver’s licenses on June 24. The Saudi reform could make the commute to work less difficult for women, encouraging more women to actively seek work opportunities and making the employment of women workers more attractive for business firms. The government expects the number of women holding driver’s licenses to top 3 million in 2020, and the women labor force participation rate to reach 30 percent by 2030, up from

FIGURE 58

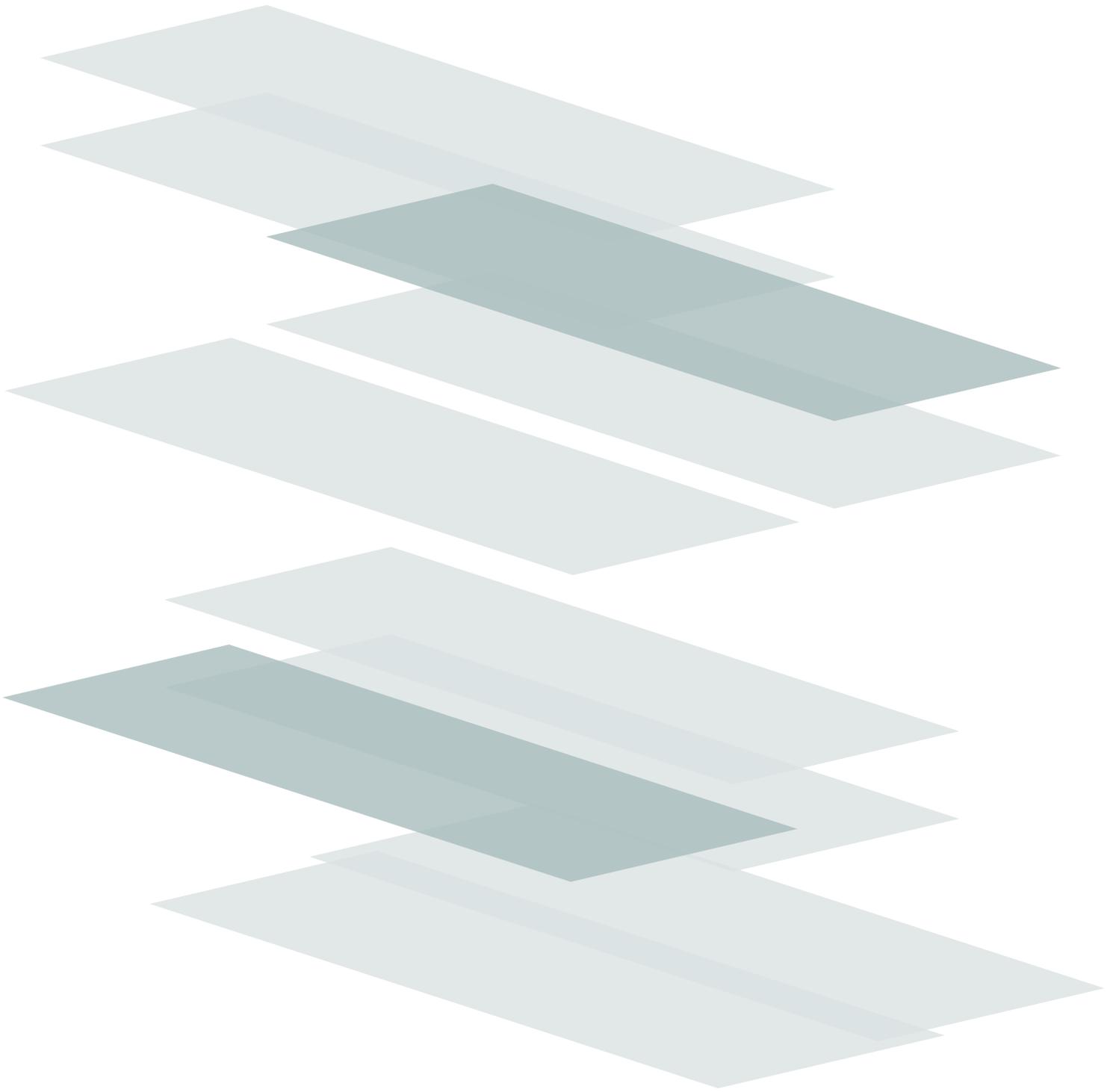
Labor force participation, and Wage equality for similar work. Female/Male ratio, 1 = parity

Source: World Economic Forum, The Global Gender Gap Report 2017.



the current 20 percent. Going forward, greater easing of guardianship rules—women were allowed access to government services, including education and healthcare, without the consent of a guardian in May 2017—would take the reforms several steps further.

In the **UAE**, the cabinet recently approved new draft legislation guaranteeing equal pay for men and women, in a bid to encourage higher labor force participation among women nationals. The government is also reviewing maternity leave allocations and creating more flexibility for part-time workers. Both are embedded in the country’s “Emiratisation” drive. The UAE has a higher participation among women in the public and private sectors compared with other GCC countries, and the government previously created a new state agency, the Gender Balance Council, to advance women’s participation in the public-sector workforce. The UAE offers a model that other GCC countries could consider.



COUNTRY SUMMARIES

BAHRAIN

This year, fears over Bahrain's liquidity position came to the fore and necessitated regional partners to pledge a US\$10bn aid package that is helping reduce currency pressures, cover immediate debt payments and help meet short-term financing needs. Notwithstanding steady growth in the real sector, increased risks associated with large current account and fiscal deficits triggered strong market reactions in the first half of 2018, while a legacy of slow adjustment to the 2014 oil shock led public debt to reach a record 90 percent of GDP in 2017. Net foreign reserves fell to a month's worth of import cover in June 2018, increasing Bahrain's external vulnerability. Proposed financial support program from GCC partners will be tied to the achievement of fiscal adjustment targets monitored by the Arab Monetary Fund. Economic growth is projected to ease gradually in 2018-19 as continued financing of large infrastructure and commercial projects is expected to taper off. Higher oil prices will provide some relief on the fiscal deficit, which is expected to improve to 4.8 percent of GDP in 2019. A potential increase in Bahraini oil production from newly discovered hydrocarbon reserves will complement several prominent non-oil projects to support continued GDP growth. However, unlike the sustained twin deficits faced by the country, these bright prospects are far in the future and prone to uncertainties. A critical challenge for Bahrain will be the successful design and implementation of a reform program to address the structural economic problems and sustained twin deficits in the country. Future assistance and credit market reactions will likely depend on such a reform program and close monitoring by the Arab Monetary Fund.

SELECTED ECONOMIC INDICATORS	2011	2012	2013	2014	2015	2016	2017	2018e	2019f	2020f
Nominal GDP, \$ billion	29	31	33	33	31	32	35	41	45	48
Real GDP, % change	2.0	3.7	5.4	4.4	2.9	3.2	3.9	3.2	2.6	2.8
Hydrocarbon ¹	3.6	-8.5	15.3	3.0	-0.1	-0.1	..	..	..	..
Non-hydrocarbon ¹	1.6	7.1	3.1	4.7	3.6	4.1	..	..	..	..
CPI Inflation Rate, average, %	-0.4	2.8	3.3	2.7	1.8	2.8	1.4	3.0	5.1	2.4
Government Revenues, % GDP	26.3	26.4	24.6	25.0	18.2	17.6	21.1	22.8	23.1	23.7
Government Expenditures, % GDP	27.8	31.9	34.3	28.4	36.6	35.5	34.0	27.7	27.8	27.8
Fiscal Balance, % GDP	-1.5	-5.5	-9.7	-3.4	-18.4	17.9	-12.9	-5.0	-4.8	-4.0
General Government Gross Debt, % GDP ²	32.8	36.2	43.9	44.4	66.0	81.4	88.5	88.4	91.7	97.6
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % change	44.0	17.4	10.9	-8.2	-29.6	-22.7	20.3	23.5	2.6	18.7
Merchandise Imports, % change	8.2	62.8	8.0	-7.0	-20.6	-13.5	18.3	14.4	2.8	-1.5
Current Account, % GDP	11.3	8.4	7.4	4.6	-2.4	-4.6	-4.5	-2.8	-1.9	-3.4
Official Reserves, \$ billion ³	4.5	5.2	5.3	6.1	3.4	2.5	2.6	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon sector, % GDP ¹	21.4	18.9	20.7	20.4	19.8	19.2	..	..	..	..
Hydrocarbon revenue, % of total revenue ¹	87.9	87.2	88.3	86.2	78.1	75.7	75.1	..	..	..
Hydrocarbon exports, % total exports ⁴	40.7	50.5	47.8	45.9	35.9	32.6	39.9	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, "Macro Poverty Outlook, October 2018", unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2018.

