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Gulf Economic Monitor

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Deepening Reforms
In Focus: Pension systems in the Gulf



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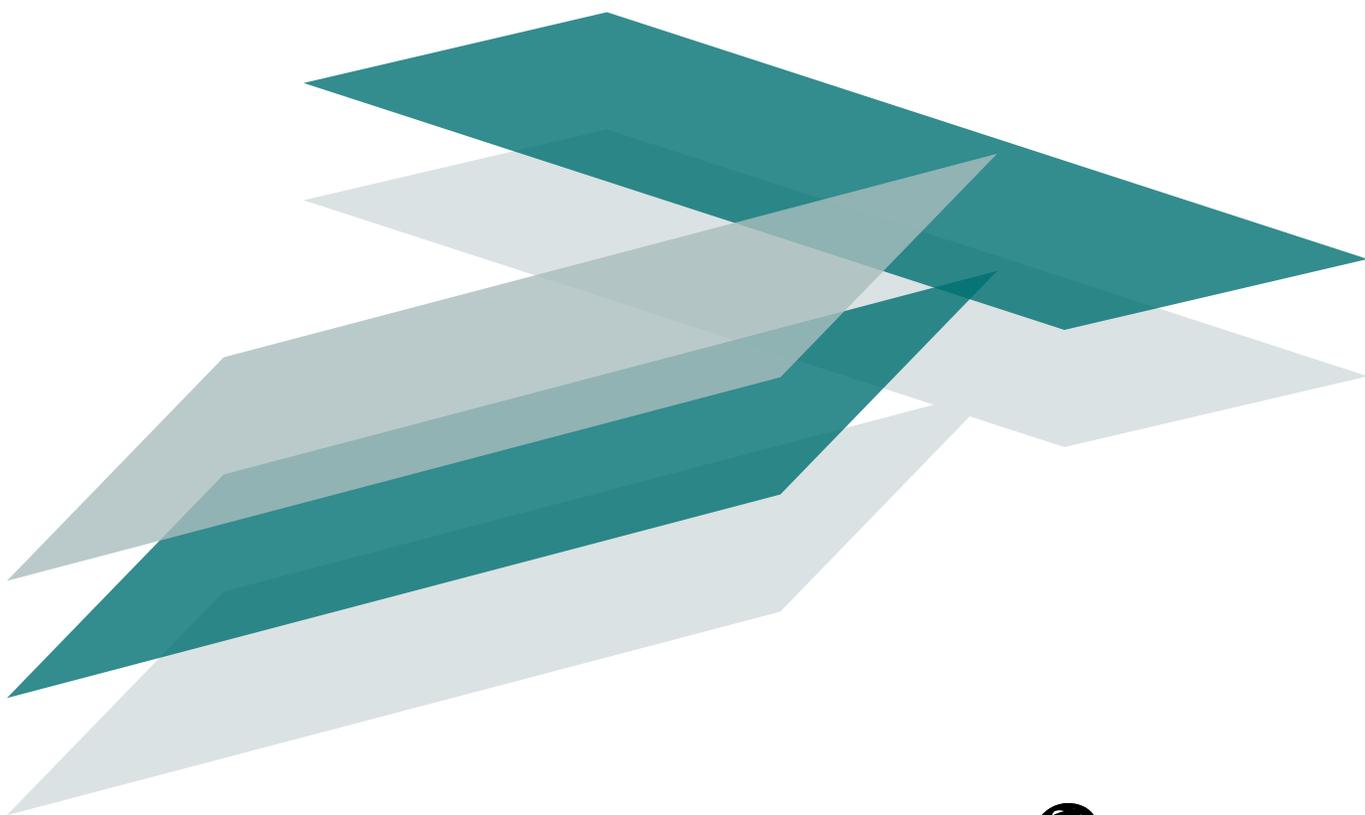


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ACRONYMS

BBL	Barrel (unit of volume for crude oil and petroleum products)	PIF	Public Investment Fund
CPI	Consumer Price Index	PMI	Purchasing Manager Index
EMDE	Emerging Market and Developing Economy	PPP	Public Private Partnerships
FIFA	Federation Internationale de Football Association	Q1	First Quarter
IEA	International Energy Agency	Q2	Second Quarter
FOMC	Federal Open Market Committee (of the U.S. Federal Reserve Board)	Q3	Third Quarter
GCC	Gulf Cooperation Council	Q4	Fourth Quarter
GDP	Gross Domestic Product	QOQ	Quarter-On-Quarter
GRE	Government Related Entities	RHS	Right Hand Side (right vertical axis of chart)
IFC	International Finance Corporation	SAAR	Seasonally-Adjusted Annualized Rate
IMF	International Monetary Fund	SAMA	Saudi Arabia Monetary Authority
JODI	Joint Oil Data Initiative	SOE	State-Owned Enterprise
LHS	Left Hand Side (left vertical axis of chart)	SWF	Sovereign Wealth Fund
LNG	Liquefied Natural Gas	UAE	United Arab Emirates
MBD	Million Barrels per Day	US\$	U.S. dollar
MENA	Middle East and North Africa	VAT	Value-Added Tax
MMBTU	Million British Thermal Units (unit of measurement for natural gas prices)	YOY	Year-Over-Year
OPEC	Organization of Petroleum Exporting Countries		

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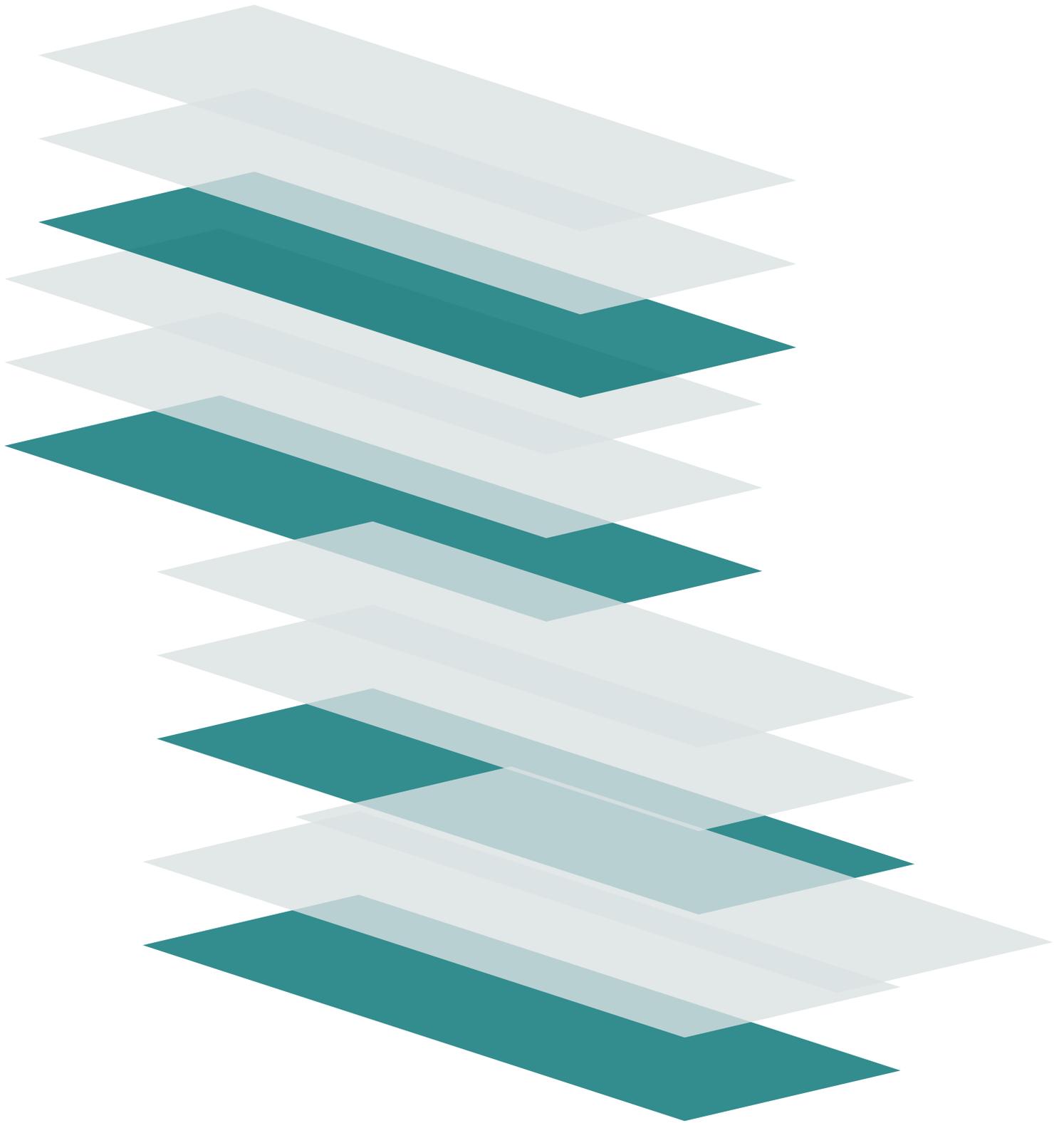
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TABLE OF CONTENTS

5	From the Director
6	Executive Summary
8	The Pulse of the Region
8	The global backdrop
9	Global outlook and risks
11	Regional developments
	<i>Growth, economic activity and sentiment</i>
	<i>Public finances and fiscal reforms</i>
	<i>Trade and external balances</i>
	<i>Prices and credit</i>
	<i>Monetary policy</i>
18	Near term prospects and key risks
24	Risks and long-term challenges
30	Spotlight: Interview with Kevin Carey
32	In Focus: Reforming Pension Systems in the GCC
32	The pension industry landscape
33	Challenges for the pension schemes
35	Options for reform
37	Conclusion
38	Key Economic Indicators
38	Country summary tables
44	Commodity prices tables
45	Oil production table
46	References



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

NADIR MOHAMMED



FOREWORD

This second edition of the twice-yearly Gulf Economic Monitor describes recent economic developments, near-term prospects, and broader reform priorities in the Gulf Cooperation Council (GCC) countries (“The Pulse of the Region”). Regional aggregate GDP growth in 2017 weakened to just 0.5 percent, weighed down by oil production cuts and tighter fiscal policy that took a toll on non-oil growth. Prospects, however, are for a gradual strengthening, helped by the partial recovery in energy prices, the expiration of oil production cuts after 2018, and an easing of fiscal austerity. Aggregate growth in the region is expected to strengthen to 2.1 and 2.7 percent in 2018 and 2019, respectively.

Risks to the outlook include potential external headwinds resulting from the tightening of monetary policy in advanced economies and/or geopolitical tensions that lead to volatility in global financial markets or commodity prices. Although fiscal and external balances are improving, the region continues to face large financing needs among both sovereigns and corporates, and thus remains vulnerable to volatility in global capital flows and the cost of funding. Finally, the reform agendas under consideration in GCC countries are necessarily complex and require considerable political resolve. Any slippage – due to weak institutional capacity or weakening political will – could negatively impact the credibility of the policy reform framework. It could also dampen investor sentiment and set in motion a negative cycle of lower private investment and output growth in the near term.

The Monitor also describes how, following three years of sustained fiscal adjustments to lower oil prices, the GCC countries, led by the Kingdom of Saudi Arabia, are shifting attention towards deeper structural reforms. These are needed to breathe new life into sluggish domestic economies, create jobs for young people and strengthen private investment, to broaden the economic base and to anchor longer term fiscal sustainability. Sustained progress on reforms is needed if the region is to sever its longer-term fortunes from those of the energy sector which will undergo major transformation over the next few decades as part of the global transition to a low-carbon economy and towards cleaner fuels. The report, however, cautions against policy complacency stemming from the recent partial recovery in oil prices that leads to loss in reform momentum. Instead, it urges countries to double down on reforms in order to secure the long term futures of their economies and their people.

The final part of the report includes an analytical “In Focus” section that discusses the sustainability, equity, and welfare challenges confronting regional pension systems. These need to be addressed urgently to avoid them being a drag on economic growth, fiscal sustainability, and labor market stability. Among the potential solutions that could help improve pension outcomes, the report underscores the importance of improving efficiency by reducing the fragmentation visible in current systems in the GCC; making access and contributions as simple and automatic as possible to workers through strengthening ID and IT systems and the capabilities of pension administration bodies; strengthening the governance of pension institutions, and developing or creating regulators and supervisors who can successfully supervise pensions. Finally, if GCC countries wish to attract global talent, they will also need to consider potential solutions for expatriates that help to meet their long-term pension and financial security needs.

Executive Summary

The global economy and global trade continued to expand in 2017, led by strengthening demand across advanced and developing economies. Global trade grew at an over-four percent pace in the year. Oil markets have tightened as energy demand has strengthened in line with the global recovery, and as crude oil supply has been curtailed by OPEC and Russia (the OPEC+ agreement). This has boosted the average crude oil price to around US\$53 a barrel in 2017, up 24 percent from 2016, and to around US\$64 currently. Global financing conditions have remained favorable despite a 100 basis-point policy rate hike by the U.S. Federal Reserve since November 2016.

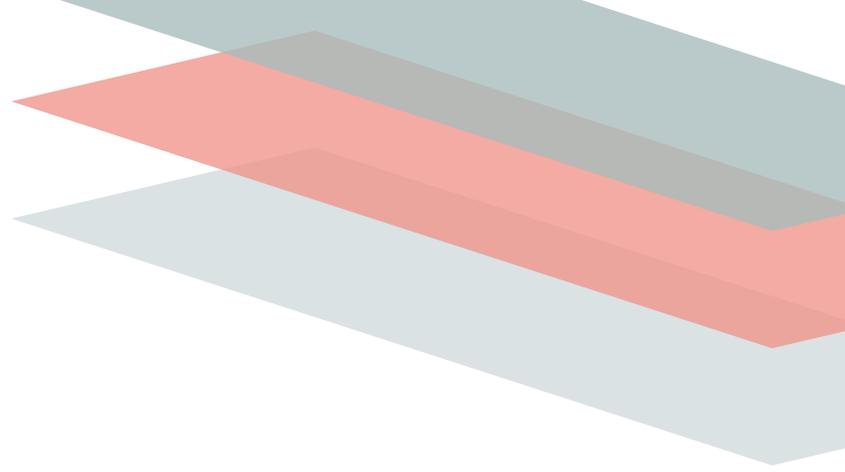
Economic activity was weaker than expected across the GCC during 2017, dragged down by lower crude oil production and the negative short-term effects of fiscal adjustment. Growth for the region is estimated at just 0.5 percent, the weakest in several years and down from 2.5 percent the previous year. The GCC reduced oil output beginning in January 2017 and the OPEC and Russia agreed twice to extend the 1.8 million barrel a day output cutback through December 2018. The GCC governments continued with fiscal adjustment measures with Saudi Arabia and the UAE introducing excise taxes on tobacco and carbonated drinks. External debt issuance continued to increase to help fund deficits.

Trade balances have begun to improve aided by rising export receipts due to higher oil prices, while fiscal austerity has kept imports depressed. This is helping ease pressure on currencies and reserves. Inflation has moderated with the weaker activity. Credit growth has also slowed, reflecting weaker demand due

to tightened fiscal policy and a cooling of the regional property boom. Government deposits at banks grew, including in Qatar to compensate for the withdrawals by foreign depositors following the diplomatic rift with Saudi Arabia, the UAE and other Arab countries. Central banks raised interest rates to maintain their currency pegs, but policy remains accommodative with low real rates.

The outlook for the global economy remains positive. Global growth is expected to strengthen to an average 3.0 percent annually in 2017-19. Crude oil prices are expected to average US\$58 a barrel in 2018 and edge up to US\$59 a barrel in 2019, kept in check by rising US oil production and as growth in global energy demand moderates. Global financing conditions should gradually tighten, but are generally expected to remain accommodative. Risks to the baseline global outlook are skewed to the downside and include bouts of global financial volatility, weaker than expected energy prices, geopolitical tensions and rising trade protectionism.

Growth in the GCC is expected to resume in 2018-19 supported by a moderate recovery in oil prices, as the OPEC+ production restraint helps oil prices and supports a slower pace of fiscal consolidation and an upgrade in investor sentiment. The expiry of the agreement after 2018 should provide support to headline growth as oil production rises. The recovery will be led by fixed investment and there will be less of a drag on growth from a poor performance in public consumption and net exports. Despite this improvement, aggregate growth for the region will remain soft at just 2.1 and 2.7 percent in 2018



and 2019 respectively, a significant deceleration compared to years prior to the fall in oil prices in 2014. Inflation will pick up in 2018 as the value-added tax (VAT) is introduced across the region, but will moderate in 2019. The recovery in oil prices will help reverse, or narrow, current account deficits, albeit at different paces based on services and income account results.