3/ IMF, International Financial Statistics.

4/ U.N. Comtrade.

KUWAIT

Kuwait's economy contracted by an estimated 1 percent in 2017 as OPEC-related oil production cuts weighed on growth, with hydrocarbons accounting for nearly half of GDP. Non-oil activity has been supported by the implementation of large infrastructure, transport and refinery projects as part of the five-year Development Plan. Household confidence and spending are improving, in part due to strengthening oil prices and steady hiring by the government. Fiscal pressures have lessened – on a general government basis, counting investment income and transfers to the sovereign wealth fund, public finances are in a small surplus – and public debt remains low. The current account shifted back into a small surplus in 2017 on recovering oil exports. Growth is expected to gradually improve to about 3 percent in the medium term, supported by infrastructure spending, and as oil production rises. Current account and budgetary pressures are expected to continue easing on the back of a partial recovery in oil revenues, and as government spending is gradually trimmed. Key challenges include high dependence on hydrocarbons and parliamentary opposition to deep structural reforms. A poor business environment and onerous regulations – Kuwait is ranked 96th out of 190 countries in the Doing Business rankings – have hampered the development of the private nonoil sector. Comprehensive reforms are needed to rebalance the economy away from the energy sector to a more diversified growth path underpinned by a quality labor force, innovation and private sector entrepreneurship and job creation.

SELECTED ECONOMIC INDICATORS	2011	2012	2013	2014	2015	2016	2017	2018e	2019f	2020f
Nominal GDP, \$ billion	154	174	174	163	115	109	120	123	130	137
Real GDP, % change	9.6	6.6	1.1	0.5	0.6	2.9	-3.5	1.7	3.6	3.6
Hydrocarbon ¹	15.6	10.3	-1.8	-2.1	-1.7	3.9	-7.2	1.6	3.7	3.4
Non-hydrocarbon ¹	4.1	3.9	4.1	5.0	0.1	1.8	2.5	1.4	2.4	2.8
CPI Inflation Rate, average, %	4.9	3.2	2.7	2.9	3.3	3.2	1.6	2.2	3.0	3.0
Government Revenues, % GDP	71.1	65.7	64.4	53.9	39.5	39.6	44.1	47.6	46.3	44.9
Government Expenditures, % GDP	40.0	39.1	38.3	46.3	52.9	53.6	53.1	53.5	51.2	49.2
Fiscal Balance, % GDP ²	31.1	26.6	26.1	7.6	-13.4	-13.9	-9.0	-5.9	-4.9	-4.4
General Government Gross Debt, % GDP ³	4.6	3.6	3.1	3.4	4.7	9.9	20.7	18.8	25.3	30.3
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % change	53.2	16.3	-3.3	-9.7	-47.9	-14.6	18.6	26.6	3.2	4.6
Merchandise Imports, % change	15.5	7.3	5.5	5.5	-1.6	1.6	9.4	11.0	5.0	4
Current Account, % GDP	42.9	45.5	40.3	33.5	3.5	-4.6	5.9	10.6	7.8	5.9
Official Reserves, \$ billion ⁴	25.8	28.9	29.4	32.1	28.3	31.0	33.6	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon sector, % GDP ¹	54.7	56.3	54.8	53.1	52.6	53.2	50.8	..	..	..
Hydrocarbon revenue, % of total revenue ¹	94.5	93.6	92.1	90.3	88.6	89.2	89.3	..	..	..
Hydrocarbon exports, % total exports ⁵	93.1	93.8	92.7	93.0	90.2	89.5	91.6	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, "Macro Poverty Outlook, October 2018", unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ Excluding investment income.

3/ IMF, World Economic Outlook, October 2018.

4/ IMF, International Financial Statistics.

5/ U.N. Comtrade.

OMAN

Following a contraction in 2017 due to compliance with the OPEC+ oil production cuts, Oman continued to register double-digit fiscal and current account deficits in 2017 due to slow adjustment to the 2014 oil price shock. This led to a further increase in public debt to 46 percent of GDP and a credit ratings downgrade. High unemployment among Omani workers remains a primary concern, estimated at 17 percent in 2017; youth unemployment is nearly 50 percent. The authorities launched an initiative to increase private sector employment for nationals in 2018, including a temporary ban on new visas for foreign workers, but results have so far been limited. Real GDP growth is projected to gradually recover to 2.8 percent by 2020 as the OPEC+ agreement unwinds, and a potential boost from planned investments to diversify the economy. The fiscal deficit is projected to reach single digits by 2020, supported by higher oil prices and the planned introduction of VAT and excise taxes, while the current account is also expected to improve on higher oil exports. Macroeconomic and structural reforms to restore fiscal and external sustainability, maintain policy predictability, and support job creation, are key policy concerns. In addition to the planned revenue-enhancing measures, expenditure reduction through wage bill and subsidy reform, along with more efficient public service delivery, is critical. The main risk relates to a delay in adequate fiscal adjustment, which in an adverse global financial environment of volatility could worsen debt sustainability and affect the cost of financing.

SELECTED ECONOMIC INDICATORS	2011	2012	2013	2014	2015	2016	2017	2018e	2019f	2020f
Nominal GDP, \$ billion	68	77	79	81	69	67	73	79	84	86
Real GDP, % change	-1.1	9.3	4.4	2.8	4.7	5.0	-0.9	1.9	3.4	2.8
Hydrocarbon ¹	2.0	3.0	2.8	-1.0	4.4	2.3	..	..	..	..
Non-hydrocarbon ¹	5.5	10.1	9.2	4.6	5.5	1.8	..	..	..	..
CPI Inflation Rate, average, %	4.1	2.9	2.1	1.0	0.1	1.1	1.6	2.1	3.0	3.2
Government Revenues, % GDP	48.7	48.7	49.5	46.3	35.0	30.0	31.1	36.8	36.2	36.5
Government Expenditures, % GDP	39.3	44.1	44.9	47.4	51.7	50.9	44.8	43.2	41.4	41.4
Fiscal Balance, % GDP	9.4	4.6	4.7	-1.1	-16.7	-20.9	-13.7	-6.4	-5.2	-4.9
General Government Gross Debt, % GDP ²	5.2	4.9	5.0	4.9	15.5	32.5	46.9	48.7	45.1	43.8
General Government Net Debt, % GDP ²	-29.7	-29.1	-43.9	-44.1	-43.1	-28.5	-10.8	-1.5	-2.8	-3.9
Merchandise Exports, % change	28.7	10.7	8.2	-5.1	-33.4	-22.8	16.0	13.8	19.5	19.7
Merchandise Imports, % change	20.3	19.2	25.0	-13.0	-4.8	-19.9	1.4	0.9	-5.9	0.9
Current Account, % GDP	13.0	10.2	6.6	5.2	-15.9	-18.7	-15.1	-9.8	-8.8	-7.6
Official Reserves, \$ billion ³	14.4	14.4	16.0	16.3	17.5	20.3	16.1	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon sector, % GDP ¹	44.3	42.7	41.2	39.8	39.6	39.2	38.3	..	..	..
Hydrocarbon revenue, % of total revenue ¹	84.4	84.7	85.7	84.3	78.7	68.2	72.9	..	..	..
Hydrocarbon exports, % total exports ⁴	80.8	81.1	79.1	79.0	72.7	68.4	78.1	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, "Macro Poverty Outlook, October 2018", unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2018.

3/ IMF, International Financial Statistics.

4/ U.N. Comtrade.

QATAR

Economic activity has rebounded following a slowdown in growth to 1.6 percent in 2017, supported by a successful rerouting of trade flows following the rift with GCC neighbors, higher energy prices and 2022 FIFA World Cup related spending. Food and imported goods prices have also eased with the recovery in trade activity and the opening of a new port. A strong increase in export receipts helped shift the current account into a surplus of 3.8 percent of GDP in 2017, versus a deficit of over 5 percent in 2016. Public finances have improved, supported by the recovery in energy prices and fiscal restraint. The banking system remains well capitalized and asset quality strong, and liquidity pressures that emerged mid-2017 have waned. The outlook remains positive, with growth expected to gradually rise to 3 percent in the medium term, with strengthening of hydrocarbon prices, World Cup-related infrastructure spending, and as the US\$10 billion Barzan natural gas facility comes onstream in 2020. The fiscal balance is expected to remain in a small surplus, supported by a planned VAT to be implemented in the medium term, while the current account surplus is expected to remain in single digits (compared to double-digits prior to 2014), with a recovery in imports related to infrastructure spending. Reforms protecting foreign workers and introducing permanent residency rights for highly-skilled expats, as well as allowing full foreign ownership of companies, will help with Qatar's longer-term efforts to become a knowledge-based and diversified economy.

SELECTED ECONOMIC INDICATORS	2011	2012	2013	2014	2015	2016	2017	2018e	2019f	2020f
Nominal GDP, \$ billion	168	187	199	206	162	162	167	181	190	200
Real GDP, % change	12.9	5.3	4.5	4.0	3.9	2.1	1.6	2.3	2.7	3.0
Hydrocarbon ¹	15.0	1.2	0.1	-0.6	-0.5	-1.0	-1.1	..	..	..
Non-hydrocarbon ¹	11.0	9.9	10.4	9.8	8.2	5.6	4.2	..	..	..
CPI Inflation Rate, average, %	1.9	1.9	3.1	3.1	1.9	2.9	0.4	2.0	3.8	2.2
Government Revenues, % GDP	34.0	39.6	46.8	44.8	44.3	28.7	31.5	33.3	33.0	32.1
Government Expenditures, % GDP	29.9	31.2	33.9	32.2	42.9	33.4	33.1	31.0	30.1	29.2
Fiscal Balance, % GDP	4.1	8.3	13.0	12.6	1.4	-4.7	-1.6	2.3	2.9	2.9
General Government Gross Debt, % GDP ²	33.5	32.1	30.9	24.9	35.5	46.7	53.8	53.4	48.7	44.8
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % change	52.7	16.2	0.3	-5.0	-39.0	-20.0	5.0	-2.3	0.5	-0.9
Merchandise Imports, % change	28.6	14.3	2.2	-1.0	-8.5	8.0	-0.3	3.5	4.4	4.5
Current Account, % GDP	30.9	33.2	30.4	23.9	8.5	-5.4	3.6	7.4	7.6	7.9
Official Reserves, \$ billion ³	16.2	32.5	41.6	42.7	36.5	30.8	13.8	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon sector, % GDP ¹	60.1	58.1	55.7	53.2	51.1	49.5	48.4	..	..	..
Hydrocarbon revenue, % of total revenue ¹	81.3	77.1	92.4	87.7	93.0	82.4	82.7	..	..	..
Hydrocarbon exports, % total exports ⁴	91.5	91.3	90.7	89.7	86.5	83.2	85.7	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, "Macro Poverty Outlook, October 2018", unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2018.

3/ IMF, International Financial Statistics.

4/ U.N. Comtrade.

SAUDI ARABIA

Economic activity is recovering from a mild contraction in 2017, driven by higher oil production and rising consumer spending. The implementation of Saudi Arabia's structural reform program is starting to show early results. A quota-based policy for Saudi nationals has shown positive results in terms of increasing participation of Saudi nationals, including women, in the workforce, though many outgoing expatriate workers are yet to be replaced by nationals. Non-oil revenues picked up in 2018 as the authorities rolled out a 5 percent Value Added Tax (VAT) and levied excise duties on some products and levies on foreign workers. With the oil price currently trading above US\$70/bbl, compared to reference price estimates in the low US\$60/bbl range, budget balance is likely to be achieved ahead of the 2023 target. GDP is expected to grow by just over 2 percent, driven by higher oil production, increased non-oil exports and strong domestic demand. External accounts are expected to also strengthen further along with oil prices and production and register a current account surplus. Going forward, a key challenge relates to the provision of adequate labor to support sustained growth. Reforms will be needed to reduce the reservation wage for nationals as well as to better manage foreign labor admission and mobility across sectors. Finally, increasing oil prices could risk slowing the pace and depth of reform efforts. Hence, sustained political and social support for reforms will be critical for the successful implementation of Vision 2030.

SELECTED ECONOMIC INDICATORS	2011	2012	2013	2014	2015	2016	2017	2018e	2019f	2020f
Nominal GDP, \$ billion	671	736	747	756	654	645	687	805	869	941
Real GDP, % change	10.0	5.4	2.7	3.7	4.1	1.7	-0.9	2.0	2.1	2.2
Hydrocarbon ¹	12.2	5.1	-1.6	2.1	5.3	3.6	-3.1	..	..	..
Non-hydrocarbon ¹	8.2	5.5	6.4	4.9	3.2	0.2	1.1	..	..	..
CPI Inflation Rate, average, %	5.8	2.9	3.5	2.7	2.2	3.5	-0.2	3.7	2.0	2.2
Government Revenues, % GDP	44.4	45.1	41.2	36.7	25.0	21.5	26.9	30.5	31.0	30.9
Government Expenditures, % GDP	32.8	33.2	35.5	40.2	40.8	38.7	35.9	34.5	32.9	31.3
Fiscal Balance, % GDP	11.6	11.9	5.6	-3.5	-15.8	-17.2	-9.0	-4.1	-1.9	-0.5
General Government Gross Debt, % GDP ²	5.4	3.0	2.1	1.6	5.8	13.1	17.2	19.4	20.4	21.2
General Government Net Debt, % GDP ²	-37.7	-47.7	-50.9	-47.1	-35.9	-17.1	-7.7	-0.6	1.1	2.3
Merchandise Exports, % change	45.2	6.5	-3.2	-8.9	-40.6	-9.8	17.1	-0.9	-20.2	-27.8
Merchandise Imports, % change	23.1	18.2	8.1	3.3	0.5	-19.7	7.0	3.4	6.5	6.6
Current Account, % GDP	23.6	22.4	18.1	9.8	-8.7	-3.7	0.0	9.8	9.7	9.5
Official Reserves, \$ billion ³	540.7	656.5	725.3	731.9	616.0	535.4	496.0	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon sector, % GDP ¹	45.7	45.6	43.7	43.0	43.5	44.3	43.3	..	..	..
Hydrocarbon revenue, % of total revenue ¹	92.6	91.8	89.8	87.8	72.8	64.2	63.0	..	..	..
Hydrocarbon exports, % total exports ⁴	85.8	86.3	85.5	83.8	73.5	73.3	77.2	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, "Macro Poverty Outlook, October 2018", unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2018.

3/ IMF, International Financial Statistics.

4/ U.N. Comtrade.

UNITED ARAB EMIRATES

GDP growth slowed to 0.8 percent in 2017 due largely to the OPEC+ agreement to cut oil production. However, the recovery in oil prices and the effects of non-oil tax reforms implemented since 2015 have helped reduce the fiscal deficit in 2017, while a pickup in non-oil exports further improved the current account surplus to reach 4.7 percent of GDP. The federal government resumed with reforms to attract talent and FDI in 2018, including reducing costs associated with hiring expatriates and an overhaul of the visa requirements for skilled foreign workers, as well as announcing its intention to allow 100 percent ownership of companies for non-GCC nationals. The economic outlook remains positive, with growth projected to reach 3.2 percent by 2020 with the unwinding of the OPEC+ agreement, a planned government stimulus package and impetus from the Dubai Expo 2020. The real estate market may continue to face headwinds in the medium term due to an oversupply and a tapering of expatriate population growth. The fiscal deficit is expected to reach close to balance by 2020 with further strengthening of oil prices and increased non-oil revenue from the new VAT and excise taxes. The main policy concerns relate to the UAE's ability to further deepen its education and labor market reforms to generate productivity gains, especially for nationals and in previously sheltered sectors. Additionally, manufacturing, trade, transport and tourism dynamics continue to be influenced by global and regional developments, which remain subject to uncertainty. Coping with these dynamics requires a combination of flexible markets/policies and fiscal buffers.