Fiscal balances are set to steadily improve across the GCC with the expected gains underpinned by ongoing fiscal reform and new adjustment measures to be implemented in 2018-19, including the introduction of consumption taxes. The gains will help moderate the recent rise in government debt. The GCC countries are expected to maintain their currency pegs to the U.S. dollar and central banks will likely follow U.S. rate hikes. The positive medium-term outlook requires strong banks, and the GCC banks are generally well capitalized to take advantage of the expected recovery in growth.

Risks to the regional outlook are on the downside in the medium term. Lower than expected oil prices could exert pressure on the OPEC producers to extend or deepen their production reduction agreement and dampen medium-term growth in the GCC countries. Any further escalation of the diplomatic dispute should be avoided as it could have negative repercussions on the region as a whole. Slippage in the implementation of country reform plans arising from weak institutional capacity will rob the GCC of the benefits of fiscal adjustment and of deeper structural reforms that aim to diversify their economies.

Over the longer term, the enduring dominance of oil and gas production, exports, and revenues in the GCC countries argues for the vigorous implementation of structural reforms. The terms of trade shocks in 2008-09 and in 2014-16 barely dented the dominance of the hydrocarbon sector in the GCC, with the bulk of the adjustment so far driven by spending cuts rather than the emergence of other traded sectors.

Structural reforms should focus on: economic diversification, private sector development, and labor market and fiscal reforms including pensions, which are discussed in the In Focus chapter of this report. The GCC's economic diversification ambitions (away from hydrocarbons) are articulated in various country Vision statements and investment plans, bannered by

Saudi Arabia's which aims to lift the private sector share of the economy from 40 to 65 percent and the small and medium enterprise contribution from 20 to 35 percent. Implementing these structural transformation programs requires continuing political commitment from the GCC governments.

Further fiscal consolidation remains a necessity in parallel with these transformation programs. Energy prices subsidies declined by 1.5-5.0 percentage points of GDP from 2013 to 2016, but the gains in petroleum subsidy reform were due more to the decline in benchmark international prices than to domestic price increases. The introduction of the VAT should help the GCC raise non-hydrocarbon revenues by an estimated at 1.2-2.1 percent of GDP. Other measures are equally vital: second round adjustments to energy and other subsidized prices while protecting the most vulnerable households, control of the wage bill, and strengthening of the quality of public investment. Addressing sustainability, equity and welfare challenges confronting pension and social benefit systems will be critical if these are not to be a drag on economic growth, fiscal sustainability and labor market stability.

Promoting private sector activity will enable economic diversification. Playing oversized roles in their economies, including through state-owned enterprises, the GCC governments have begun to consider the privatization of state assets. They are also increasingly turning to public and private partnerships to engage private capital in infrastructure. While privatization and PPPs will be vital elements of private sector development, the overriding strategy for the GCC governments will be to establish the enabling business environment by creating the legal framework for private activity, reforming regulation, and promoting competition.

The GCC countries must reform their labor markets to support private activity. Distortionary policies have created labor market segmentation: the public sector attracts nationals through high wages, while the private sector employs mainly low-skilled foreigners. Reducing the incentives favoring public over private sector employment will encourage nationals to seek private sector jobs. Attracting and retaining highly skilled foreign workers is necessary if the GCC are to become knowledge driven economies. Increasing the labor force participation of women will invigorate the labor markets.

The Pulse of the Region

The global backdrop

The global economy and trade continue to expand, led by strengthening demand across advanced and developing economies

The cyclical recovery in global growth, underway since mid-2016, strengthened further during 2017. Global growth averaged 3.4 percent quarter-on-quarter at a seasonally-adjusted annualized rate (qoq saar) in the first three quarters of 2017, up from an average 2.5 percent in the first three quarters of 2016 (Figure 1). The upswing reflects: stronger domestic demand, in the advanced economies, principally in the United States, the Euro Area and Japan; resilient growth in developing economies led by China; and, renewed activity among the major commodity exporters including Brazil and Russia. The global manufacturing Purchasing Managers' Index (PMI) indicates that the strong momentum continued into the final quarter of 2017 (Figure 2).

Strengthening demand has spilled over into trade, which expanded briskly during 2017, following two years of pronounced weakness (Figure 3), and indications are that momentum was maintained in the final quarter (Figure 2).

Oil markets have tightened as energy supply has been curtailed

The price of benchmark Brent crude rose steadily in the

second half of 2017, reaching over US\$60 a barrel currently, thanks to the maintenance of a deal struck at the end of 2016 between OPEC and Russia (the OPEC+ agreement) to jointly curb production (Figure 4). This deal, which was set to expire in March 2018, has been extended through December 2018. Global energy demand has also lifted over this period, helping to support the recovery in prices. Production rose in November to 97.8 mbd, with the OPEC output lower for the fourth consecutive month at 32.4 mbd but with non-OPEC output edging higher. The OPEC producers raised their compliance rate with the supply reduction pact to 91 percent through November 2017. Inventories continued to fall from their previous record levels, signaling an ongoing market re-balancing. Nevertheless, expectations are that price upside potential will remain limited by rising shale production in North America.

Global financing conditions have remained favorable

Long-term bond yields in the United States remained steady in 2017, despite the cumulative 100 basis-point increase in the Federal Reserve policy rate from November 2016 to December 2017 (Figure 5). The low yields reflect the expectations of a more gradual phase of monetary policy normalization by the Federal Reserve. The U.S. dollar has also depreciated by 6.3 percent in real effective terms from January to December 2017. In emerging markets, portfolio flows remained stable, and asset prices, buoyant.

FIGURE 1

Global GDP growth Quarter-on-quarter seasonally-adjusted annualized rate

Source: World Bank Group.

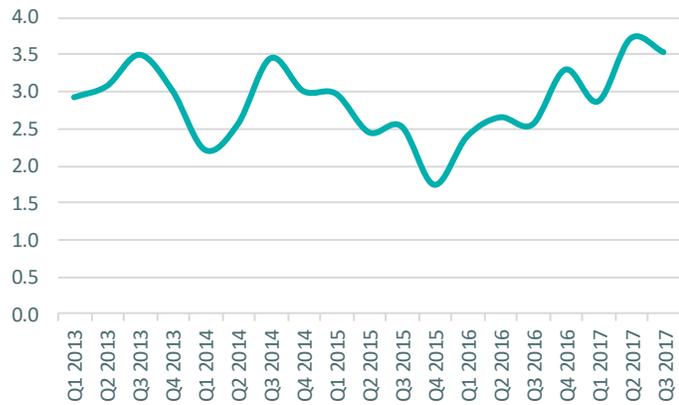


FIGURE 2

Purchasing Managers' Index (PMI) 50+ = expansion

Sources: Haver Analytics, JPMorgan, Markit Economics.



FIGURE 3

Global trade growth Percent year-on-year

Source: World Bank Group.

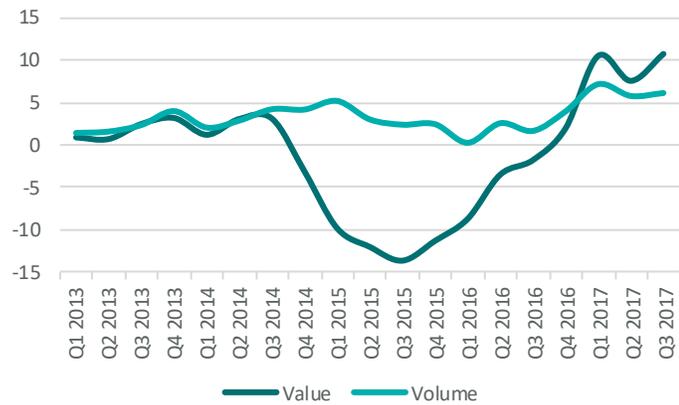
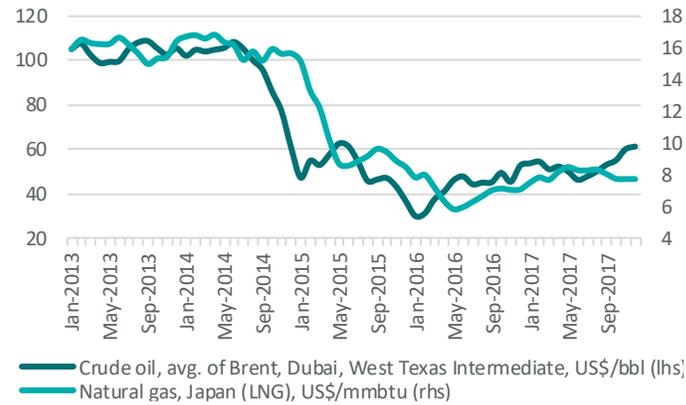


FIGURE 4

Energy prices US\$

Source: World Bank Group.



Global outlook and risks

The outlook for the global economy remains positive

Global growth is expected to strengthen to around 3.0 percent annually in 2017-19, from a post-crisis low of 2.4 percent in 2016 (World Bank, 2018a). In the advanced economies, growth will reach 2.2 percent in 2018 following a broad-based domestic demand-led recovery, before moderating to 1.9 percent in 2019 as negative output gaps shrink and more modest productivity gains weigh on potential growth. In the emerging market and developing economies (EMDEs), growth is anticipated to reach an average of 4.6 percent in 2018-19 (Figure 6), with activity in the commodity importers strengthening while obstacles to growth in the commodity

FIGURE 5

Long-term US interest rates Percent

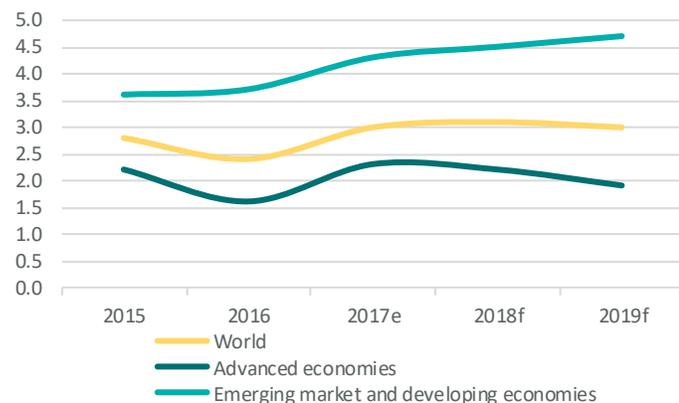
Source: Haver Analytics.



FIGURE 6

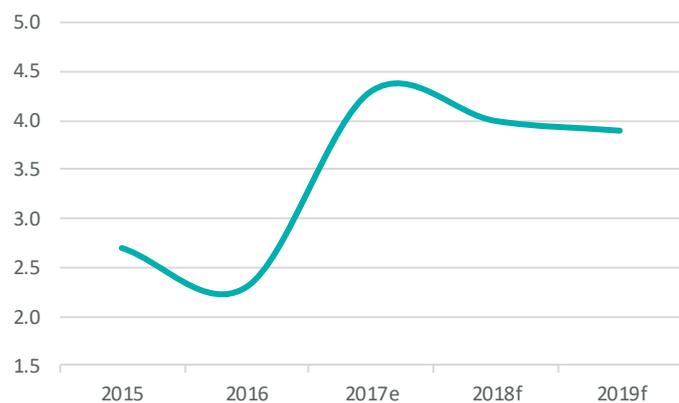
GDP growth Percent year-on-year

Source: World Bank Group, "Global Economic Prospects", January 2018.

**FIGURE 7**

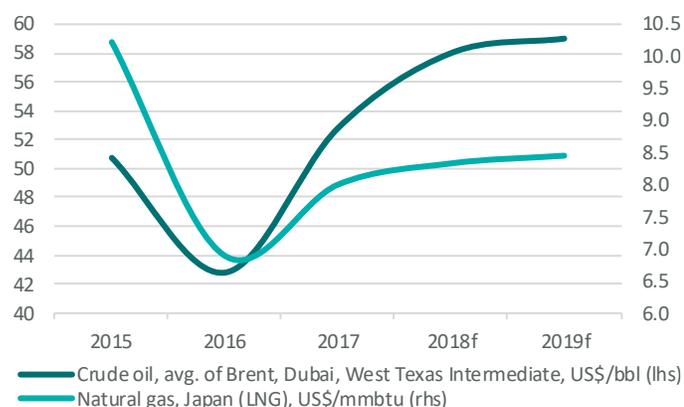
Trade volume growth Percent year-on-year

Source: World Bank Group, "Global Economic Prospects", January 2018.

**FIGURE 8**

Energy prices US\$

Source: World Bank Group, "Global Economic Prospects", January 2018.



exporters gradually diminish. Growth in the EMDEs will be supported by improved external factors, including a favorable global financial environment.

Global trade is also expected to remain strong at around 4.0 percent in 2018-19. The forecast represents a significant upgrade from previous projections and reflects a recovery in global demand especially capital spending by the advanced economies, a rebound by China from its protracted trade slowdown, and renewed imports by commodity importer EMDEs (Figure 7).

Oil prices are still expected to recover at a moderate pace. Crude oil prices, which averaged US\$53 per barrel in 2017, are expected to average US\$58 per barrel in 2018 as the market continues to rebalance (Figure 8). The increase reflects strong oil demand, falling stocks, and production restraint among the OPEC and non-OPEC producers. Projected increases in U.S. shale production make it unlikely that the global market will tighten significantly in 2018. Natural gas prices are projected to rise 3 percent in 2018. Markets are seen remaining well supplied over the next several years due to a surge in LNG capacity, mainly from Australia and the United States, and the likely reemergence of Egypt as a gas exporter with the scale-up of production from the Zohr field.

Global financing conditions are assumed to remain accommodative. The normalization of monetary policy in the United States matters for the GCC countries, whose currencies are pegged to the U.S. dollar, and for whom policy will tighten in tandem.¹ Nevertheless, the increase in U.S. policy rates is expected to proceed gradually and without triggering large increases in market volatility. An easing of lending conditions in the major economies is expected to offset the anticipated gradual rise in long-term interest rates. Most emerging markets are expected to face generally accommodative financial conditions, with higher policy rates partially offset by a recovery in risk appetite.

Risks to the baseline global outlook are skewed to the downside in the medium term (World Bank, 2018a). Faster than expected policy rate or balance sheet normalization by the U.S. and the major central banks could raise borrowing costs and trigger an abrupt tightening of financing conditions to the detriment of EMDEs. Other major risks include those emanating from unilateral trade restrictions and retaliatory responses that slow global trade and raise the cost of tradable goods for consumers, and rising geopolitical tensions that affect economic activity or hurt investor confidence.

In energy markets, there are substantial risks to the forecast. Supply to the global market from politically-stressed oil producers, including Iraq, Libya, Nigeria, and Venezuela could be volatile. Conversely, while an agreement to extend oil cuts

¹ Kuwait's currency is anchored to a basket of currencies in which the U.S. dollar has a relatively heavy weighting.

FIGURE 9

GDP growth
Percent year-on-year

Source: Haver Analytics.

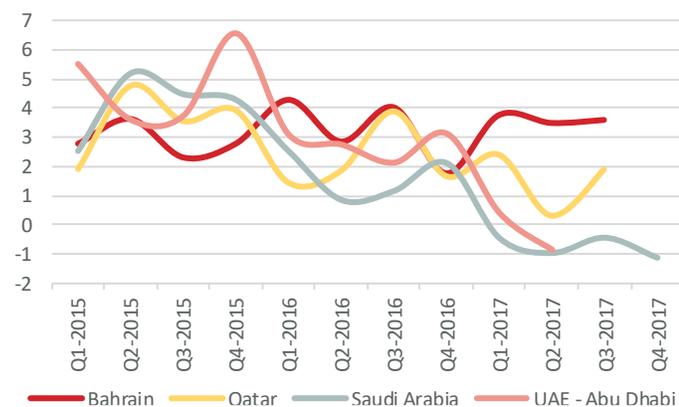
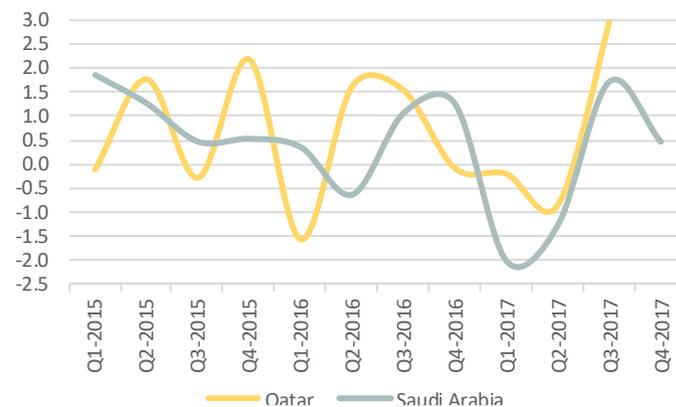


FIGURE 10

GDP growth
Quarter-on-quarter

Source: Haver Analytics.



through 2018 has been finalized, it is unclear how long OPEC and Russia can keep prices high without bringing too much U.S. shale oil supply back online. Over the medium to long term, however, global energy markets are anticipated to undergo a significant shift away from coal and oil towards lower-carbon fuels, with the shift mainly driven by countries' commitments under the Paris agreement to lower global carbon emissions.² While the pace of the transition is uncertain, it will be affected by both technological innovation which lowers the cost of producing cleaner energy (e.g. through renewable energy) and shifts in policy by major energy consumers such as India and China.³ This suggests continued urgency for energy producers like the GCC to undertake structural reforms that reduce their dependence on commodities and diversify their economies.