SELECTED ECONOMIC INDICATORS	2011	2012	2013	2014	2015	2016	2017	2018e	2019f	2020f
Nominal GDP, \$ billion	351	375	390	403	358	357	383	412	428	447
Real GDP, % change	6.9	4.5	5.1	4.4	5.1	3.0	0.8	2.0	3.0	3.2
Hydrocarbon ¹	11.7	4.8	3.1	0.1	5.2	2.6	-3.0	..	..	..
Non-hydrocarbon ¹	4.7	4.3	5.9	6.4	5.0	3.2	2.5	..	..	..
CPI Inflation Rate, average, %	0.9	0.7	1.1	2.4	4.1	1.6	2.0	4.2	2.5	2.5
Government Revenues, % GDP	37.5	40.0	40.7	35.0	29.0	29.1	29.9	29.6	29.2	28.3
Government Expenditures, % GDP	32.1	31.0	32.3	33.1	32.5	31.6	31.6	31.0	30.1	28.8
Fiscal Balance, % GDP	5.3	8.9	8.4	1.9	-3.5	-2.4	-1.8	-1.4	-0.8	-0.5
General Government Gross Debt, % GDP ²	17.4	17.0	15.8	15.5	18.7	20.2	19.7	17.8	17.6	17.5
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % change	41.4	19.1	3.2	-7.6	-12.4	-1.8	4.6	11.7	3.5	3.0
Merchandise Imports, % change	18.8	11.6	5.8	1.6	-4.6	1.2	1.2	8.0	5.0	7.0
Current Account, % GDP	12.6	19.7	19.0	13.5	4.9	1.4	4.6	5.3	5.1	4.4
Official Reserves, \$ billion ³	37.3	47.0	68.2	78.4	93.7	85.1	95.1	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon sector, % GDP ¹	32.5	32.6	32.0	30.7	30.8	30.6	29.5	..	..	..
Hydrocarbon revenue, % of total revenue ¹	69.1	67.7	63.6	62.9	45.3	22.8	34.5	..	..	..
Hydrocarbon exports, % total exports ⁴	59.4	61.0	62.7	63.9	52.4	44.3	50.2	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, "Macro Poverty Outlook, October 2018", unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2018.

3/ IMF, International Financial Statistics.

4/ U.N. Comtrade.

COMMODITY PRICES TABLES

NOMINAL US DOLLARS

ENERGY	Unit	2014	2015	2016	2017	2018e	2019f	2020f	2025f	2030f
Coal, Australia	\$/mt	70.1	58.9	66.1	88.5	108.0	100.0	90.0	73.5	60.0
Crude oil, average	\$/bbl	96.2	50.8	42.8	52.8	72.0	74.0	69.0	64.3	60.0
Natural gas, Europe	\$/mmbtu	10.1	7.3	4.6	5.6	8.0	7.5	7.0	7.5	8.0
Natural gas, U.S.	\$/mmbtu	4.4	2.6	2.5	3.0	2.9	2.7	2.7	3.3	4.0
Natural gas LNG, Japan	\$/mmbtu	16.0	10.9	7.4	8.6	10.0	9.7	8.5	9.8	10.0

Source: World Bank Group, "Commodity Markets Outlook", October 2018.

Notes: e = estimate, f = forecast.

CONSTANT US DOLLARS, 2010=100

ENERGY	Unit	2014	2015	2016	2017	2018e	2019f	2020f	2025f	2030f
Coal, Australia	\$/mt	64.8	60.2	70.3	91.0	111.9	101.6	89.9	67.3	50.3
Crude oil, average	\$/bbl	88.9	51.9	45.5	54.3	74.6	75.2	68.9	59.0	50.3
Natural gas, Europe	\$/mmbtu	9.3	7.4	4.8	5.8	8.3	7.6	7.0	6.9	6.7
Natural gas, U.S.	\$/mmbtu	4.0	2.7	2.7	3.0	3.0	2.7	2.7	3.0	3.4
Natural gas LNG, Japan	\$/mmbtu	14.8	11.2	7.8	8.8	10.4	9.9	8.5	9.0	8.4

Source: World Bank Group, "Commodity Markets Outlook", October 2018.

Notes: e = estimate, f = forecast.

OIL PRODUCTION TABLE

CRUDE OIL PRODUCTION

Unit 1000b/day	2012	2013	2014	2015	2016	2017	Q1-18	Q2-18	Jul-18	Aug-18
Bahrain	0.17	0.20	0.20	0.20	0.20	0.20	0.17	0.21	0.21	..
Kuwait	2.46	2.55	2.59	2.75	2.88	2.71	2.70	2.71	2.80	2.83
Oman	0.92	0.95	0.94	0.98	1.01	0.98	0.97	0.98	0.98	0.98
Qatar	0.74	0.73	0.70	0.65	0.65	0.61	0.60	0.61	0.62	0.62
Saudi Arabia	9.51	9.40	9.53	10.12	10.42	9.96	9.95	10.14	10.35	10.42
United Arab Emirates	2.65	2.76	2.77	2.93	3.05	2.93	2.84	2.88	2.98	2.98

Sources: International Energy Agency, "Oil Market Report", September 2018, and Joint Organizations Data Initiative, Oil World Database.



Interview with

Carmen Nonay

MENA Practice Manager,
World Bank Group

What, in your view, are the key water challenges in the GCC countries?

First of all, I would like to emphasize that the GCC countries have the highest levels of water stress in the world. These stress levels rise when water withdrawals for human, agricultural, and industrial uses are higher than the level of renewable water resources. In all the GCC countries, water withdrawals are more than 95 percent of available surface freshwater. Furthermore, domestic water consumption for GCC residents is almost twice the consumption for those of other high-income countries. This high consumption relates in part to disincentives to use water wisely, such as low water tariffs, lack of metering, and lack of water-saving devices. Moving away from high levels of water consumption can potentially free up water to meet projected demands and thereby also potentially avoid or defer expensive supply-side investments. There's room for improvement, because countries with similar levels of development and much greater freshwater resource endowments have much lower levels of per capita water consumption.

I think it is important to note an additional challenge related to water security in the GCC: namely, heavy reliance on the energy sector for water production, treatment, and conveyance, as well as wastewater treatment and distribution. In the GCC countries, this challenge is compounded by the scarcity of freshwater resource endowment and heavy dependency on energy-intensive water desalination.

Another challenge that undercuts water security is that water tariffs are very low in some GCC countries. For example, high-income GCC domestic water users pay less for their household water than high-income citizens of Paris, Barcelona, and London. Overall, the Middle East and North Africa region spends a higher proportion of GDP (about 2 percent) on water subsidies than any other region.

In addition to low water tariffs that do not encourage good management, nonrevenue water also presents a challenge to the sustainability of the water service delivery model in the GCC countries. Nonrevenue water is water that has been produced and is 'lost' before it reaches the customer, through leaks, theft, or legal use with no payment. Levels of nonrevenue water can be reduced using appropriate management and technical actions. The 'retrieved' water can then be used to meet increasing demands, deferring investments in expensive supply-side options.

Finally, climate change will have significant effects on the water sector, accentuating shortages in already water-scarce regions, and, in combination with bad water management practices, contributing to slower growth. Indeed, we estimate at the World Bank that water scarcity related to climate change might lead to 6 to 14 percent reductions in annual GDP growth in the MENA region. Climate change is also associated with higher risks of coastal flooding and more extreme rainfall events.

How challenging do you think it will be to achieve water security in a water-scarce region?

Well, in our view, water security does not need to be expensive or rely on nonrenewable energy sources. Innovation in technology

and management creates opportunities to reduce the costs of water supply. New water recycling and desalination technologies may lead to significant cost reductions. One example is the cutting-edge technology for water desalination using solar power, which is an untapped renewable energy opportunity. Recycled water is also part of the solution to closing the supply-demand gap. As urban water demand rises with population expansion, the volume of wastewater will also increase. Even if some GCC countries collect more than half of their wastewater, they recycle only half of this collected wastewater, losing opportunities to create additional much needed water supply.

So, what can be done to achieve water security?

First, the effective management of water resources is critical to water security. The key dimensions of this relate to managing supplies in a cost-efficient manner amid uncertainties (such as rainfall and groundwater), managing demand (due to with increasing population), and managing the cost of energy (such as costs of desalination). Governments can pull a number of levers to achieve these objectives, including diversifying water supplies, improving water storage, and planning for contingencies. Data to inform policies will be a critical input into better water management. However, such data are often lacking, and to fill this gap, policy makers should prioritize structured assessments of the availability, quality and use of water and other water metrics, as well as how these variables might change over time (e.g. due to population growth, or climate change).

Second, it will be important to put in place the right set of incentives—in particular arrangements to manage water withdrawals. This will require strengthening governance arrangements for surface and groundwater resources that would set out the implicit and explicit rights and expectations for water withdrawals and collective management. As the *In Focus* section discusses, the Om Er Rbia River Basin Agency in Morocco is a good example of such efforts: the agency regulates the management of over-exploited aquifers through agreements among stakeholders on the use of groundwater.

Third, I want to emphasize that we definitely see signs of positive change in the GCC. In particular, there is more private sector involvement emerging, while institutional roles are also realigning. To ensure better outcomes for users, this realignment needs to focus on accountability and financial sustainability, while also clearly defining institutional roles and performance indicators. Cost recovery—which is needed to anchor financial sustainability and incentivize long term investment—is still a challenge in some GCC countries, although reforms in this area have begun.

Finally, as we discuss in the *In Focus* section, policy makers also need to pay attention to the regulatory and oversight functions required to ensure successful private sector engagement. This has hitherto been overlooked, but is a crucial element in ensuring that private sector providers provide quality services for users.