Regional developments

GROWTH, ECONOMIC ACTIVITY AND SENTIMENT

Economic activity was weaker than expected across the GCC ...

Growth in the Gulf Cooperation Council (GCC) economies was weaker than expected in the first three quarters of 2017. The results contrast with those reported for the global economy and reflect lower crude oil production by the OPEC countries and softer domestic activity overall. With the subdued

three quarter outturns, growth for the GCC is expected to be lower in 2017 than previously forecast (Gulf Economic Monitor, June 2017).

Saudi Arabia, the GCC's largest economy, posted its weakest economic performance since 2009, with the economy contracting by 0.7 percent in 2017. The weakness reflected the impact of oil production cuts undertaken as part of the OPEC+ agreement, and soft non-oil sector growth due to ongoing fiscal adjustment. As a result the economy slipped into a recession during 2017, shrinking by 2 percent quarter-on-quarter seasonally adjusted rates (qoq, sa) in Q1 and by 1.3 percent in the second quarter (Figure 9 and Figure 10). The second half of the year fared better, but quarterly growth softened in the fourth quarter to 0.5 percent (qoq sa).

In the UAE, the economy in Abu Dhabi contracted by 0.9 percent yoy in the second quarter of 2017. Growth in the federal capital and the largest of seven emirates had been 2.8 percent yoy in the second quarter of 2016. In Dubai, the second largest emirate, the growth rate was 3.2 percent in the first quarter of 2017, compared to 2.4 percent in the first quarter of 2016 and 3.9 percent in the fourth quarter of 2016. As with Saudi Arabia, the slowdown in the UAE, the GCC's second largest economy, was largely due to weakness in the hydrocarbon sector. Property markets have also softened, particularly in Dubai as reflected in a slowing land and building sales transactions over the course of 2017.

Economic activity was likely sluggish in the UAE in the second half of the year. Non-hydrocarbon GDP had only given growth a weak lift in the first and second quarters of the year. With PMI data, which cover the non-hydrocarbon sector, indicating that output and new orders were in expansion territory through 2017, an uptick in the total economy index (the headline index) in December 2017 (Figure 11) indicates that a recovery is, however, likely in the offing in 2018.

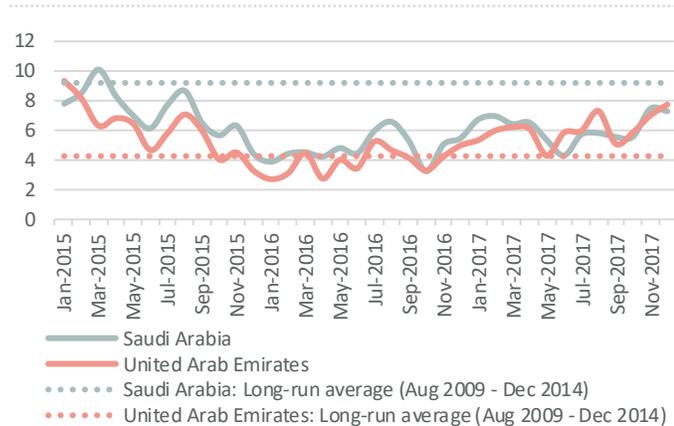
2/ Natural gas is likely to be less affected than coal and oil because it is relatively cleaner in combustion, and is likely to be a bridge fuel in the transition to a low-carbon global economy.

3/ For example, India has announced that it will allow the sale of only electric cars by 2030 while China plans to end the sale of fossil-fuel-burning vehicles, though it's not yet clear when the ban will kick in. The United Kingdom and France have both recently decided to outlaw the sale of new internal-combustion cars by 2040.

FIGURE 11

Purchasing Managers' Indexes (PMI) Deviations from Index Value of 50 (Expansion)

Sources: Haver Analytics, Emirates NBD and IHS Markit.



Qatar has been affected by, but is successfully adjusting to, the diplomatic rift with Saudi Arabia, the UAE and other Arab countries. Growth was anemic in the first half of the year, before the diplomatic rift, with the economy contracting 0.2 percent qoq sa in the first quarter of 2017 and 0.9 percent in the second quarter (Figure 10), mainly reflecting the effects of fiscal consolidation over the past year, in particular, with the efforts to rationalize public capital expenditures. Saudi Arabia, the UAE, Bahrain, and Egypt severed diplomatic relations and froze trade flows with Qatar in June 2017. These measures led to an initial sharp drop in imports of 40 and 35 percent yoy in June and July respectively and contributed to an increase in food inflation to 5.1 percent yoy in July. They also dented investor sentiment, as reflected in a drop in equity prices, and squeezed commercial bank access to foreign funds, reflected in the decline in non-resident deposits at Qatari banks (from US\$51 billion, or 24 percent of total bank deposits, in May 2017 to US\$39 billion, or 19 percent of total bank deposits, in September). The funding squeeze raised interbank rates and forced commercial banks to borrow more from the Qatar Central Bank.

However, the impact has been short-lived. Qatar has responded to the trade restrictions by re-routing trade (using Iranian airspace and Omani ports and opening the new \$7.4 billion Hamad Port), diversifying sources of imports (purchasing food from or through Iran, Oman, Turkey and China) and enhancing domestic food processing. As a result, food inflation has decelerated, while goods imports are back to pre-dispute levels. Qatar has also explored other sources of bank finance; the government increased public sector deposits by US\$28 billion from May to September; and, the central bank injected liquidity into the financial system. Growth has subsequently recovered to 3.0 percent qoq sa in the third quarter of 2017.

Oil production cuts also weighed down on growth in Kuwait in the first half of the year. However, non-oil activity has remained

relatively buoyant. Consumer spending picked up during the course of 2017, also reflected in strengthening import demand for consumer goods. On a further positive note, residential property sales rose 20 percent yoy in the third quarter, following healthy gains in the second quarter, signaling that the correction of the past two years has run its course. A strong pipeline of, and the speedier award of contracts for, infrastructure projects under the 2015-19 Development Plan have supported activity in the non-oil sector, particularly in construction and transport. Still, overall growth has slowed down in the country, which remains among the most dependent among the GCC economies on the hydrocarbon sector (55 percent of real GDP in 2016), as crude oil production declined 5.1 percent yoy in the first three quarters of 2017 from a year earlier.

Oil production also dropped by 3.0 percent yoy in the first three quarters of 2017 in Oman, still largely dependent on the hydrocarbon sector (40 percent of GDP in 2015). Imports (a proxy for consumer spending in Oman) were flat in the first quarter of 2017, although they gained in the second quarter. Weaker public spending in the period had knockdown effects on private consumption.

Bahrain was the sole exception, with growth picking up in the first three quarters of 2017. The economy grew by an average 3.6 percent yoy in the period from 1.5 percent yoy in the fourth quarter of 2016 (Figure 1). Bahrain is least dependent among the GCC countries on hydrocarbons (20 percent of GDP in 2015), and growth in the first three quarters was driven by non-oil activity, anchored on the private sector. Growth in the year likely exceeded that forecast at midyear, the exception among the GCC economies.

... dragged down by lower crude oil production...

The GCC reduced oil output beginning in January 2017. OPEC had originally agreed the previous November to cut oil production by 1.2 million barrels per day (mbd) for a half-year beginning in January 2017. The deal aimed to end the three-year supply glut in the global oil market and support international oil prices which had fallen by more than a third from US\$111 per barrel (Brent crude) in June 2014 to US\$31 per barrel in January 2016. The agreement was broadened in December 2016, with non-OPEC suppliers, led by Russia, pledging 0.6 mbd of additional output cuts. This agreement has been subsequently extended to continue through 2018.

As OPEC's biggest producer, Saudi Arabia has shouldered the largest cutbacks. Crude oil production by Saudi Arabia fell 4.2 percent from 10.4 mbd in the first three quarters of 2016 to 9.9 mbd in the first three quarters of 2017 (Figure 12). Production by the other GCC producers, including by Oman, a non-OPEC member together with Bahrain, dropped 3.4 percent from a combined 7.5 mbd to a combined 7.2 mbd over the same two periods. Overall, compliance by the OPEC members to the production agreement was 115 percent in November 2017 and averaged 91 percent in January to November 2017, according to the International Energy Agency. Meanwhile, Brent prices

climbed steadily over the past six months reaching US\$67 per barrel, up more than 40 percent from US\$46.4 in November 2016, when the agreement was first struck.

PUBLIC FINANCES AND FISCAL REFORMS

... and the negative short-term effects of fiscal adjustment

The GCC countries continued with fiscal adjustment plans, albeit at different paces in 2017. Many of the fiscal consolidation plans were set soon after oil prices collapsed from mid-2014 and caused huge fiscal deficits through 2016. In many cases, the adjustment measures were front-loaded in 2015-16. Most governments continued with second phase efforts in 2017, although some have proceeded more cautiously and gradually than originally planned. Altogether, the reforms, so far focused on energy price and subsidy adjustments and government expenditure reductions, have dampened domestic demand in the GCC countries. However, policy makers have also begun to turn attention towards measures to potentially soften the impact of the subsidy and tax reforms on consumers.

Saudi Arabia introduced a 100 percent excise tax on tobacco and sugary drinks and a 50 percent excise tax on soft drinks in June 2017. Spending on subsidies was 65 percent lower in the first half of 2017 from a year earlier, and grants 24 percent smaller. Overall, Saudi Arabia's fiscal deficit has fallen from 16.9 percent of GDP in 2016 to an estimated 9.0 percent in 2017. Improving fiscal outturns gave the government an occasion to pause with compensation reform -- the government reversed in April 2017 some of the cuts in civil service allowances enacted in September 2016. Nevertheless, it has proceeded with key policy measures aimed at generating fiscal savings and enhancing revenues, including the introduction of a VAT in January, a hike in gasoline prices (by 83-127 percent, depending on the type), and higher electricity tariffs.

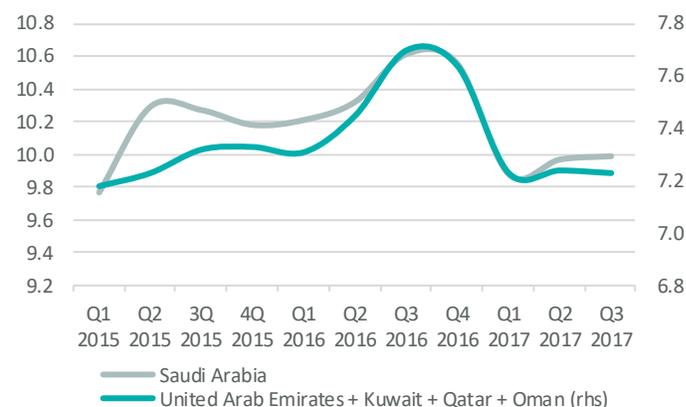
In an effort to ease the direct and indirect impact of the fiscal balance measures on vulnerable segments of the population, Saudi Arabia unveiled a new national cash transfer scheme, "Citizens' Account", in December 2016. The program reimburses low- and middle-income households for the welfare losses they incur during the fiscal reform process. The government earmarked Saudi Riyal 30.0 billion (US\$8.0 billion) annually for the program and confirmed the first set of disbursements in December 2017, which varied by the income of the beneficiary household and their number of dependents. The support scheme aims to assist vulnerable households cope with the economic costs of the fuel price increases, the VAT on food and beverage items, and changes in wages and public sector allowances. As such, it remains vital that the program be well-targeted to ensure that the transfer payments reach the intended beneficiaries.

The UAE announced excise taxes on tobacco beginning in October 2017, and in tandem with Saudi Arabia, also implemented the VAT in January 2018. As with Saudi Arabia, the

FIGURE 12

Crude oil production Million barrels per day

Source: International Energy Agency (IEA), "Monthly Oil Market Report", December 2017.



rates are 100 percent on tobacco products and energy drinks and 50 percent on carbonated drinks. In general, the UAE has emphasized revenue measures this year; previously, the government increased electricity and water tariffs, removed fuel subsidies, and reduced capital transfers to Government Related Entities (GREs). More recently, the government has focused on fees: a 4 percent municipality fee on hotel bills and a 3 percent municipality fee on the annual value of expatriates' rental contracts in Abu Dhabi, and parking fees and fees for hotels and airport passengers in Dubai. Altogether, the previous and current measures helped the government close the fiscal deficit in 2017.

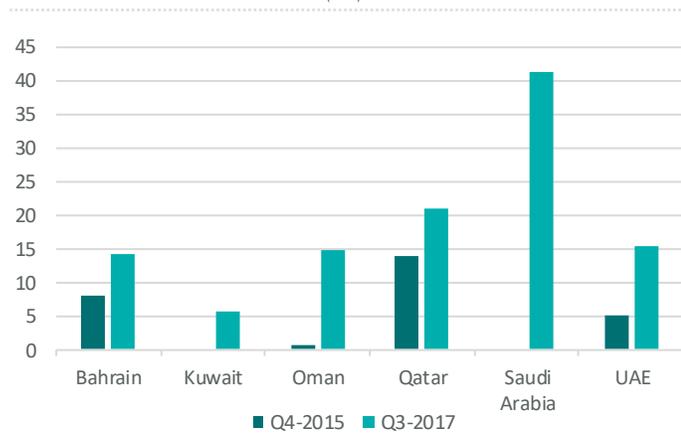
Fiscal consolidation in Qatar has helped to narrow the fiscal deficit. In response to the fall in international oil and gas prices, the government had cut back current spending and embarked on energy subsidy reform. Notably it had also pared back a substantial public investment program for 2014-2024 to \$130 billion from \$180 billion, prioritizing projects related to the FIFA 2022 World Cup. As a result, the fiscal deficit is estimated to have declined to 4.9 percent in 2017 from 9 percent in 2016. Qatar is expected to slow consolidation measures to contain the costs of the diplomatic rift with Saudi Arabia, the UAE and other Arab countries. Government efforts to ease the costs of the measures imposed on the economy and to lighten the effects of the measures on the population will likely limit the scope for cutting spending sharply. The fiscal costs of dealing with the imposed measures, including the costs to the government of rearranging supply chains in the economy, will not pose a substantial risk to fiscal stability, however, given the country's huge financial buffers.

Fiscal reforms are progressing more slowly in Kuwait, reflecting divergent views between the government and the country's parliament regarding spending priorities. With low oil prices persisting, the government had posted consecutive double-digit deficits of about 17 percent of GDP (excluding investment

FIGURE 13

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

Source: Bank for International Settlements (BIS).



income from the sovereign wealth fund (SWF), the Kuwait Investment Authority (KIA) and transfers to the inter-generational saving fund, the Future Generations Fund) in FY2015-16, a far cry from double-digit surpluses prior to 2014. However, on a general government basis (including investment income and transfers to the SWF), public sector finances are in modest surplus. The government has also had some success in undertaking partial energy subsidy reforms, raising electricity utility prices in September 2016. However, the second round of electricity and water tariff adjustments on apartments, implemented in August 2017, were less than initially proposed. Plans to introduce a 10 percent corporate tax have also been shelved, and Kuwait is lagging both Saudi Arabia and the UAE in the implementation of indirect taxes, particularly excises. The government, instead, has started to focus on potential cost-savings from other sources, including through the use of public private partnerships (PPPs) to finance infrastructure projects and through the privatization of state assets. The Kuwaiti public sector is among the largest in the world and also relative to its GCC peers, with spending amounting to 51 percent of GDP in 2016. But it is also among the most dependent on oil receipts, which contributed 89 percent of total revenues, highlighting the need for the authorities to more aggressively develop non-oil sources of public revenues.

Fiscal outturns in the first half of the year indicate that Oman is on course to narrow its fiscal deficit in 2017. Total revenues were 28 percent higher in the first half of 2017 than in the same period in 2016, mainly due to stronger oil revenue than in 2016. Total expenditures were about 3 percent lower year-on-year. The savings came from higher utility tariffs on large customers. Overall, the government, which has had the biggest fiscal deficit in the GCC in the past two years (17.5 percent of GDP in 2015 and 20.6 percent of GDP in 2016), managed to cut the budget deficit 31 percent from Omani Rials 3.7 billion (US\$9.7 billion) in the first half of 2016 to Omani Rials 2.4 billion (US\$6.3 billion) in the first half of 2017.

Bahrain has introduced some fiscal adjustment measures. The revenue enhancing initiatives include higher tobacco and alcohol taxes and higher government service fees. However, the government may need a more sizable and front-loaded fiscal consolidation program, considering that Bahrain is the most indebted among the GCC countries (82 percent of GDP in 2016). The government may well consider other non-oil revenue measures, further cuts to energy subsidies, and steps to contain the wage bill.

International debt issuance continues to increase

To fund fiscal deficits, Saudi Arabia and the UAE followed up with more international sovereign debt issues in 2017. Saudi Arabia turned to the international debt market for the third time in less than a year with the largest emerging market debt sale in the year, a US\$12.5 billion issue (a US\$3.0 billion five-year tranche, US\$5.0 billion 10-year tranche, and US\$4.5 billion 30-year tranche) in September 2017. The global bond followed a US\$9.0 billion Sukuk (Islamic bond) in April 2017 and a US\$17.5 billion conventional bond in October 2016, Saudi Arabia's first international sale ever for which demand was four times the debt sale. Abu Dhabi, the largest of the UAE's seven emirates, joined Saudi Arabia in tapping strong investor demand for emerging market debt with a US\$10.0 billion issue (a US\$3.0 billion five-year tranche, US\$4.0 billion 10-year tranche, and US\$3.0 billion 30-year tranche) in October 2017.

Kuwait debuted in the international sovereign bond market in March 2017. A US\$3.5 billion five-year bond and a US\$4.5 billion ten-year issue attracted more than US\$20.0 billion in bids and sold at yields of around 2.8 percent and 3.6 percent respectively. Oman completed 90 percent of its foreign borrowing plan for 2017 with a US\$5.0 billion issue (a US\$1.0 billion five-year tranche, US\$2.0 billion 10-year tranche and US\$2.0 billion 30-year tranche) in March 2017 and a US\$2.0 billion Sukuk sale in May 2017. Earlier, Oman returned to the international bond market after an absence of 20 years with a US\$1.0 billion five-year issue and a US\$1.5 10-year issue in June 2016. Qatar also returned to the market with its first sale after four years with a US\$9.0 billion bond issue in May 2016, and indications are that the government is considering another bond issuance in the coming months. In August, Fitch became the third major credit rating agency to downgrade Qatar's long-term debt rating one notch to AA- (on par with Belgium and South Korea). Downgraded to four levels below investment-grade at B-1 by Moody's in July 2017, Bahrain raised US\$3.0 billion in three tranches in September 2017, including a US\$1.2 billion Sukuk, after receiving bids worth US\$15.0 billion. This followed a US\$600 million conventional issue in February 2017 and a US\$1.0 billion conventional bond and US\$1.0 billion Sukuk in October 2016.

In addition to international debt issues, Saudi Arabia raised debt financing from local investors. Three monthly domestic Sukuk sales, starting in July 2017, raised Saudi Riyals 37.0 billion (US\$9.9 billion).

TRADE AND EXTERNAL BALANCES

Export receipts have begun to rise with the uptick in oil prices, while fiscal austerity has kept imports depressed...

Production quotas initially kept crude export volumes low and receipts subdued, notwithstanding higher oil prices. Crude oil export shipments by the GCC countries fell in line with their production cuts following the OPEC+ agreement (Figure 14). Crude oil export receipts have subsequently picked up moderately (Figure 15). The rise in oil prices to over \$60 in the fourth quarter of 2017 will lead to further improvement in receipts.

Qatar's gas exports have continued despite the diplomatic rift with Saudi Arabia, the UAE and the other Arab countries. Qatar is the world's largest producer and supplier of liquefied natural gas (LNG), exporting 7.6 million tons in 2016, approximately 30 percent of global supply, mainly to Japan and other customers in Asia. Natural gas comprises a larger portion of Qatar's goods exports (48 percent of total merchandise exports in 2016) than does crude oil (36 percent). While Qatar has kept global natural gas exports flowing during the standoff, including to the UAE and Egypt, rising global energy supplies are keeping natural gas prices subdued and this should continue to weigh on overall hydrocarbon receipts.

Bahrain and the UAE benefitted from the global trade recovery. Bahrain and the UAE are least dependent among the GCC countries on hydrocarbon exports, and would have benefitted most from the upswing in global trade beginning in mid-2016 (Figure 16). Still, non-hydrocarbon exports remain small, relative to hydrocarbon exports, among the GCC to make a significant impact on the group's headline trade numbers. Oman has meanwhile benefited from a re-routing of trade by Qatar away from Saudi Arabia and the UAE.

Import growth may have bottomed out from mid- to late-last year, but the improvement appeared weak in the first half of 2017. For the five GCC countries for which 2017 import data are available, imports were still weak for Saudi Arabia and Qatar in the third quarter of 2017 (Figure 17). The economy fell into a recession in the second quarter of 2017 in Saudi Arabia, and budgetary expenditures declined two percent yoy in the first half of 2017, affecting imports. Imports dropped more than 35 percent yoy in June and July in Qatar after the diplomatic conflict erupted in early June and closed off trade routes to the country. Imports continued to decline in November, but at a slower rate of 2 percent yoy. On a positive note, import growth may have begun to stabilize in Bahrain and Kuwait. Bahrain posted a 18.3 percent yoy growth in the third quarter of 2017, after an average 7.9 percent yoy uptick in the first and second quarters. And, Kuwait reported a 13 percent yoy increase in the third quarter of 2017 following an 11.2 percent yoy gain in the first quarter.

Subdued imports amid a modest recovery in exports resulted in Kuwait, Oman, Qatar and Saudi Arabia posting trade

FIGURE 14

Crude oil exports
Million barrels per day

Source: Joint Oil Data Initiative (JODI) Oil World Database.

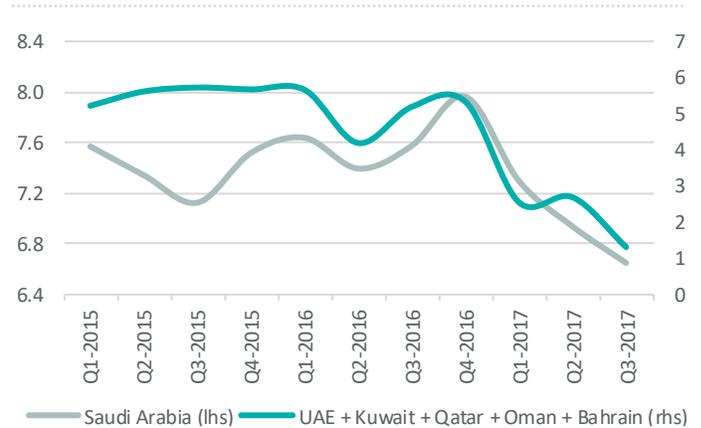


FIGURE 15

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

Sources: Haver Analytics, International Monetary Fund (IMF).



FIGURE 16

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

Source: Haver Analytics.

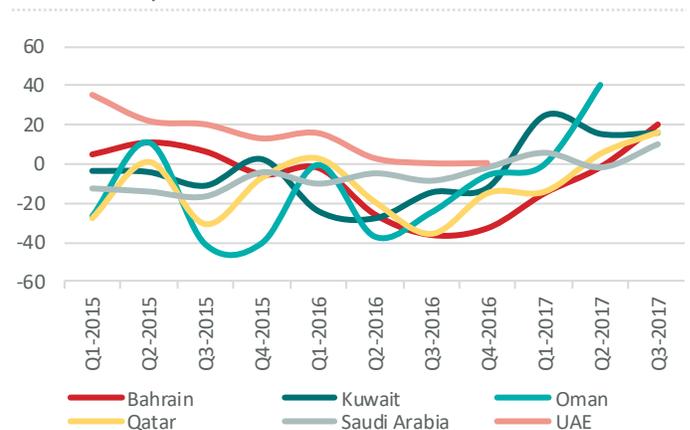
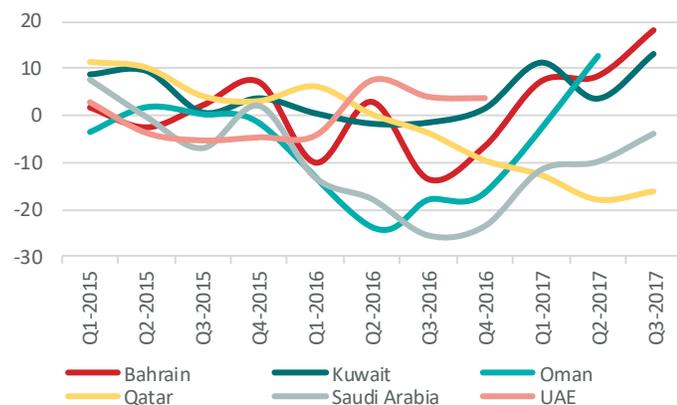


FIGURE 17

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

Sources: Haver Analytics, International Monetary Fund (IMF).



surpluses in the first to third quarters of 2017. Additionally, Qatar and Saudi Arabia reported current account surpluses through the third quarter of 2017, reversing the deficits in 2016 and 2017.

... easing pressure on currencies and reserves

The early trade surpluses have eased pressure on the GCC currencies, just as the U.S. dollar has weakened. Previously, a strengthening U.S. dollar (the U.S. dollar index gained 13.3 percent in broad nominal terms and 12.4 percent in broad price-adjusted terms from January 2015 to its 14-year high in December 2016), collapsing oil prices beginning in mid-2014, and sharp current account deficits in 2015-16 exerted pressure on the GCC currencies' peg to the U.S. dollar. The GCC countries drew down 22 percent of reserves from a combined \$908 billion in end-2014 to US\$705 billion in end-2016.

Maintaining their dollar pegs, the GCC currencies have depreciated against trading partner currencies in tandem with the U.S. dollar. The U.S. dollar lost 5.7 percent in broad nominal terms from January to November 2017, and the GCC currencies adjusted in the same direction (Figure 18).

Qatar and Saudi Arabia continued to draw down on reserves in the first half of 2017, although for altogether different purposes. Qatar used US\$9.5 billion of reserves in the second quarter of 2017 as it battled the measures imposed on it. The decline has been stemmed in recent months, and reserves have begun to increase, nonetheless at US\$37 billion in end-November 2017, these are still down 8 percent relative to end-June 2017. The reduction in reserves (excluding gold) in Saudi Arabia – from US\$535 billion at the end of 2016 to US\$484 billion at the end of September 2017 – is reportedly associated with the transfer of assets from the Saudi Arabia Monetary Authority (SAMA), which controls the sovereign wealth fund SAMA Foreign Holdings, to the

FIGURE 18

Nominal effective exchange rates Change, + = appreciation

Sources: U.S. Federal Reserve Board, International Monetary Fund (IMF).



other Saudi sovereign wealth fund Public Investment Fund (PIF), and the deposit by the PIF of funds with banks abroad. Reserves have since slightly improved to US\$493 billion at the end of 2017.

By at least one metric, months of imports of goods, the GCC foreign reserve positions are generally adequate, except in Bahrain. Notwithstanding the drawdowns, Saudi Arabia's reserves stood at close to 50 months of imports of goods in the third quarter of 2017, compared to 56 months in end-2016. By mid-year, Kuwait had 13 months and Qatar 11 months, and at the end of the first quarter, Oman had 7.5 months. The UAE had foreign reserves worth five months of imports in end-2016 and Bahrain four months, although the latter had dropped to two months in end-June 2017.

Other than the foreign reserves held by their central banks, the GCC countries also have recourse to the assets of their sovereign wealth funds. GCC sovereign wealth funds are among the largest in the world, including in Qatar, Kuwait and the UAE, which have served as anchors for investor confidence in their economies and have earned generally high investment grade ratings in international markets.

In addition, Bahrain has had support from a regional resource, the GCC Development Fund. Bahrain has the smallest central bank foreign reserves and the smallest sovereign wealth fund (Mumtalakat Holding Company) with assets estimated at around US\$10.6 billion, one third of 2016 GDP. But Bahrain has had the strong support of the GCC, especially Saudi Arabia, through the GCC Development Fund, which supports the Vision 2030 development goals. Bahrain had been allocated US\$6.7 billion for projects as of end-June 2017. The explicit support from the GCC and the implicit backing of Saudi Arabia likely played some part in supporting investor confidence in Bahrain's US\$3.0 billion international debt sale in September 2017.

PRICES AND CREDIT

Inflation has moderated

Consumer prices remain subdued in the GCC so far in the year, compared to 2016. Prices in Saudi Arabia have been falling since the beginning of 2017, reflecting sluggish domestic demand (Figure 19). Deflation pressures eased somewhat in June after the government introduced excise taxes on tobacco, sugary drinks and soft drinks (food and beverages account for 20 percent of the consumer price index (CPI) basket). Inflation has decelerated in the UAE; in Kuwait, due to weak food prices and declining housing costs; and, in Qatar, despite the disruption in food imports beginning in June 2017. The economic measures imposed on Qatar had a mixed impact on the country's inflation, pushing up food prices on one hand but depressing housing prices on the other.

After rising to a four-year high of 2.8 percent in March 2017, inflation in Oman moderated to 1.7 percent yoy in November. With subsidy reform ongoing (domestic fuel prices were linked to movements in international oil prices beginning in early 2016), inflation is likely to edge up again in the coming months. Inflation has slowly risen in 2017 in Bahrain, from 0.8 percent yoy in January to 2.9 percent yoy in November. Still, the annual rate in 2017 will remain lower than the 3.0 percent in 2016. Higher utility tariffs will lead to a further pickup of inflation in Bahrain, although not as much as in 2016 when cuts to subsidies exerted upward pressure on prices.

Credit growth has slowed

Bank credit to the private sector has trended downward across the region. In part, this reflects both weaker demand due to a slowing of the infrastructure boom across the GCC region as governments have tightened fiscal policy and a cooling of regional property booms. Credit growth in the first to third quarters of 2017 was lower than in the first to third quarters of 2016 in all of the GCC countries (Figure 20). In Qatar, private sector credit growth has stabilized at around 7 percent yoy in recent months, despite the diplomatic rift, likely due to continued demand related to FIFA projects.

Deposits at banks, including government deposits, grew in the period. Total deposits at banks grew faster in the first to third quarters of 2017 than they did a year ago, except in Kuwait where the growth rate has trended downward. Government deposits also grew more robustly in countries where they comprise an important source of bank funding. In Oman, where they comprise 20 percent of bank liabilities, government deposits expanded an average 14 percent yoy in the first to third quarters of 2017. In Qatar, the increase in government deposits has more than compensated for withdrawals by foreign depositors, so that public sector deposits now account for more than a third of banking sector deposits.

FIGURE 19

CPI inflation Percent year-on-year

Source: Haver Analytics.

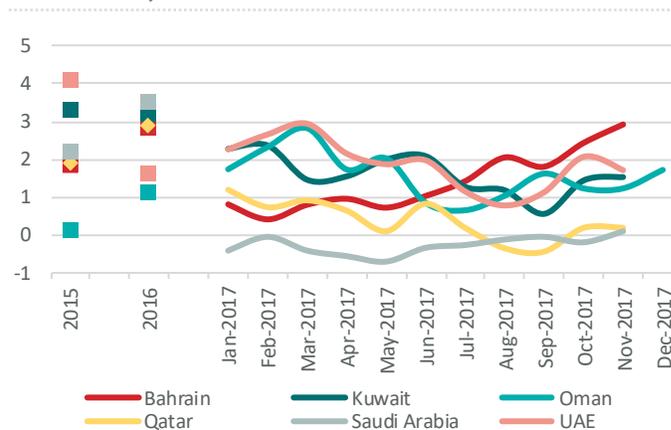


FIGURE 20

Bank claims on the private sector, growth Percent year-on-year

Source: Haver Analytics.