In focus

Water for prosperity and development

This Special Focus summarizes emerging challenges and opportunities for the water sector in the Gulf Cooperation Council (GCC) countries and suggests ways to respond to these challenges in the context of growing climate change and demographic pressures. GCC countries are characterized by high levels of water stress, some of the highest levels of water consumption in the world and dependence on energy-intensive water desalination. At the same time, there is scope to improve the delivery of water services. Following a description of the GCC's water resources and water service delivery challenges, two sets of recommendations and related actions are discussed. The first set relates to managing a diverse set of conventional and nonconventional water resources for security and sustainability. The second set of recommendations is linked to delivering better water services with accountability and financial sustainability.

The GCC countries' water challenges

Water stress and groundwater depletion

The GCC countries have the highest levels of water stress in the world. Water stress arises when water withdrawals for human, agricultural, and industrial uses are higher than the level of renewable water resources—that is, a high water withdrawal-to-availability ratio. In all the GCC countries, water withdrawals are more than 95% of surface freshwater availability, as shown in Figure 59. This indicates greater competition for limited

freshwater resources, the need to augment supplies with nonconventional sources, and in most cases, unsustainable use of freshwater resources.

The share of unsustainable groundwater use in the GCC countries is the highest in the world. The GCC countries are a global hotspot for unsustainable groundwater abstraction (Wada and Bierkens 2014). Unsustainable groundwater abstraction arises when the rate of groundwater pumping exceeds the rate at which groundwater is naturally recharged. If the groundwater balance of a country is compared with a bank account, then unsustainable groundwater use is equivalent to the withdrawal of money faster than it is deposited. In some GCC countries, almost all groundwater abstraction is unsustainable, as shown in Figure 60. When groundwater resources are abstracted faster than they are replenished, the quality of the remaining groundwater decreases, and the resource eventually becomes depleted, thus posing a major risk to the GCC countries.

Domestic water consumption for GCC residents is almost twice the consumption for residents of other high-income countries. Countries with similar levels of development and much greater freshwater resource endowments have much lower levels of residential water consumption (PwC 2014). This high consumption is due in part to disincentives to use water wisely, such as low water tariffs, lack of metering, and lack of water-saving devices. Reducing high residential water consumption can potentially free up water to meet projected demands, allowing for the deferral of expensive supply-side investments.

The water-energy nexus and emerging solutions to close the water supply-demand gap

GCC countries rely on the energy sector for their water security. Water production, treatment, and conveyance, as well as wastewater treatment and distribution, require energy. In the GCC countries, given the scarce freshwater resource endowment and heavy dependency on energy-intensive water desalination, the water sector is heavily dependent on energy. As such, any policy affecting energy allocation and consumption, including subsidies, will distort how water is allocated, managed, and eventually used. This highlights the need for integrated water and energy sector strategies.

The GCC countries account for about half of the world’s installed desalination capacity (Global Water Intelligence 2016). The GCC countries top world rankings for energy consumed in desalination (Figure 61). Low energy prices and technology improvements, which have lowered plant operational costs, have in part enabled the steady growth of desalination. Desalination and wastewater reuse offer the potential for highly reliable water supplies independent of the effects of climate change. These technologies are appealing because they provide a “drought-proof” supply source, essentially allowing countries to break free from natural physical water scarcity. However, beyond the cost of the actual desalination technologies, costs per cubic meter of water delivered depend on a range of factors such as salinity levels, energy prices, and water subsidies. Approximately half the costs of desalination consist of energy costs, which, given the volatility of the energy market, adds considerable challenges to the future of desalination relying on nonrenewable fossil fuels in the Middle East and North Africa (World Bank 2012).

Long-term effects of desalination need to be taken into account. Desalination costs and feasibility depend on the quality of seawater at the intakes. Excessive brine discharge or lack of wastewater treatment complicate desalination processes, increasing costs and forcing plants to shut down occasionally. Brine discharge from desalination plants significantly degrades the water and salt mass balances of receiving water bodies. In the Arabian Gulf, brine discharge from desalination plants increases ambient seawater salinity by about 20 percent. This can have long-term negative impacts on the environment and on the desalination process itself. Negative environmental impacts can occur where brine is discharged close to vulnerable aquatic ecosystems. Vulnerable aquatic ecosystems include shallow seas with little circulation and abundant marine biodiversity. Open-sea and high-energy marine environments tend to be less sensitive to changes in salt mass balances because of the faster mixing of the waters. Brine discharge can also have detrimental effects on the desalination process itself. The salinity concentrations of Red Sea and Arabian Gulf waters have increased due to desalination. As a result, desalination plants produce less potable water for the same amount of energy input. This raises the cost of desalination (Bashitialshaeer, Persson, and Aljaradin 2011; Dawoud and Al Mulla 2012).

FIGURE 59

Water stress Water withdrawals as % surface freshwater availability

Source: World Bank 2017a.

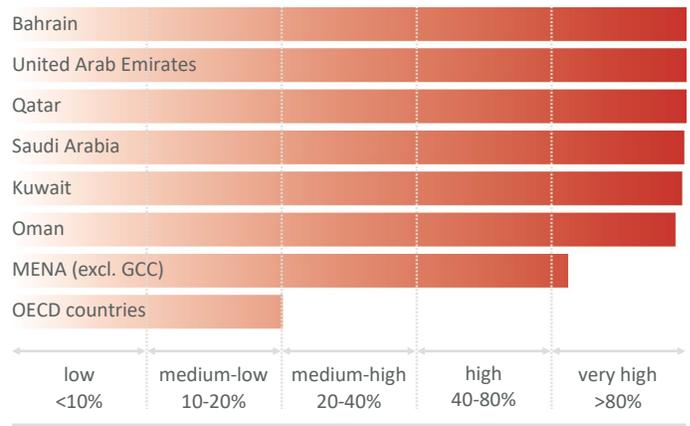


FIGURE 60

Groundwater depletion Share of groundwater abstraction that exceeds natural recharge

Source: World Bank 2017a, Note: *excluding GCC.

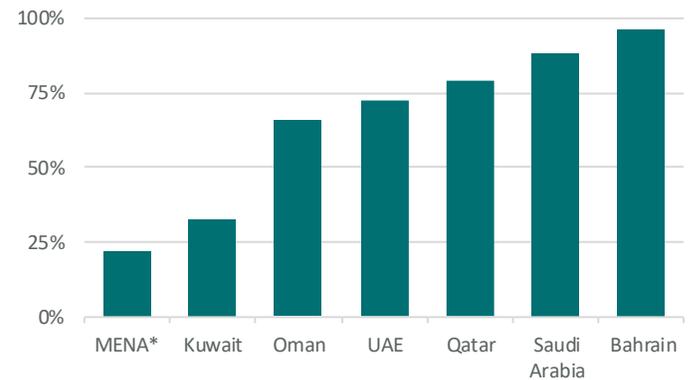


FIGURE 61

Energy demand for desalination and water reuse Mtoe (million tonne of oil equivalent)

Source: World Bank 2017b using Global Water Intelligence data.

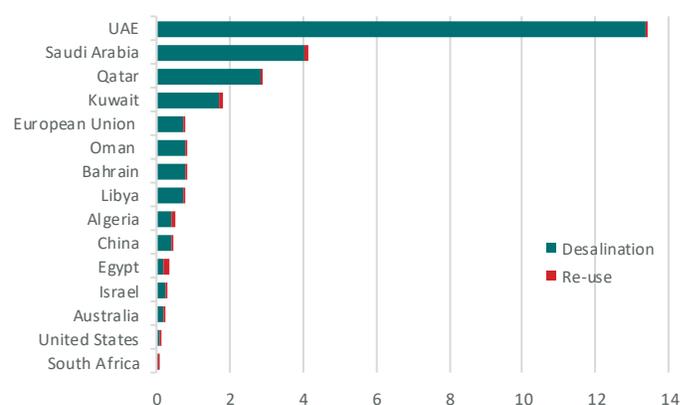


TABLE 1

Overview of desalination technologies widely used in the Middle East and North Africa region and their costs

Source: World Bank 2017b.

Note: O&M, operations and maintenance; RO, reverse osmosis; TDS, total dissolved solids; MSF, multi-stage flash distillation.

Item	Multiple stage flash	Multiple effect distillation - thermal vacuum compressor	Seawater RO (Arabian Gulf)	Hybrid
Capital costs (US\$ million /million liters per day)	<ul style="list-style-type: none"> • Range: 1.7–3.1 • Average: 2.1 	<ul style="list-style-type: none"> • Range: 1.2–2.3 • Average: 1.4 	<ul style="list-style-type: none"> • Range: 1.2–1.8 • Average: 1.5 	<ul style="list-style-type: none"> • Range: 1.5–2.2 • Average: 1.8
O&M costs (US\$/m ³)	<ul style="list-style-type: none"> • Range: 0.22–0.30 • Average: 0.26 	<ul style="list-style-type: none"> • Range: 0.11–0.25 • Average: 0.14 	<ul style="list-style-type: none"> • Range: 0.36–1.01 • Average: 0.64 	<ul style="list-style-type: none"> • Range: 0.14–0.25 • Average: 0.23
Cost of water production (US\$/m ³)	<ul style="list-style-type: none"> • Range: 1.02–1.74 • Average: 1.44 	<ul style="list-style-type: none"> • Range: 1.12–1.50 • Average: 1.39 	<ul style="list-style-type: none"> • Range: 0.96–1.92 • Average: 1.35 	<ul style="list-style-type: none"> • Range: 0.95–1.3 • Average: 1.15
Key advantages	<ul style="list-style-type: none"> • Simplest to operate • Lowest O&M costs • More cost-effective than RO for seawater with TDS > 46 parts per thousand • Low TDS and boron product water • Source water quality has limited effect on performance 	<ul style="list-style-type: none"> • Lower energy demand than MSF • Uses less chemicals than MSF and RO • Cost of water comparable with RO for large plants • Low TDS and boron product water 	<ul style="list-style-type: none"> • No need for steam • Lowest total energy use • Lowest capital and water production costs • Discharge does not create thermal pollution 	<ul style="list-style-type: none"> • Lower capital costs • Lowest RO energy use • Lowest RO production cost • Second-pass RO system not needed
Key disadvantages	<ul style="list-style-type: none"> • Highest energy use • Highest thermal discharge footprint 	<ul style="list-style-type: none"> • More complex to operate than MSF • Higher energy use than RO 	<ul style="list-style-type: none"> • Highest O&M costs • Most complex operation • Reliability sensitive to source water quality 	<ul style="list-style-type: none"> • Most complex desalination plant configuration

Water security does not need to be expensive or rely on nonrenewable energy sources. Technological and management innovation offers opportunities to reduce the costs of water supply. Emerging water recycling and desalination technologies could lead to significant cost reductions, yet choosing the best technology option is challenging. Some of these technologies are listed in Table 1 and include multi-effect distillation, hybrid desalination systems, nano-membranes, adsorption, and electrochemical desalination.

Leapfrogging to cutting-edge technology for water desalination using solar power is another renewable energy opportunity that remains untapped. Desalination powered by solar energy will not only ensure affordable, sustainable, and secure freshwater supply, but will also help increase the capacity for new industrial and farming activities and reduce domestic gas consumption for water production (World Bank 2012).

Two key pillars of a long-term desalination infrastructure strategy are emerging—adopting more-energy-efficient desalination technologies, such as reverse osmosis, and transitioning to alternate energy fuels, such as solar. Solar photovoltaic technology can be used for membrane-based reverse osmosis desalination. Reverse osmosis is the preferred desalination

technology in other parts of the world. Potable water supplies in Singapore and parts of Spain, Australia, and the United States rely primarily on reverse osmosis (World Bank 2017b).

Recycled water is also part of the solution to closing the supply-demand gap. As urban water demand grows in response to population expansion, the volume of wastewater will also increase. Traditionally, the public sector collected all wastewater and treated and recycled or disposed of it, normally in the sea. The growing trend in the world’s arid regions is for some users to retain their wastewater, treat and recycle it, and use it internally for industrial processing and landscaping. The recycled wastewater subsector is the most challenging given the magnitude of the problems needing resolution, the work that needs to be done, and the costs of doing it. Figure 62 shows the level of wastewater collection in the GCC countries and the level of treated wastewater that is recycled. Although some GCC countries collect more than half of their wastewater, they recycle only half of this collected wastewater, missing the opportunity to create additional water supply.

Another alternative and possibly lower cost option to augment water supplies is to use groundwater aquifers as reservoirs. This water management solution, often referred to as

managed aquifer recharge², could significantly improve water security by increasing water storage capacity, which is currently very low in the GCC countries (Figure 63). Water policy innovations are needed for managed aquifer recharge to work. First, conjunctive use planning of recycled water and groundwater resources needs to be in place. Second, regulation of groundwater use and groundwater and associated land zoning, as appropriate, are needed to establish a groundwater reserve and ensure that groundwater resources remain pollution free. For managed aquifer recharge to become part of the solution, groundwater needs to be abstracted at sustainable levels.

In the context of a highly subsidized supply of gas for power generation and low consumer tariffs, it will continue to be difficult for solar-based desalination, wastewater recycling, and managed aquifer recharge options to compete with fossil fuel-based desalination options. A detailed strategic plan with dated targets and an approved list of incentives, including auction or feed-in tariff-based policies, priority in dispatch, and other conditions, may be needed to attract more participation and investments from the private sector.

Water service delivery and financing

Despite this challenging water resource situation, water tariffs are very low in some GCC countries. Low water tariffs indicate that water utilities have very low cost recoveries and rely on government subsidies to finance their operations. For example, high-income GCC domestic water users pay less for their household water than high-income citizens of Paris, Barcelona, and London (Figure 64). The difference is even more striking between the GCC countries, with water users in Abu Dhabi paying about 50 times as much as water users in Riyadh, as shown in Figure 64. Overall, the Middle East and North Africa (MENA) region spends a higher proportion of gross domestic product (about 2%) on water subsidies than any other region in the world (Kochhar et al. 2015).

High water subsidies and low water tariffs undermine incentives for efficient water use and encourage over-exploitation. Part of the water challenge in the GCC countries lies in managing demand and putting the right water-saving incentives in place. The GCC countries are reported to have the greatest domestic per capita water consumption in the world, as analysis of national domestic per capita consumption suggests (Figure 65). These are politically sensitive issues, yet it is essential that they be addressed to improve water service delivery and water resource productivity. The more energy and water are subsidized, the higher the demand is as their true cost is externalized.

Nonrevenue water also challenges the sustainability of the water service delivery model in the GCC countries. Levels

2/ Managed aquifer recharge consists of intentionally recharging aquifers (e.g., via pumping or infiltration basins), which can be done for different purposes: storing water and preventing evaporative losses, improving water quality, sustaining groundwater levels.

FIGURE 62

Collected and recycled wastewater Percentage of wastewater produced

Source: World Bank 2017b.

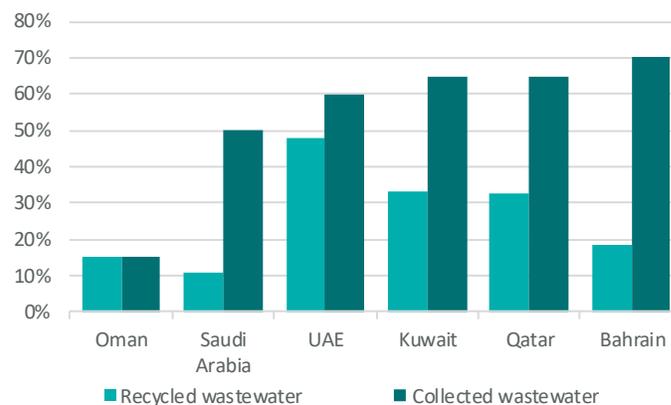


FIGURE 63

Dam capacity per capita m3/inhabitant

Source: Haver Analytics.

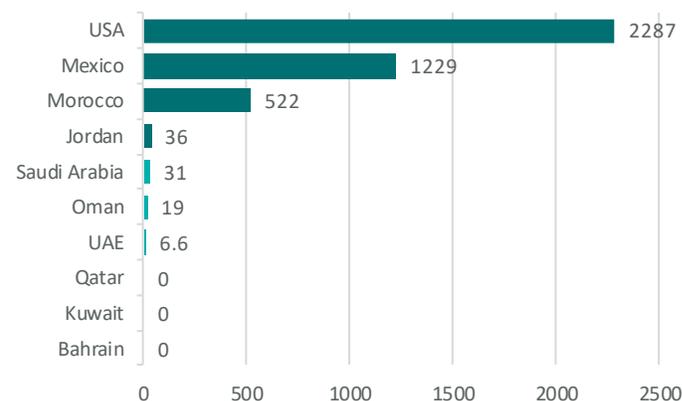


FIGURE 64

Combined water and wastewater bill in selected cities USD per m3

Source: Global Water Intelligence Water Tariff Survey 2016 using exchange rates on July 1, 2016. Note: average water use varies according to household size and water utility and is here assumed to be 15 cubic meters per month.