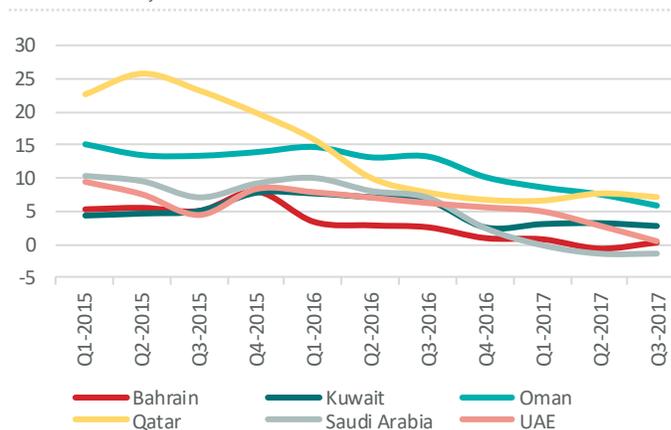


FIGURE 21

Government deposits at banks, growth Percent year-on-year

Source: Haver Analytics.

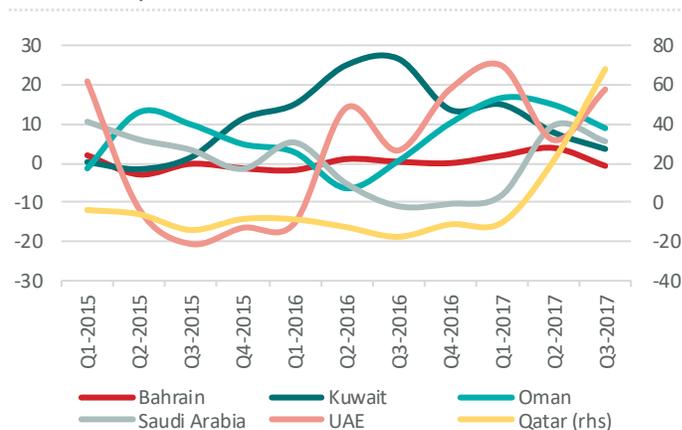


FIGURE 22

Central bank policy rates
Percent

Source: Haver Analytics.

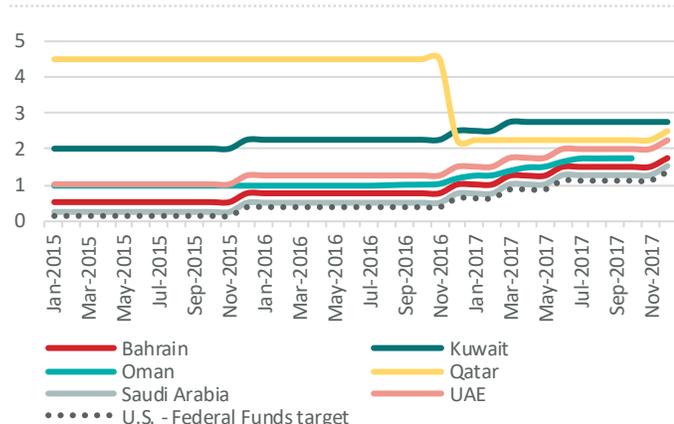


FIGURE 23

Lending rate, adjusted for CPI inflation rate
Percent

Sources: IMF, International Financial Statistics.

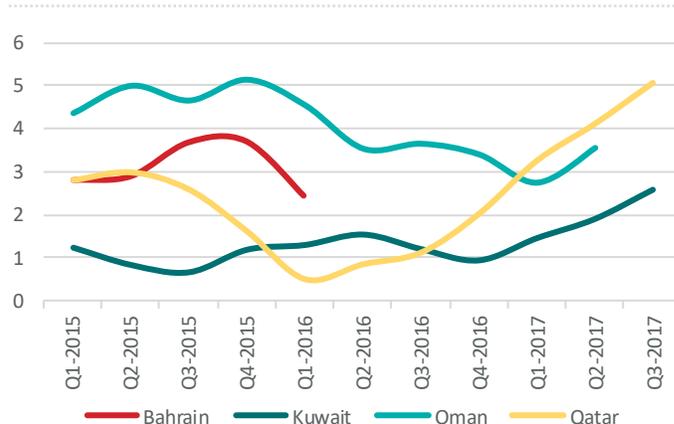


FIGURE 24

GDP growth
Percent year-on-year

Source: World Bank Group.

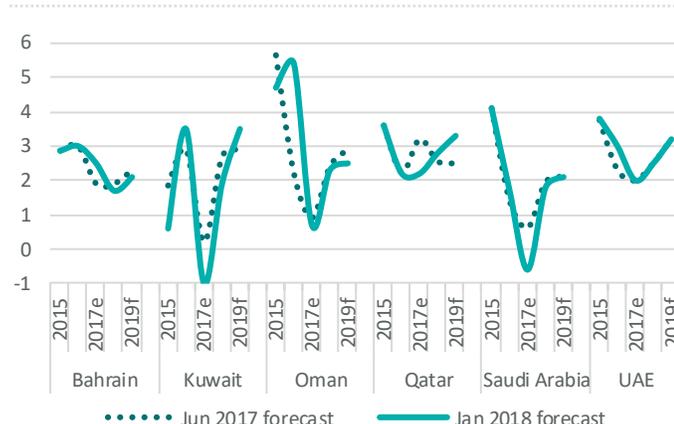
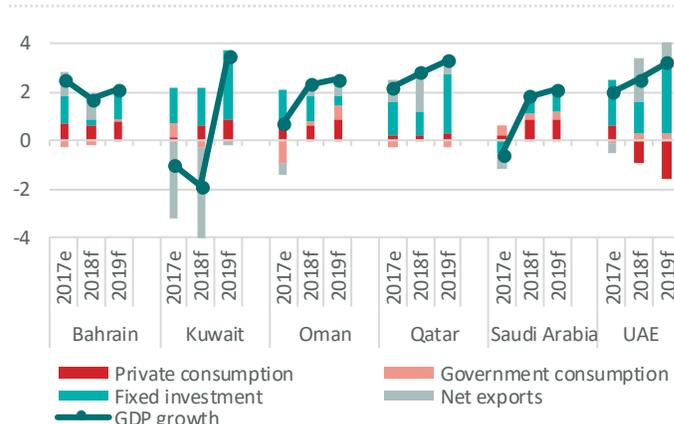


FIGURE 25

GDP growth, percent year-on-year, and contribution to growth, percentage points

Source: World Bank Group.



MONETARY POLICY

Central banks raised rates, but policy remains accommodative

Most GCC central banks raised policy rates in tandem with the U.S. Federal Reserve. With their currencies pegged to the U.S. dollar (or to a basket of currencies with a heavy weighting on the U.S. dollar, in the case of Kuwait), the GCC central banks largely matched the U.S. rate hikes of December 2016 and of March, June, and December 2017. Saudi Arabia, the UAE, and Bahrain raised policy rates four times over the same period; Kuwait, twice (in December 2016 and March 2017); and Qatar, once (in December 2017). Oman raised rates gradually each month, taking the average repo rate from 1.19 percent in December 2016 to 1.74 percent in October 2017. Notwithstanding the rate increases, monetary

policy remains accommodative. Real lending rates stand mostly under 5 percent (Figure 23).

Near term prospects and key risks

The economic outlook for the GCC countries remains positive (Table 1), supported by a gradual and moderate recovery in oil prices and the expiry of the OPEC+ production agreement after 2018, sustained construction activity, and a slower pace of fiscal austerity (Figure 24). Aggregate regional growth is projected to increase from a very weak 0.5 percent in 2017 to 2.1 percent in 2018 and 2.7 percent in 2019, mainly led by a resumption in growth in Saudi Arabia and Kuwait. Stronger global growth and robust international trade and favorable financing conditions will support the upturn in the GCC economies.

TABLE 1

MENA GCC forecast summary

(annual percent change,
unless otherwise specified)

	2015	2016	2017e	2018f	2019f
AGGREGATE GCC COUNTRIES					
GDP at market prices	3.7	2.5	0.5	2.1	2.7
<i>Contributions to growth</i>					
Private consumption	-0.1	0.7	0.5	0.9	0.9
Government consumption	0.3	-2.6	0.1	0.2	0.2
Fixed investment	1.2	-1.1	1.2	0.9	1.9
Net exports, GNFS ¹	1.2	4.4	-0.7	0.7	0.4
Current account balance (% of GDP)	-2.2	-3.3	1.7	2.0	2.2
Fiscal balance (% of GDP)	-9.1	-10.5	-6.1	-5.0	-3.4
Terms of trade	2.2	9.2	-1.9	0.2	-0.4
INDIVIDUAL GCC COUNTRIES					
GDP at market prices					
United Arab Emirates	3.8	3.0	2.0	2.5	3.2
Bahrain	2.9	3.0	2.5	1.7	2.1
Kuwait	0.6	3.6	-1.0	1.9	3.5
Oman	4.7	5.4	0.7	2.3	2.5
Qatar	4.0	2.2	2.2	2.8	3.3
Kingdom of Saudi Arabia	4.1	1.7	-0.6	1.8	2.1

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).

Growth in 2018 will be led by fixed investment

Fixed investment will lift growth in most GCC countries. Massive construction and public investment programs are underway in the UAE, Qatar, and Kuwait (Figure 25). There will be scope for contributions to growth from private consumption, as well, in Saudi Arabia, Oman and Bahrain. Overall, there will be less of a drag to growth from a poor performance in public consumption and net exports in 2018-19 than in 2015-17.

Growth will recover moderately in Saudi Arabia to 1.8 percent in 2018, as the economy adjusts to the effects of the fiscal consolidation begun in 2015. Growth will then strengthen in the medium term, beginning at 2.1 percent yoy in 2019, as the structural reform measures advanced under Vision 2030 and the National Transformation Program are implemented. The reforms aim to reduce the country's dependence on oil and expedite the development of the private sector. The economy contracted in Saudi Arabia in 2017, at an estimated 0.6 percent. Oil GDP will decline in line with Saudi Arabia's commitments under the OPEC+ agreement under which the world's second biggest oil producer in 2016 shoulders the largest of the OPEC production cutbacks through end 2018.

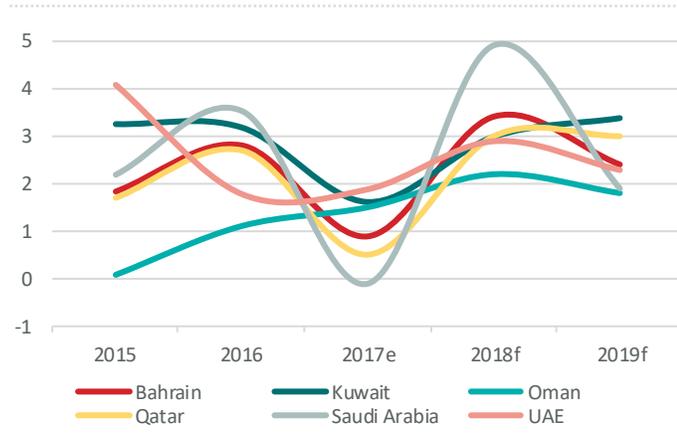
In the UAE, fixed investment will spur growth back to over 3.0 percent by 2019. The implementation of mega projects associated with Dubai's hosting of the universal exposition Expo 2020 (the first to be held in the MENA region) is expected

to boost fixed investment growth. The 2018 budget for Dubai envisages a 20 percent increase in spending over 2017 budget plans and a 46.5 percent increase in infrastructure investment. Growth in the UAE will also be supported by an easing in the pace of fiscal consolidation, underway since 2015, and a recovery in trade and tourism. The UAE will continue to benefit from its safe haven status in the region and its role as a commercial hub in trade with Iran. The implementation of the value-added tax (VAT) and excise taxes in 2018 is not expected to have a significant adverse impact on economic growth.

Fixed investment is also expected to drive growth in Qatar through 2019, barring an escalation of the country's rift with its GCC partners or any worsening of the economic fallout from the measures imposed on the country. The multi-year US\$130 billion infrastructure program (98 percent of 2016 GDP) for the 2020 FIFA World Cup will help offset the effects of the measures imposed by Saudi Arabia, the UAE, and other Arab countries. The future launch of the US\$10 billion Barzan Gas Project, slated to add 2 billion cubic feet per day to the production capacity of the world's largest LNG gas exporter, will also support medium-term growth, which is expected to pick up to 2.8 percent in 2018 and 3.3 percent in 2019. Major labor reforms announced in the summer for expatriate workers --- a first among GCC countries --- will improve conditions for expatriates, and also help attract and retain highly skilled expatriates who are necessary to meet long term diversification objectives. Growth in 2017 was likely a percentage point lower than previously

FIGURE 26**CPI inflation**
Percent

Source: World Bank Group.



forecast, at 2.2 percent, embedding the effects of the ongoing fiscal consolidation as well as of trade diversion resulting from the measures imposed on Qatar by its larger GCC partners.

Growth in Kuwait is expected to rebound to 3.5 percent in 2019. Early improvements in project implementation and gains in fixed investment were unlikely to have offset the decline in oil GDP in 2017 for the GCC's economy that is second most dependent on the hydrocarbon sector. However, plans to invest US\$115 billion (over 107 percent of 2016 GDP) in the oil sector over the next five years should boost oil GDP in line with the gradual recovery in oil prices in 2018-19. The growth forecast for 2019 assumes continued improvements in project implementation under the Five-Year Development Plan for 2015/16 to 2019/20, including progress with long-stalled strategic large-scale infrastructure and construction projects, and with public-private partnerships (PPPs).

In Oman, growth is expected to recover to 2.3 percent in 2018, after a moderate growth rate of less than 1 percent in 2017. The expected growth recovery will be mainly driven by a boost in the hydrocarbon sector accompanied by pro-business reforms. The state-owned Oman Oil Company and British Petroleum started production in September 2017 from the massive US\$16.0 billion Khazzan Gas Project. Deploying the largest application so far in the Middle East of U.S.-style fracking technology, the two phases of the project will deliver an estimated 10.5 trillion cubic feet of recoverable gas resources by 2020. In general, recent efforts by the authorities to advance the goals of the 9th Five-Year Development Plan of 2016-20 through a set of concrete actions under the National Program for Enhancing Economic Diversification (Tandfeedh), including projects in manufacturing, logistics and tourism, are expected to boost growth prospects in the medium-term.

Bahrain may not replicate last year's growth uptick in 2017-19. Elevated levels of oil production in early 2016 have not since

been sustained. External funding for major infrastructure projects will likely be cut by a fourth following the diplomatic rift with Qatar (the GCC Development Fund had previously committed US\$10.0 billion for projects through 2021, US\$2.5 billion of which had been pledged by Qatar). Exports from industrial projects slated for completion in 2019-21 will partially offset the lower levels of fixed investment in the future: aluminum exports from the new potline at Aluminium Bahrain, set to become operational in 2019, and petroleum products from the expansion of the Sitra oil refinery, in 2020-21. Growth is forecast at 1.7 percent in 2018 and 2.1 percent in 2019.

Inflation will pick up in 2018, but moderate in 2019

Inflation is expected to generally pick up in the GCC in 2018, as the VAT is introduced across the region. In Saudi Arabia and the UAE, where the authorities have implemented the VAT and excise taxes starting in January 2018, CPI inflation is anticipated to rise to 4.9 percent and 2.9 percent respectively (Figure 26). These and the other forecasts of rising inflation in 2018 assume that the inflationary impact of the VAT will be one-off, and will not lead workers to demand higher wages or sellers to raise prices more generally. The forecasts also assume that the VAT will not have cascading effects --- the maximum direct effect on the price level will not exceed the tax rate (5 percent). These appear to be reasonable assumptions, reinforced by the expectation that the zero-rating (i.e., the exemption) of certain classes of goods and services will reduce the inflationary impact of the tax.

Thereafter, inflation will moderate in 2019. The inflationary impact of the VAT will dissipate after 2018-19. Moreover, the GCC governments would have implemented the bulk of energy price subsidy reforms by the end of the forecast period, dampening their short-term price-boosting effects. Inflation is expected to hover under 2 percent in Oman and Saudi Arabia in 2019, under 2.5 percent in Bahrain and the UAE, and under 3.5 percent in Kuwait.

The recovery in oil prices will help reverse, or narrow, current account deficits

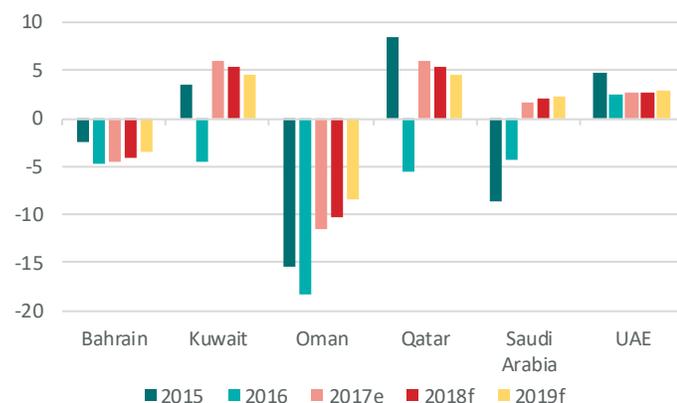
The GCC countries, except Oman and Bahrain, are expected to post current account surpluses, at the latest by 2019. Exports will benefit from the conclusion of the OPEC+ supply reduction agreement -- expected after 2018 -- and the gradual and moderate recovery in oil prices through 2018-19 as oversupply in oil markets diminishes. The pace at which current account balances will improve will vary among the GCC countries (Figure 27), determined as well by the performance of their services, primary income, and secondary income accounts.

The surplus in the UAE will be more modest than in the past, averaging 2.8 percent of GDP in 2017-19, compared to 13.9 percent of GDP in 2010-13 before oil prices halved from mid-2014. In addition to a better crude oil export performance, progress with transportation infrastructure projects will augment

FIGURE 27

Current account balance Percent of GDP

Source: World Bank Group.



non-oil export earnings. In Saudi Arabia, the recovery in oil prices will boost oil export receipts. Merchandise trade will also be spurred by rising export volumes of aluminum, phosphates and petrochemicals. The authorities have also announced plans to curb current transfers (remittances). Qatar will benefit from the recovery in oil and gas prices. Its surplus will decline, however, as capital goods imports for its infrastructure projects expand and as the import costs associated with the diversion of trade to alternative partners (that has been necessitated by the rift with its neighbors) increase. The country's continued reliance on international oil firms and foreign workers will keep its primary and secondary income accounts in deficit. Qatar is most reliant among the GCC countries on expatriate labor, with some 2.2 million expatriate workers in the country relative to a native population of about 300,000.

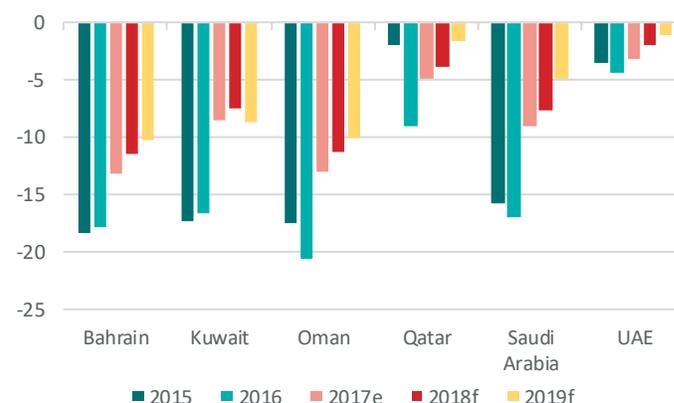
Kuwait is expected to post a current account surplus in 2017-19. The trade performance in Kuwait will be driven by oil exports, which have comprised over 90 percent of total merchandise exports over the past two decades. The improvement in oil prices, relative to previous years, will lead to a modest narrowing of the current account deficit in Bahrain in 2017-19. An increase in exports from major industrial projects, aluminum from Aluminum Bahrain and refined petroleum products from the Sitra oil refinery, will also help narrow the deficit.

The current account deficit in Oman will likely persist, but should narrow steadily over 2017-19. Oman will maintain a merchandise goods trade surplus as oil prices recover and as natural gas exports increase following the start of production from the Khazzan Gas Project. The services account, historically in deficit, will benefit from rising tourism receipts. As in Qatar, the primary income account in Oman will remain in deficit from continuing profit repatriation by foreign companies, and the secondary income account, from high levels of outward remittances in the GCC economy that is second most dependent on expatriate labor.

FIGURE 28

General government balance Percent of GDP

Source: World Bank Group. Note: Kuwait's balance excludes investment income and transfers to the sovereign wealth fund.



Fiscal adjustment will continue, with favorable results...

Fiscal balances are set to steadily improve across the GCC countries. The expected gains are underpinned by fiscal reforms, many of which are underway and others of which are to be introduced in 2018 and 2019 (Figure 28). All six GCC countries had previously agreed to implement a region-wide harmonized value added tax (VAT) system starting in 2018. The Unified VAT Agreement allows a basic tax rate of 5 percent, albeit with certain classes of goods and services exempt from coverage, and sets the framework under which each member state will issue its own local law to implement the tax. The degree of preparedness for the VAT varies, with the UAE the most advanced in terms of administrative and business capacity and systems. Saudi Arabia and the UAE are implementing the tax in January 2018, with the other GCC countries expected to follow suit by 2019.

In Saudi Arabia, the fiscal deficit is expected to narrow substantially from 16.9 percent of GDP in 2016 to 4.9 percent of GDP in 2019. The government previously committed that the next phases of the revenue and expenditure reform programs outlined in the Fiscal Balance Program will be introduced as scheduled, including: the continued reform of the household allowance program from 2017 onward; the implementation of the VAT in 2018; the introduction of luxury tariffs in 2018; the adjustment of non-household electricity prices and household water prices to their reference prices by 2018 and 2019 respectively; and, the linkage of all unpegged energy product prices to reference prices by 2019. The government also committed that expenditure savings identified by the Bureau of Spending Rationalizations will be realized.

The 2018 Saudi budget, however, indicates that the authorities are now taking a more gradual approach to fiscal adjustment, prioritizing growth over fiscal consolidation and pushing out

plans to balance the budget to 2023 (from 2020 previously) in order to soften the impact of the adjustment on households and firms. Spending is expected to rise by 5.6 percent in 2018 over 2017 budgeted levels, the highest on record for the country. This reflects a more gradual approach to cutting subsidies: the target of reaching parity with international oil prices has been postponed from 2020 to 2025. The higher spending also reflects earmarks for the “Citizens’ Account” cash transfer program. The deficit is projected to decline to 7.6 percent of GDP in 2018, supported by rising oil revenues and receipts from the newly introduced VAT. The deficit could however prove larger given the cost of new support measures announced in January 2018: additional monthly allowances for state employees, pensioners and social security recipients; extra stipends for students; one-off bonuses for soldiers on the Yemen front; and, state coverage of VAT costs for health and education services as well as for first-time home purchases. Besides the issuance of debt, the 2018 fiscal deficit is expected to be partly financed by drawdowns of Saudi Riyal from the stock of government deposits and international reserves.

The fiscal position will remain sustainable in the UAE in the forecast period. Ample fiscal space will allow the UAE to more gradually execute its fiscal adjustment program, which had been front-loaded in 2015-16 following the collapse of oil prices from mid-2014. The introduction of the VAT in 2018 will complement recent energy subsidy reforms and help diversify revenues away from oil. Moreover, continued efforts to contain the growth of public spending will generate fiscal savings to help support public investment. The deficit is expected to improve steadily from 3.2 percent of GDP in 2017 to 1.0 percent of GDP in 2019.

Notwithstanding the diplomatic rift, Qatar is expected to continue with its fiscal consolidation plan in the medium-term. The government is expected to persevere with fiscal adjustment, focusing on tax policy, including the VAT and indirect taxes and levies, as well as tax administration measures. The government is also expected to continue to reduce subsidies and to rationalize recurrent expenditures, albeit at a more measured pace as Qatar endeavors to protect its population from the economic and social costs of the trade restrictions. The introduction of the VAT and excise taxes in 2018-19 will help Qatar contain the deficit at under 4.0 percent of GDP in 2018-19.

Kuwait will likely post fiscal deficits in the near term, but lower than in 2015 and 2016, when investment income from and transfers to the sovereign wealth fund are excluded from the calculations. For many years, the government has anchored fiscal policy on obligatory annual transfers of resources (a minimum 10 percent of all state revenues and 10 percent of the net income of the General Reserve Fund) to the Future Generations Fund (the inter-generational saving fund), which has helped provide the government substantial stock of asset buffers of over US\$500 billion. The sovereign wealth fund, the inter-generational saving fund and the low gross government debt in end-2017, estimated around 27 percent of GDP, provide Kuwait the policy space to implement fiscal consolidation

gradually, while increasing public investment to support growth. Nevertheless, fiscal reforms are necessary. The public sector is one of the largest in the world, with a spending to GDP ratio of just over 50 percent. Oil rents are distributed through subsidies, transfers and public employment, with 80 percent of employed Kuwaiti nationals working in the public sector. Reducing the heavy footprint of the state on the economy, and shifting its role from “rowing to steering” the economy is critical if private sector activity is to flourish. The government is expected to gradually remove fuel and electricity subsidies, reprice government services and implement the VAT to channel spending towards more productive uses, and to help diversify revenue away from oil. A medium-term fiscal framework will help guide implementation of the fiscal consolidation plan.

Oman should come close to cutting its large fiscal deficit by half by 2019. Fiscal outturns in the first half of 2017 indicate that the deficit is expected to narrow to 13 percent in the year from 20.8 percent in 2016. A forecast fiscal deficit of 10.1 percent of GDP by 2019 assumes the timely and steadfast implementation of fiscal adjustment: the introduction of the VAT and the imposition of excise duties. The government has also agreed to raise the basic corporate income tax rate to 15 percent from 12 percent, to impose a 3 percent rate on very small companies that had been previously exempt, and remove other exemptions.

Bahrain will see a modest improvement in its fiscal position through 2019. The fiscal deficit is forecast to narrow slightly from an estimated 13.2 percent of GDP in 2017 to 10.2 percent of GDP in 2019. Some of the increase in revenues from the planned implementation of the VAT in 2018-19 will be offset by rising interest payments on government debt. Bahrain has the largest gross government debt among the GCC countries.

...and help moderate the recent rise in gross government debt

Narrowing fiscal deficits imply that the increase in government debt over the forecast period will be relatively more moderate than recently experienced. General government gross debt is forecast to stay flat at around 21 percent of GDP in the UAE in 2017-19, and at 54 percent of GDP in Qatar. Gross debt will still rise, but stay under 55 percent of GDP in Oman, under 40 percent of GDP in Kuwait and under 25 percent of GDP in Saudi Arabia. In Bahrain, where the fiscal deficit will decline only modestly, gross debt will expand from 91 percent of GDP in 2017 to 107 percent of GDP in 2019.

International debt securities issuance will remain important for deficit financing in the medium-term. On the assumption that global financing conditions will remain benign in the forecast period, the GCC governments will likely return to the international debt market for additional sovereign issues in 2018-19. Debt sale terms had been favorable in 2017. Saudi Arabia’s US\$9.0 billion issue was 3.6 times over-subscribed; Kuwait’s US\$8.0 billion, 3.6 times; Oman’s US\$7.0 billion, four times;

FIGURE 29

**General government gross debt
Percent of GDP**

Source: World Bank Group, IMF "World Economic Outlook", October 2017.

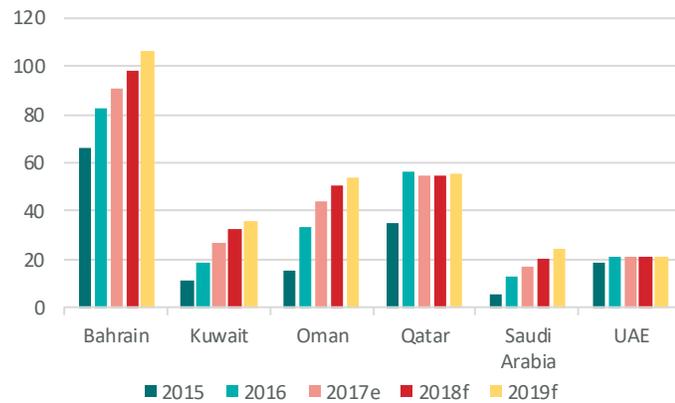


FIGURE 30

U.S. Federal Reserve FOMC participants' assessments of appropriate monetary policy, mid-point of target range or target level for the Federal Funds rate, December 2017

Source: U.S. Federal Reserve Board. Note: Part of the Federal Open Market Committee's (FOMC's) Summary of Economic Projections released along with the policy decision statement, the "dot plot" shows where each FOMC meeting participant thinks the Federal Funds rate should be at the end of the year for the next few years and in the longer run.

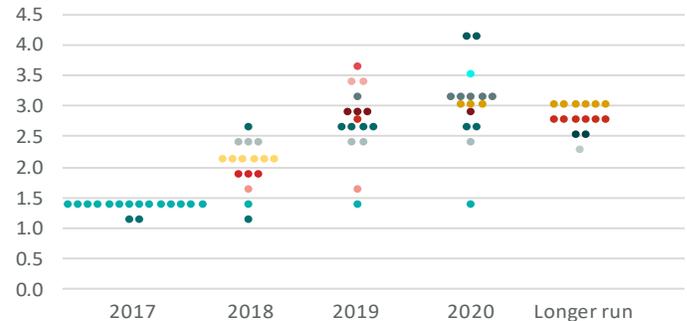


FIGURE 31

Capital adequacy ratios, and Liquidity ratios, end-2016

Source: World Bank Group.

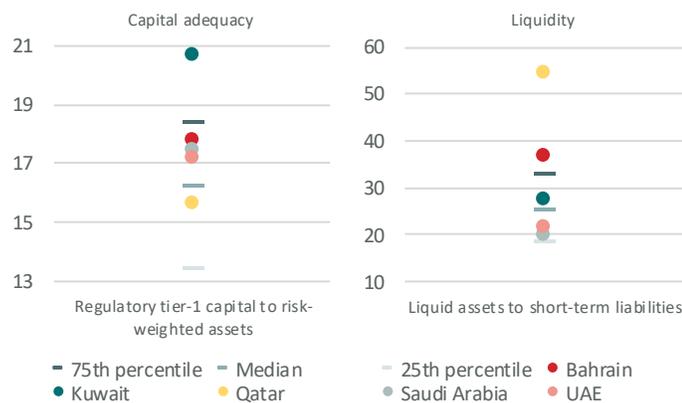
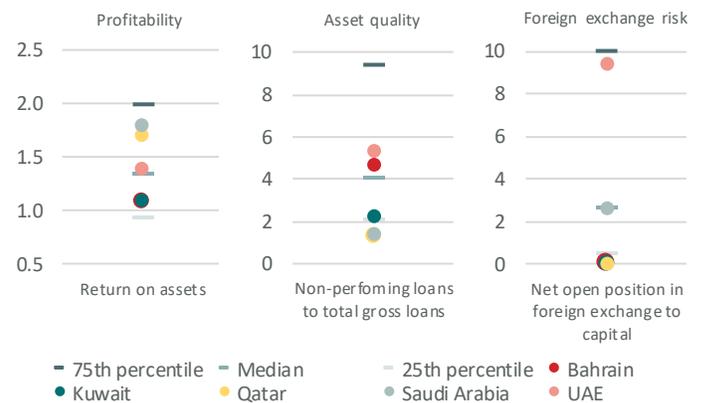


FIGURE 32

Profitability, Asset quality, Foreign exchange risk, end-2016

Source: World Bank Group.



and, Bahrain's US\$3.0 billion, five times. Thanks to the prospect of a low interest rate environment, GCC issuances will likely attract investors anew, given their better yield and superior credit quality.

Maintaining their currency pegs, central banks will likely follow U.S. rate hikes

The GCC countries are likely to maintain their currency pegs. The exchange rate anchor implies that the GCC central banks will likely raise rates in tandem with the U.S. Federal Reserve. The U.S. central bank, which raised rates anew in December 2017, signaled that it saw the Federal Funds rate at 2.125 percent in 2018 (median value) and at 2.8675 percent by the end of 2019 (Figure 30). The GCC central banks will likely keep pace with the U.S. rate increases. Declining international reserves in Oman and Bahrain are of concern however.

Banks remain well-capitalized

The positive medium term outlook requires strong GCC banks. According to the 20172 IMF Financial System Stability Assessment on Saudi Arabia, the banking system had started to normalize by end-2016 after sharply higher government domestic borrowing tightened banking liquidity in 2015-16. Stress tests show that most banks, including all systematically important banks, would be able to continue meeting regulatory capital requirements in the event of additional severe economic shocks. Moreover, all banks would be able to cope with additional adverse liquidity shocks.