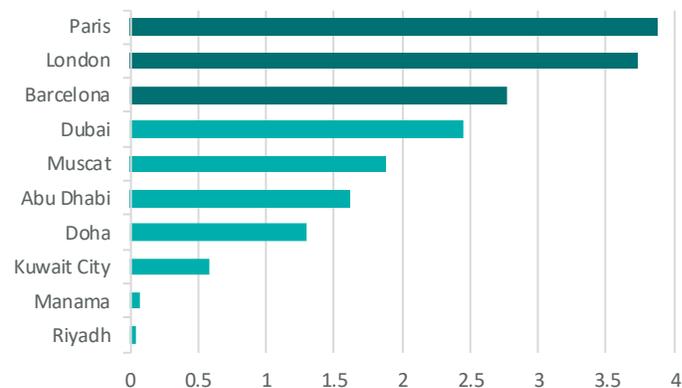
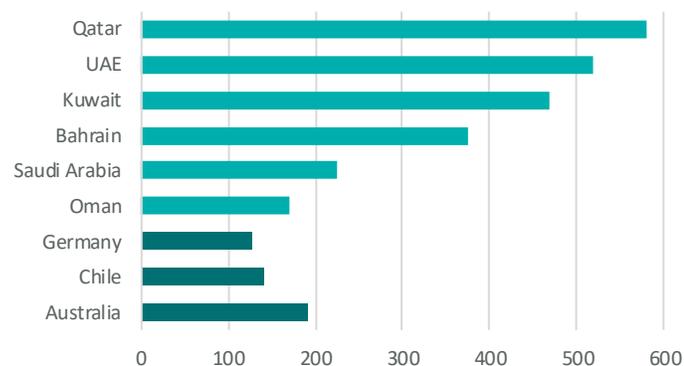


FIGURE 65

Domestic water consumption

Litres/person/day

Source: Al Zubari 2017 for the GCC countries, International Benchmarking Network for Water and Sanitation Utilities for Australia and Chile, and Environment Agency for Germany. Note: Estimates should be used with caution because domestic consumption is defined and calculated in different ways from country to country and between different water suppliers in the same country.



of nonrevenue water³ in some GCC countries stand well above median values for other high-income countries (Figure 66). High levels of nonrevenue water can be reduced using appropriate management and technical actions. The “retrieved” water can then be used to meet increasing demands, deferring investments in expensive supply-side options.

Demographic growth, climate change, and fiscal challenges

Investments in infrastructure and reforms are required to address demographic growth, climate change, and other uncertainties such as energy prices. Projected increases in water demand from population growth, especially in urban areas, could lead to further unregulated exploitation of groundwater resources. Demographic growth will raise supply costs and costs to collect and treat wastewater, posing fiscal challenges.

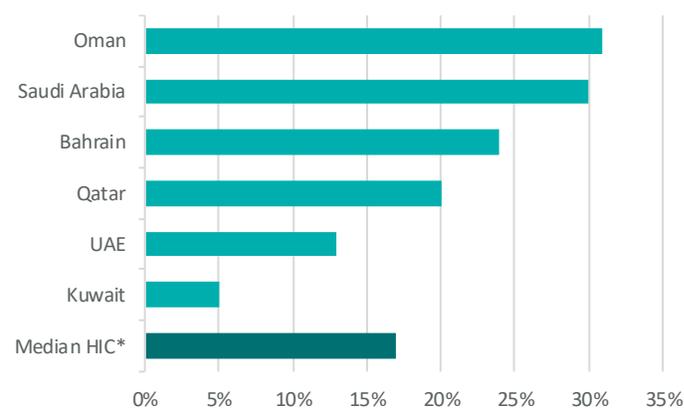
Climate change effects on the water sector are going to be significant. The World Bank estimates that water scarcity related to climate change might lead to 6-14 percent reductions in annual GDP growth in the region (World Bank 2016). Climate change will bring about higher temperatures, leading to increased water requirements for agriculture. It will also increase coastal flood risk and cause more extreme rainfall events (Verner 2012), leading to flash floods, such as the 2009 floods in Jeddah, Saudi Arabia, which brought losses of US\$1.36 billion (World Bank 2014). All these effects will pose additional challenges to the planning and operation of water systems, requiring novel management and decision-making tools to support water sector investments in the face of climate change.

3/ Nonrevenue water is water that has been produced and is “lost” before it reaches the customer (through leaks, theft, or legal use for which no payment is made).

FIGURE 66

Nonrevenue water in the GCC and high-income countries (HIC) rates

Source: PwC 2014 and International Benchmarking Network for Water and Sanitation Utilities.



Taking the water security agenda forward

Managing a diverse set of conventional and non-conventional water resources for security and sustainability

Managing water resources in a cost-efficient, resilient way is a key element of water security. Water resource management aims to provide reliable supplies amid uncertainties related to supply availability (rainfall, groundwater), demand (increasing population), and energy (costs of desalination) at a reasonable cost. Different measures exist to achieve these objectives, including diversification of water supplies, storage, and contingency planning. Identifying the most cost-effective and resilient water management strategy requires understanding the extent to which data and information, on water and economic variables, are available and the extent to which governance, incentives, and institutions are aligned to make change happen.

One of the big challenges of water management in the GCC is the availability of data to inform policies. Data on water-related variables, such as availability and use, and economic-related variables, such as cost of option, are often lacking. Effective assessment of the availability, in quantity and quality, and use of water resources is a first step toward achieving sustainable water resource management. This includes monitoring of surface and groundwater resources, actual rates of water use, and wastewater and effluent discharges. It also includes assessing how these water-related variables might change in the future as a result of increasing population, food security concerns, or climate change and developing responses that are proportionate to these changes (Box 1).

Economic and financial assessments are key to sustainable water resources management. Water supply options are often

BOX 1

Confronting uncertainty in water-related projects

The World Bank has developed a practical risk-based tool for the management of climate risks in water projects. This tool, the Decision Tree Framework, provides resource-limited project planners and program managers with a cost-effective, effort-efficient, scientifically defensible, repeatable, and clear method for demonstrating the resilience of a project to climate change. The framework adopts a “bottom-up” approach to risk assessment that aims at a thorough understanding of a project’s vulnerabilities to climate change in the context of other nonclimate uncertainties (e.g., economic, environmental, demographic, political). The framework helps to identify projects that perform well across a wide range of potential future climate conditions, as opposed to seeking solutions that are optimal in expected conditions but vulnerable to conditions deviating from the expected.

selected without considering cheaper alternatives, leading to financially unsustainable and economically costly outcomes. Water resource planning needs to transparently account for economic and financial costs when comparing options. This includes costing a range of supply-side and demand-side options, in particular for nonconventional supplies such as desalination and wastewater reuse. Fully exploiting wastewater reuse means gaining a full picture of the costs and benefits, identifying potential uses, and accounting for the benefits of improved treatment in terms of water quality.

In addition, institutional coordination is needed to develop consensus and implement policies for sustainable water resources management. Global experience shows that, to achieve water management objectives, mechanisms to develop consensus across sectors and geographic jurisdictions need to be in place. This is especially important when shifts in intersectoral water allocation are being planned, requiring an understanding of the relationships between the objectives of the water sector and the priorities of the other sectors.

Reflecting this, policy makers around the world have begun to accord much greater priority to water resource management and institutional coordination, through the preparation of comprehensive water sector strategies, as part of efforts to preserve and better manage water resources. Key elements of these strategies have included improved coordination between institutions tasked with delivering water services (water utilities, irrigation authorities) and those tasked with managing and allocating water resources (river basin authorities) and increased integration with energy and agricultural policies. For instance, in Tunisia the government has adopted a water sector policy aimed at rationalizing the use of water and modernizing water

The tool has been used to help Lima, Peru’s water utility (SEDAPAL) plan for the future. The World Bank has recently completed a comprehensive study of SEDAPAL’s \$2.7 billion master plan for water resources to 2040. In spite of SEDAPAL’s Master Plan, key questions remained. Could the proposed investments ensure reliability in the face of climate change and population uncertainties? Are they all required? What if there are delays? What is the best sequence so that investments ensure both “no regrets” and maximum future adaptability?