Financial soundness indicators also show that other GCC banking sectors are well-capitalized. While the other GCC financial systems have not been recently subject to comprehensive and in-depth assessments, as done in Saudi Arabia, basic financial

strength and vulnerability indicators show that banks in the GCC countries score well on capital adequacy and liquidity relative to the global median or to Saudi Arabia, as a benchmark (Figure 31). Nonetheless, profitability, asset quality, and foreign exchange risk ratios need careful monitoring in some cases (Figure 32).

Risks and long-term challenges

Risks to the regional outlook are on the downside in the medium-term

In the near- to medium-term, the risks to the positive outlook arise from uncertainty in the oil price forecast, any escalation in the ongoing diplomatic rift between Qatar and Saudi Arabia and its partners, and weak institutional capacity which may derail progress with the difficult structural reform measures.

There are significant upside and downside risks to the oil price forecast. On the upside, stronger demand, world output disruptions arising from geopolitical disputes, or production shortfalls in U.S. shale could tighten markets and raise prices above the forecast. On the downside, slower demand growth, faster than expected growth in U.S. shale oil production, rising output from Libya and Nigeria (which are exempt from the production cuts), or weaker compliance with the OPEC+ agreement could derail the rebalancing and lower prices below the forecast. Lower than expected oil prices will dampen medium-term growth in the GCC economies, given their heavy reliance on oil and gas production, exports and revenues, and will exert pressure on the OPEC producers and their non-OPEC allies to extend or deepen the production agreement.

Any escalation of the diplomatic dispute in the GCC could hurt economic prospects in the region as a whole. The harm will arise not from any further disruption to trade, given the small amount of intra-regional goods exchange in the GCC, but from damage to investor sentiment, which will derail investment activity, or to market sentiment, which will disrupt financial flows.

The multi-sectoral reform agendas of the GCC countries are necessarily complex, requiring strong political resolve as well as strategic coordination and strong institutional capabilities if they are to be implemented well. Slippage on any of these fronts will rob the GCC of the benefits of fiscal adjustment and of economic reorganization. Complacency may set in as oil prices rise and fiscal and external account deficits narrow. Political resistance could grow as economic reforms dislodge vested business interests and expenditure and subsidy reforms harm middle and lower income households. And administrative capacity could decline as structural reform measures advance in scope and scale. The lack of institutional experience with the complexities of adjustment and reform programs could also be a complicating factor.

The enduring dominance of oil and gas production, exports and revenues in the GCC economies (Box 1) argues for the vigorous

BOX 1

Hydrocarbon GDP, exports and revenues in the GCC

The oil and gas sectors have been the mainstay of the GCC economies historically. The decline in oil prices in 2008-09 and recently in 2014-16 barely dented the dominance of hydrocarbon production, exports, and revenues in the GCC economies.

The hydrocarbon sector accounts for more than half of GDP in Qatar, Kuwait, Saudi Arabia and Oman. Bahrain and the United Arab Emirates are the most diversified of the GCC countries; still, the hydrocarbon sector comprises roughly a third of GDP (Figure B1). The contraction of the hydrocarbon economy since oil prices collapsed beginning in mid-2014 dented GDP growth in 2014-16 (Figure B2).

Oil and gas exports comprise 80 percent or more of all merchandise exports in Kuwait, Oman, Qatar and Saudi Arabia. The ratios have remained high even in periods of falling oil and prices (Figure B3). The GCC countries suffered sizable terms-of-trade shocks in 2015-16 as oil prices collapsed (Figure B4). To shore up their economies and maintain their currency peg, the GCC increased domestic and foreign borrowing, used international reserves, and tapped past savings (i.e., the asset holdings of their sovereign wealth funds).

Kuwait, Qatar, Saudi Arabia, Oman and Bahrain relied on hydrocarbon revenues for 80-90 percent of their fiscal revenues in the past two decades. The ratio for the United Arab Emirates, the GCC member least reliant on hydrocarbon revenues, was 70 percent, although the figure dipped to 55 percent in periods of falling oil prices (Figure B5). The loss of revenues forced governments to cut spending sizably in 2015-16 (Figure B6).

FIGURE B1

Qatar, the world's largest LNG producer, has the largest hydrocarbon sector, percentage of GDP

Source: Haver Analytics.

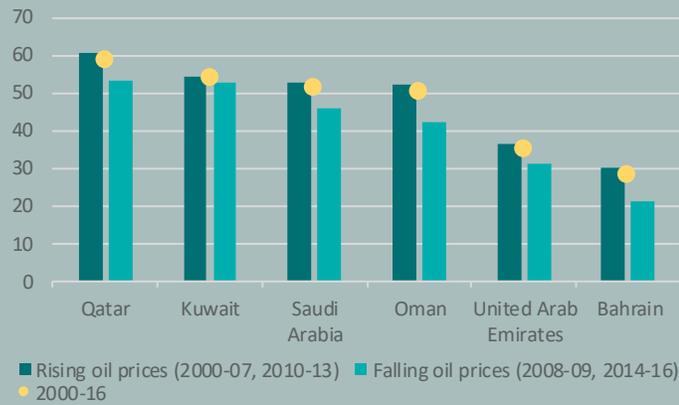


FIGURE B2

Hydrocarbon GDP contributed little to economic growth in 2015-16, in percentage points

Source: World Bank Group.

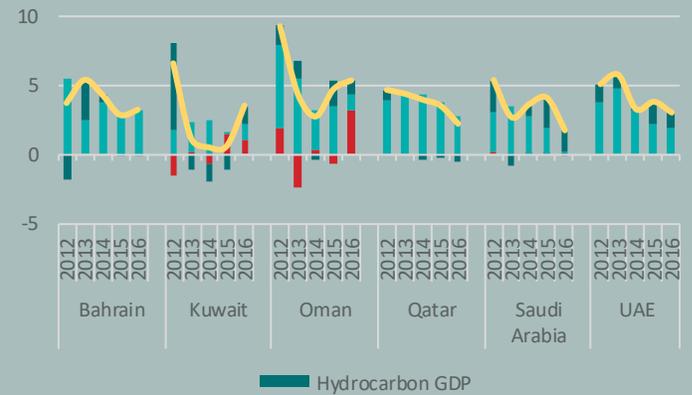


FIGURE B3

Nearly all of Kuwait's exports are hydrocarbon exports, percent of total merchandise exports

Source: U.N. Comtrade.

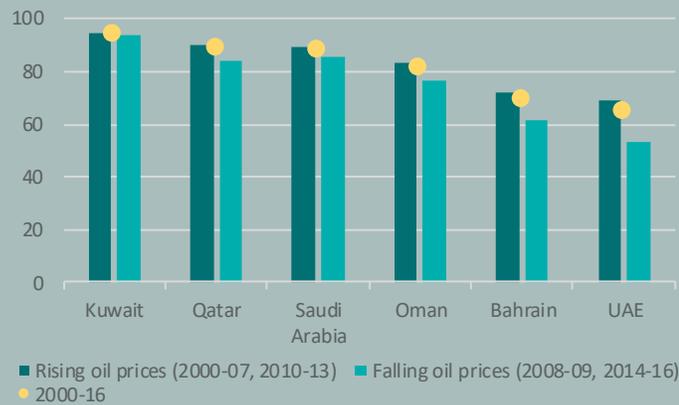


FIGURE B4

The terms of trade deteriorated most sharply for Kuwait, Saudi Arabia, Qatar and Oman, 2010 = 100

Source: Haver Analytics.

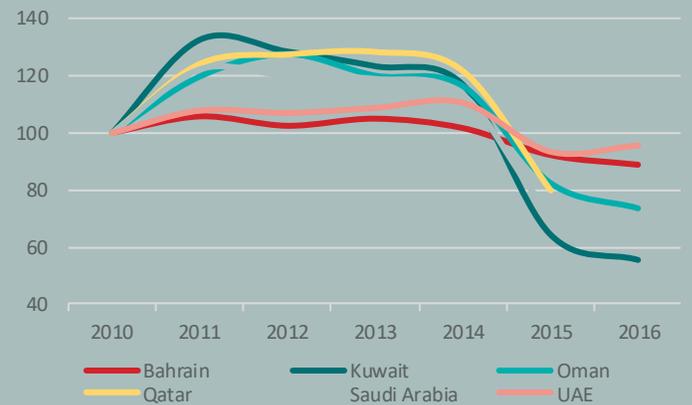


FIGURE B5

Hydrocarbon receipts are 85 percent of government revenues in Saudi Arabia, the world's second largest oil producer, percent of general government revenue

Source: Haver Analytics.

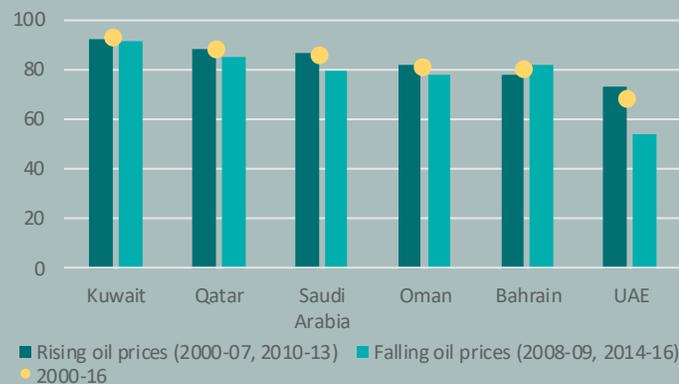
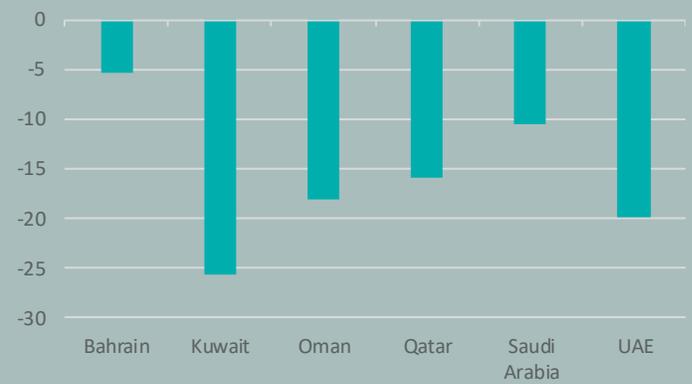


FIGURE B6

The GCC made large-scale spending cuts as hydrocarbon revenues dried up. General government spending, cumulative decrease in 2015-16, in percent from 2014

Source: World Bank Group.



implementation of structural reforms to accelerate economic diversification. Following the collapse of oil prices beginning in mid-2014, the GCC countries designed ambitious plans to transform their economies, starting with fiscal consolidation in the aftermath of the oil price decline and progressing toward private sector development, public sector reform, and social development in the medium to long term period. The downside risks to the forecasts for an economic upturn in 2018-19 highlight the need for the GCC countries to strengthen their commitment to these reform plans.

The GCC structural reform plans need clarity, prioritization, sequencing... and political commitment

The redrafting of the National Transformation Program (NTP) --- into NTP2.0 --- affords Saudi Arabia the opportunity to give its reform plans greater clarity and focus. Originally designed to overhaul the Saudi bureaucracy with program targets for each government ministry through 2020, the NTP is now one of 12 “vision realization plans” associated with Vision 2030. Detailing the program elements of the NTP, which had since been expanded to lift the private sector share of the economy from 40 to 65 percent and the small and medium enterprise (SME) contribution from 20 to 35 percent among other targets, should help with the effective implementation of Vision 2030, Saudi Arabia’s ambitious and wide-ranging effort to significantly transform its economy over the next 15 years.

As with Saudi Arabia’s Vision 2030, the other GCC countries’ own Vision documents aspire to construct competitive economies that are diversified away from hydrocarbons. Bahrain’s Economic Vision 2030, Kuwait’s Vision 2035, Oman’s Vision 2020, Qatar’s National Vision 2030, and the UAE’s Vision 2021 also aim to develop productive industries and enhance human capital in the GCC countries. The Vision statements are uniformly supported by development plans that seek to operationalize the overarching goals with specific public policies and concrete government programs, including by Qatar’s National Development Strategy (2017-22), Bahrain’s National Development Strategy (2015-18), Kuwait’s Development Plan (2015-20), and Oman’s Ninth Development Plan (2016-20) and National Program for Enhancing Economic Diversification (Tanfeedh).

The political commitment to reform remains vital. The GCC authorities would benefit from continuing efforts to refine their long-term development objectives and prioritize and sequence their reform plans as evolving conditions warrant. However, recrafting the strategy documents should not detract from the obviously more important task of executing the reform plans. Implementing the structural transformation programs across multiple sectors requires continuing political commitment from the GCC governments, which on occasion may have wavered with recent decisions to reverse previous reform measures or to postpone the initiatives to the outer years of the Vision periods. In Kuwait, for instance, while the government has announced major reforms, embedded in the Economic Reform Agenda, it has faced difficulty in building consensus, particularly from

the parliament. Accordingly, although the government has not backtracked, reforms have been watered down⁴ or postponed.

Fiscal reform and further consolidation remain a necessity

Further fiscal consolidation is needed in the GCC countries. The sharp reversal of fiscal surpluses into fiscal deficits beginning in 2014 compelled the front-loading of the fiscal adjustment in 2015-16. The early steps, focused on a first-phase increase in energy prices and utility tariffs, were a good start. Energy price subsidies declined by 1.5-5.0 percentage points of GDP from 2013 to 2016 (Figure 33). But the gains from the petroleum price subsidy reform in 2013-16 were due more to the decline in benchmark international prices than to domestic prices increases, which underlies the theme that, despite recent efforts, energy price rationalization remains an unfinished agenda (Figure 34).

But, energy price reform alone is insufficient to put public finances on a sustainable footing and to ensure that oil wealth is shared equitably with future generations. Fiscal consolidation requires both revenue and expenditure measures, and they are likely to be sizable considering the GCC countries’ heavy reliance on volatile hydrocarbon revenues, their unsustainable levels of spending on subsidies and transfers and the use of public sector employment as a key safety net.

The introduction of the value-added tax (VAT) and the excise taxes on tobacco products and carbonated drinks should help the GCC raise revenues from other than hydrocarbon sources. So far, Saudi Arabia and the UAE have passed the legislation and set the administrative arrangements to implement the VAT in January 2018. The remaining GCC countries are expected to introduce the VAT sometime in 2018 and potentially as late as 2019. The revenue from a VAT is likely to be significant for most GCC countries (Figure 35).

Measures on the expenditure side may be more contentious, but are equally vital to the adjustment effort. The reforms include: second-round adjustments to energy and other subsidized prices while protecting the most vulnerable households, control of the government wage bill by limiting both wage increases and employment, and measures to strengthen public investment management to improve implementation capacity and investment efficiency. It is important, however, that the GCC governments schedule and calibrate the fiscal proposals carefully, as any excessive tightening might exact unreasonable social costs and unduly damage growth prospects.

Promoting private sector activity will enable diversification and spur productivity

Promoting private sector activity will enable economic diversification. Playing oversized roles in their economies, including

⁴/ This is particularly true of electricity price reforms. Prices were originally intended to quadruple. However, by the time reforms were implemented, the cumulative average increase amounted to only 180 percent. In addition, plans for a business profits tax have been delayed.

FIGURE 33

**Energy price subsidies
Percent of GDP**

Source: IMF, "If Not Now, When? - Energy Pricing Reform in Arab Countries", April 2017.

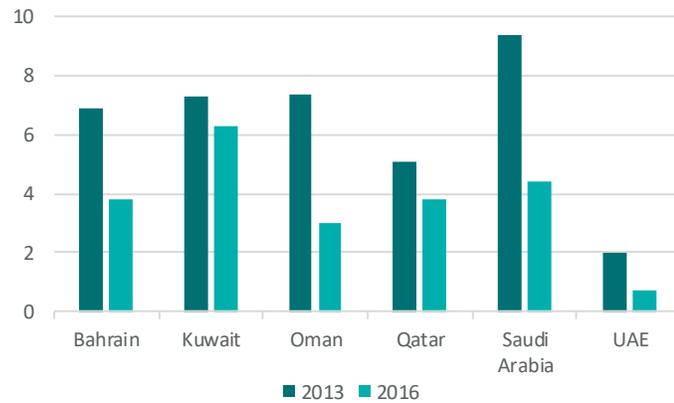


FIGURE 34

Change in petroleum price subsidies, in percent of GDP, and contributions to change in petroleum price subsidies, in percentage points

Source: IMF, "If Not Now, When? - Energy Pricing Reform in Arab Countries", April 2017.