The study helped SEDAPAL revise its Master Plan of 14 large-scale investments by identifying projects that it can embark upon now, while preparing future actions adaptively as conditions evolve. When the World Bank team analyzed the 14 projects, they found that investments representing 75 percent of the proposed cost of the Master Plan (\$2.0 billion) met water reliability targets just as much as the full \$2.7 billion plan. More capital investment did not improve reliability. The study saved the city over \$600 million.

supply and sanitation networks. In Tunisia, the World Bank has provided technical assistance and financial support for a range of water-related projects: renewal of water supply infrastructure, making better decisions relating to integrated water resources management, and providing environmentally safe recycling for wastewater. As a result, Tunisia has achieved one of the highest rates of improvement in access to water supply and sanitation among middle-income countries and, more importantly, has managed to maintain these achievements in the face of growing demands. The World Bank has significant global experience in improving intersectoral coordination and supporting intersectoral reforms. In Morocco, the recently merged government-owned water and power utility has sought to identify synergies and evaluate tradeoffs between energy and water resource planning (see World Bank 2018f). In China, in collaboration with the World Bank energy and water teams, the National Energy Agency has incorporated potential water constraints in their 5-year energy plan (2016-2020).

A water sector strategy will be useful not only to provide details on water management actions, but more importantly to coordinate the actions and decisions of the government agencies that need to work together to achieve the water sector’s objectives. For instance, achieving security of water supply requires a set of integrated, consistent decisions on water conservation, water pricing, agricultural policies, groundwater protection, use of treated sewage effluent, construction of new desalination plants, and development of strategic storage reservoirs. Thus, coordination is needed to achieve water security and improve outcomes for the people, the economy, and the environment. The World Bank has supported Brazil’s National Water Agency and the Ministries of Environment, National Integration, and Cities to develop a countrywide water sector strategy, which

focused on water resource management planning, irrigation and disaster risk management, water supply and sanitation, integrated planning, and project management and evaluation.

Water governance issues and incentives—in particular arrangements to manage water withdrawals and tools to influence intersectoral water allocations—are central elements of sustainable water management. Understanding the policy and economic tools and incentives, such as quotas and pricing, available for managing short-term adaptation and long-term shifts in water withdrawals in response to water availability helps in managing water resources for long-term sustainability. Alongside this understanding there is a need to develop governance arrangements for surface and groundwater resources in terms of implicit and explicit rights and expectations for water withdrawals and collective management. For example, in Morocco, the Om Er Rbia River Basin Agency supports regulation of the management of overexploited aquifers by facilitating agreements among stakeholders on the use of groundwater. This has led to the development of a groundwater management framework contract to define and agree on roles for groundwater use, as well as improved knowledge of climate-related risks, to be incorporated in future water resources development.

Delivering better water services with accountability and financial sustainability

In many GCC countries, how water supply and sanitation services are managed is changing. After decades of government-run utilities, institutional roles are realigning, and private actors are gradually engaging. To ensure better outcomes for users, this realignment needs to focus on accountability and financial sustainability, as well as clearly define institutional roles and sector performance indicators.

Accountability is the first element needed to deliver better water services. Accountability is a condition whereby the functional roles and responsibilities are clearly defined along the water supply chain (across the water loop from bulk water supply, storage, conveyance, treatment, delivery to water users, wastewater collection, treatment, and recycling). When areas of significant overlap or blurred responsibility exist, accountability may be diminished. This in turn worsens the customer orientation of service providers, resulting in overall poor performance and service experiences.

The second element needed to improve service delivery is financial sustainability. Lack of cost recovery is a challenge in some GCC countries, where average service costs are much greater than average service fees. Cost recovery is essential to ensure the long-term sustainability of water services and appropriate levels of investment in the operation and maintenance of water delivery systems—not just in infrastructure but also in training staff. Designing an effective tariff system helps to meet social development goals by supporting the expansion of services to underserved households. Effective tariff systems also improve overall performance by reducing utilities' dependence

on government subsidies and thus increasing their customer orientation. Global experience shows that it is possible to design multitier tariffs that moderate the effects of price increases and allow for the gradual removal of subsidies to water service providers (Vagliasindi 2013).

Achieving accountability and financial sustainability requires understanding the options available for institutional reform, including moves toward stronger private sector-led service delivery under effective public-sector oversight. As a first step, this entails identifying the priority areas of service delivery where government wishes to improve performance. Second, the alternative institutional structures available for service delivery should be considered alongside the advantages and disadvantages of different bundling and regulatory options. Third, when a model for private sector involvement has been identified, there is a need to clearly define performance targets (e.g., network reduction losses, improvement of service quality) and ascertain what is required from government to maximize the value of private contracting.

Whereas considerable attention is being paid to the role of the private sector in supporting service delivery in the GCC, the regulatory and oversight functions required to ensure successful private sector engagement have often been overlooked. Global experiences show that private sector involvement in service provision can improve utility performance and the level of service that users receive. Private sector involvement depends on the existence of the right incentives and oversight to review and reward performance, and of a formal mechanism or regulatory body capable of setting standards and holding private service providers accountable for their performance.

Whether institutional actors involved in service delivery are publicly or privately managed, performance benchmarking is needed. Benchmarking in terms of financial and quality-of-service indicators is key to identifying areas that need improvement. This calls for performance indicators that are well understood, measured, and evaluated, and for a performance assessment that is transparent and conducted by relevant institutions. In Mexico, the National Water Commission has developed and promoted the use of standardized performance indicators across the country that can be tracked and aggregated. This effort was aligned with the government's vision of reducing water sector subsidies by improving the quality of existing services through management and efficiency gains, and resulted in decreases in nonrevenue water and increases in the commercial efficiency of service providers.

Partnering with the private sector offers opportunities for improvements in service delivery, but appropriate oversight and regulatory arrangements are necessary to manage risks and ensure accountability. When countries decide to involve a private company, an open and transparent selection process and appropriate oversight arrangements are necessary to manage the private entity (Box 2). At the same time, regulatory frameworks need to be strengthened to ensure accountability and

BOX 2

Leveraging the private sector with public-private partnerships to develop nonconventional water supplies

The World Bank has global experience in leveraging financing instruments to achieve water security. These instruments include build-operate-transfer (BOT) and design-build-operate (DBO) schemes for desalination and wastewater treatment plants. Two projects illustrate this approach. One example is the New Cairo Wastewater Treatment Plant BOT scheme (2009), in which the IFC's role as transaction advisor was essential to reassure potential investors (this was the first public-private partnership (PPP) in Egypt) and design a contract that included the necessary guarantees for the project to be bankable. Another is the Red Sea–Dead Sea project, which involves the construction under a BOT scheme of a desalination plant in Aqaba, Jordan, to

provide desalinated water for Aqaba and the south of Israel (under a water trading agreement whereby Israel will provide water to the West Bank and north of Jordan), plus the construction of a pipeline between the desalination plant and the Dead Sea to carry the brine and help limit the evaporation of the Dead Sea. The Bank is providing ongoing support to the government of Jordan as the sole representative of donors in the tripartite committee between Jordan, West Bank and Gaza, and Israel, and the government of Jordan has requested the Bank to provide a \$100M Partial Risk Guarantee (PRG) for the desalination BOT. These projects can provide an opportunity for the governments to switch to a more integrated approach to water resource management—for instance, by promoting the combination of construction of new desalination plants with programs to reduce water losses in distribution, thereby promoting integrated urban water management. In the case of irrigation, DBO operations and maintenance schemes can be tested to improve service reliability for farmers, allowing them to switch to higher value crops and provide new employment opportunities for poor people in rural areas.

manage risks. There is strong potential to replicate successful management contracts in some GCC countries to improve the performance of water utilities. The challenge under this approach will be to support governments in instituting, in parallel, the necessary institutional reforms and policy changes, including subsidy reduction and reform and changes in tariff structure reflecting the costs of service provision. This would require overcoming the high political pressure to keep water tariffs below true cost, which makes investments in the water sector more challenging. Recently introduced performance-based contracts in Tunisia for sewerage services are a good illustration of the potential of this approach in situations where tariffs do not cover investment costs. In the broader context and in situations in which governments may not be interested in the short term in putting PPP schemes into place, technical

assistance to improve efficiencies of public utility offtakes (leakage, collection rates), foster corporatization, and improve the creditworthiness of public utilities will help gradually create an environment in which new opportunities for PPP projects can arise. This will also entail increasing the capacity of governments and public utilities to understand PPPs in the water sector and how to properly design and manage contracts with the private sector.

Alongside private sector involvement, fiscal reform programs can also play a role in improving service delivery. In Jordan, the government has sought the World Bank's support to improve financial viability and increase efficiency gains in the water sector. These gains will offer public electricity and water services to Jordanians in a more sustainable manner.

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