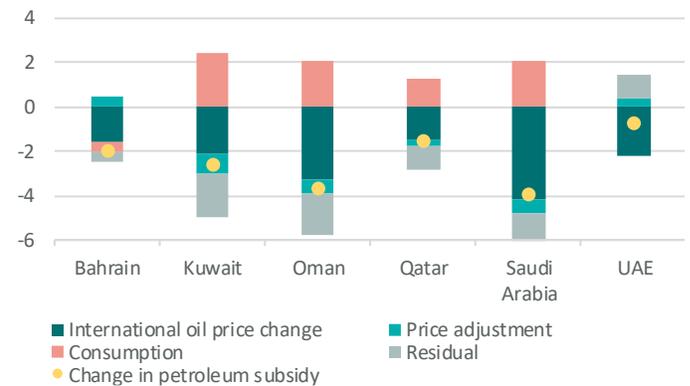


FIGURE 35

**Potential revenue from a 5 percent VAT
Percent of GDP**

Source: IMF, "Diversifying Government Revenues in the GCC: Next Steps", October 2016. Notes: the baseline estimates apply an assumed collection efficiency (C-efficiency) ratio of 58 percent (obtained from a sample of non-GCC countries) to the product of the VAT rate (5 percent) and the consumption (in percent of GDP) of the GCC countries.

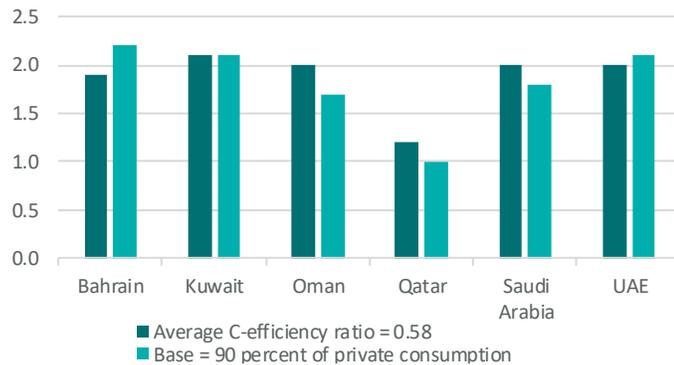
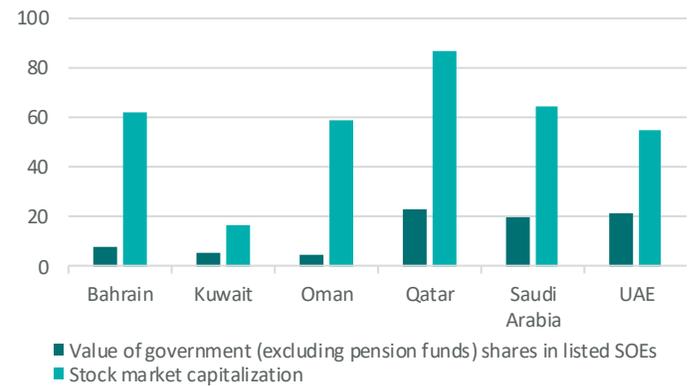


FIGURE 36

**Value of government shares in listed state-owned enterprises, and total stock market capitalization
Percent of GDP, end-2015**

Sources: IMF, "Saudi Arabia Selected Issues", October 2016, and Haver Analytics.



through state-owned enterprises, the GCC governments have begun to consider the privatization of state assets. Data on government shares in listed companies show that the market value of these assets are significant (Figure 36), and therefore the scope for private engagement is substantial.

Saudi Arabia's privatization programs should enhance private sector development in the medium to long term. The government has announced a series of initiatives, employing different modalities of private management and investment, in a wide range of sectors, including airports, waste water treatment facilities, and hospitals. In airports, the proposals include the management of the King Abdulaziz International Airport, the sale of a stake in the King Khalid International Airport to private investors, and, the transfer of ownership of the King Fahd International Airport to the Public Investment Fund (PIF), one of two Saudi sovereign wealth funds. A major test

of the government's privatization resolve comes with the planned sale in 2018 of a five percent stake in the Saudi Arabian Oil Company (Aramco), the world's largest oil and gas company by revenue, in an initial public offering (IPO) that could possibly raise US\$100 billion (15 percent of 2016 GDP), reportedly to help develop other industries in the country. The government converted Aramco to a joint stock company in January 2018, a key step to the IPO.

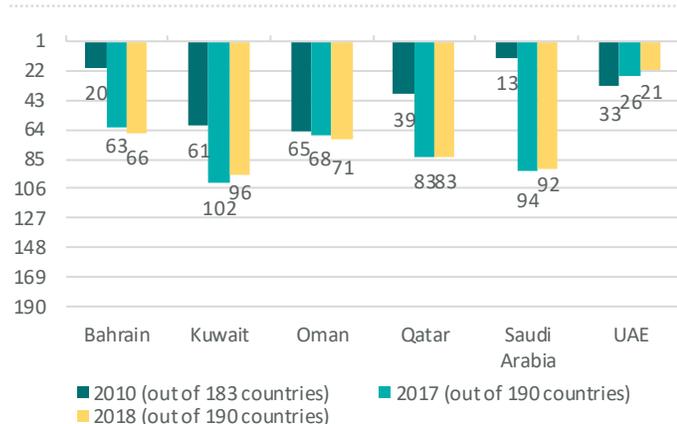
In addition the GCC countries are increasingly turning to public-private partnerships (PPPs) to engage private enterprise and capital in infrastructure. Most countries have developed or are developing the legal frameworks to tender and manage PPPs. Kuwait revised its original 2008 PPP law in 2014 and organized a new body in 2015, the Kuwait Authority for Partnership Projects (KAPP), to encourage foreign private investment. KAPP is also currently preparing

FIGURE 37

Doing Business global ranking

1 = best

Source: World Bank Group, "Doing Business 2018b".



a PPP Investor Guidebook aimed at informing and guiding public entities and private investors on best practices for structuring and implementing PPP projects. After Dubai passed a PPP law in 2015 that does not require private investors to make an initial public offering of shares in the project company, the UAE is considering a PPP law based on the Dubai model. Saudi Arabia is also considering new legislation to facilitate the tendering of PPP projects. And, Qatar and Oman have drafted PPP laws that were planned to be enacted in late 2017 or early 2018.

Several PPP projects have been tendered and awarded since. Oman's Sultan Qaboos Medical City was structured as a PPP in 2016. Dubai awarded a large car park PPP in 2016 and has opened tender for the metro transport hub Union Oasis Station. Saudi Arabia awarded four airport PPPs in 2017, in Taik, Yanbu, Hail and Al-Qassim. Kuwait has opened tenders for railways, hospitals and schools. Qatar is expected to tender a World Cup football stadium and hospitals.

The competitive and regulatory environments will determine whether the PPPs succeed. The expectation with infrastructure PPPs in the GCC, as elsewhere, is that privately implemented projects will result in greater efficiencies in the development of infrastructure, the management of assets, and the provision of services. Whether the GCC projects will achieve these efficiencies will depend on how the governments design the economic incentives and structure the business environments under which the PPP projects will operate. A lack of competition, for example, will provide the PPP projects little incentive to upgrade quality or to reduce costs. In addition, poor contract regulation – an inability to enforce the verifiable terms of contracts, to police the contracting process to deter fraud, and to create modes of resolution including through the bankruptcy code – will hobble PPP operations. Poorly structured PPPs could also contribute to contingent fiscal liabilities

Harnessing the energies of private activity and fostering private entrepreneurship is a complex undertaking. Raising the private sector's share in the economy also involves, among others, business environment reform, business development services, local economic development initiatives, and women's entrepreneurship development. The GCC authorities need to view these activities as long-term efforts, for which sustained engagement will be necessary.

Overall, the GCC countries need to focus on improving their business environment. Among GCC countries, the latest Doing Business global rankings show the UAE as having the most business friendly environment; moreover, the country has maintained its relatively high rankings over the past decade. Other GCC countries (save Oman) however have seen rankings deteriorate since 2010 (Figure 37).

Nevertheless, regulatory reforms have begun to stem the deterioration, and in the case of Kuwait and Saudi Arabia have actually begun to improve since 2016. Regulations on which the Doing Business rankings are measured, including those pertaining to property rights, investor protections, dispute resolution, and contract enforcement, are central to whether economies perform well and whether the performance is sustainable. These business rules and regulations are also well within the control of governments to enact and enforce. For the GCC countries, the quality of the business environment is crucial to any effort to raise the participation of the private sector in, and the contribution of domestic small and medium enterprises to, the economy. Saudi Arabia carried out a record number of reforms during the past year to improve the business climate for small and medium enterprises that included measures to ease the process of starting a business, registering property and stronger protections for minority investors. Paying taxes was simplified by improving the online platform for filing and paying taxes, which reduced the number of hours needed to pay taxes from 67 to 47. To facilitate trade across borders, the time for documentary compliance for exports and imports was shortened by reducing the number of documents required for customs clearance, which decreased the time for documentary compliance by nine days for both exports and imports.

Economic diversification and private sector development require labor market reforms

To advance their economic transformation objectives, the GCC countries will need to reexamine their labor market policies. Distortionary policies and practices have created segmentation in the GCC labor markets, where the public sector attracts nationals through high wages and the private sector employs mainly low-skilled foreigners. On average, foreign labor accounts for about 80 percent of private sector jobs. The segmentation is particularly acute in Qatar, which has seen huge demographic imbalances emerge because of the import of low-skilled male foreign workers to work on public investment and construction projects.

Reducing the incentives favoring public over private sector employment will encourage nationals to seek private sector jobs. The GCC governments are generally employers of first resort for nationals, and offer more generous compensation and better working conditions than the private sector. Redirecting nationals toward private sector employment, including by decreasing the public-private sector wage gap, investing in education that supports the skills needs of private industry, and providing for unemployment insurance, will serve the objectives of economic diversification and private sector development. Moreover, reducing the ready availability of government jobs, trimming the size of the public workforce, and moderating the growth of public wages will help the GCC governments cut the wage bill, advance fiscal adjustment, and boost public sector reform.

Attracting and retaining highly skilled foreign workers is also necessary if the GCC countries are to become knowledge-driven economies. There are often stringent restrictions in place on the mobility of foreign workers (who tend to be tied to one employer under sponsorship systems), most of whom are low-skilled and, thus, have low productivity.⁵ The GCC countries have begun liberalizing the movement of workers (the sponsorship system for instance has been fully liberalized in Oman and Bahrain). Qatar has passed a law allowing permanent residency for some expatriates (those providing “outstanding services”) – a first among GCC countries. Holders of the new permanent residency will be able to shift jobs freely and can, for the first time, access free state education and healthcare, and have the right to own property and run some businesses without needing a Qatari partner. Such reforms can help improve labor market outcomes by encouraging competition and efficiency in labor markets, support investments in on-the-job training, and enable countries to attract and retain the highly skilled workers needed to help achieve their long-term diversification objectives.

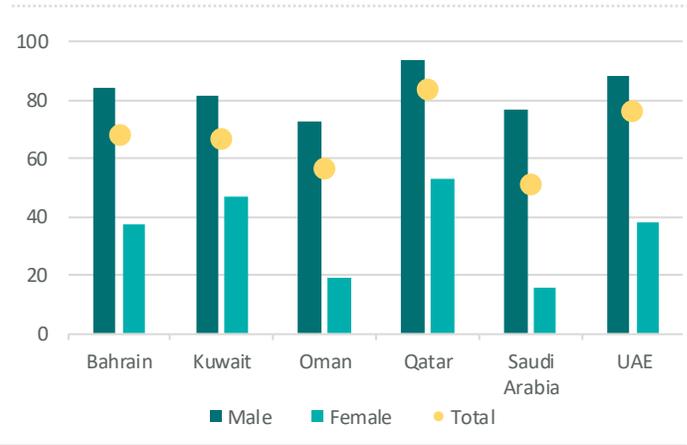
Increasing the labor force participation rate of women will invigorate the labor market. Women’s labor force participation and employment are low in the GCC countries (Figure 38). According to one study, the income loss from gender gaps in women’s labor force participation, workers’ pay, and entrepreneurship are highest in the Middle East and North Africa (MENA) region, where the estimated total loss amounts to 27 percent of income per capita. In this connection, Saudi Arabia’s recent decision to lift the ban that prohibits women from driving is a positive step that could have a significant economic impact by raising the labor force participation rate of women in the country --- it would make commute to work less difficult, would entice more women to seek work, and would make employing women more appealing to firms.

5/ According to IMF estimates, only 15 percent of workers in Saudi Arabia, Oman, Bahrain, Qatar and Kuwait possess some form of tertiary education. The UAE is an exception, where a third of expatriates that can be characterized as highly skilled. IMF. 2013. “Labor Market Reforms to Boost Employment and Productivity in the GCC”.

FIGURE 38

Employment-to-population ratio (aged 15+ years) Percent

Source: Haver Analytics.



GCC policy makers also need to address significant challenges in domestic pension systems

As in other Arab countries, GCC countries also face sustainability, equity and welfare challenges with their pension systems. These issues need to be addressed urgently if they are not to be a drag on economic growth, fiscal sustainability, and labor market stability. In particular, pension systems in the GCC are fragmented and characterized by limited coverage (mainly by excluding expatriates). Despite the low coverage, pension spending is high and benefit rates are misaligned, with contribution rates raising concerns about fiscal sustainability. The pension reform agenda is accordingly important for policy makers in the GCC countries given their aspirations to broaden their economic base, spur private sector development in the non-oil economy, and develop their labor markets. The In Focus section of this report sets out potential solutions and proposals that could help improve pension outcomes.



Interview with

Kevin Carey

MENA Practice Manager,
World Bank Group

How are the GCC economies coping with the post-2014 reality in oil markets? Are their reform efforts effective in adjusting to this new reality?

The collapse in 2014 oil prices – from over US\$110 in June 2014 to just US\$30 in January 2016 undoubtedly shook the GCC economies. The shock has exposed fundamental structural weaknesses in these economies, and the conventional way these countries operated became unsustainable.

So far, GCC countries appear to have managed to find a formula that works in adapting to new global oil price dynamics. Initially, the uncertainty about the oil price floor and the duration of low oil prices led to some delays in introducing effective measures. Their adjustments, thus, have been a mixture of some spending restraint, particularly cutting investment spending, some borrowing on international capital markets, and also some use of the big financial assets that they had built up during the boom years. Once oil prices stabilized around \$40 a barrel, the protracted nature of the oil price collapse has become clear. Going into 2018, I believe the region’s economies have a little more confidence in oil price dynamics. They have realized that the initial strategies have bought them breathing space for two-three years. But these transitory solutions will not be sufficient in addressing the medium and long-term challenges faced by the GCC economies.

What are the medium to longer term challenges that you are alluding to?

I think it is important to note that although GCC countries are high income countries, they have much room for improvement. This is evident in overall functioning of the economies, the effectiveness of their public sectors and delivery of public services, health and educational learning outcomes, employability of their citizens in an increasingly connected global environment, the lack of dynamism of their private sectors and the inability of firms (outside the oil sector) to export internationally and so on.

If you just look at the public sector, you will see that it has an outsized economic footprint across the region. Private sector firms are almost wholly dependent on government spending. Similarly, citizens count on lifetime employment in the public sector where there is weak monitoring of performance, and they depend on transfers to finance housing, education, health and subsidies for energy and water consumption. This “social contract” has undoubtedly meant that citizens enjoy a very high standard of living – they also pay no taxes. Yet, this system has also contributed to very serious distortions in the economy, affected incentives of citizens to invest in themselves (in terms of the right kind of human capital and technical skills) and also stifled innovation and creativity, which are at the heart of the dynamism of other advanced economies. The government meanwhile channels revenues from hydrocarbon resources – which is an exhaustible resource, and the outlook for which

has deteriorated given that the world is in the early stages of transitioning towards cleaner energy sources – into unproductive uses: large and bloated public sectors, high levels of subsidies, poorly planned (and at times, poorly implemented) public investment projects that are not aligned with the long-term needs and aspirations of these countries.

The upshot is that the GCC countries have realized that the status quo cannot continue. The days of depending on volatile oil revenues to fund unproductive and increasingly unaffordable expenditures are gone. Diversifying the economy and fully utilizing the talents of people has become an imperative. GCC countries have thus been transforming their economies via major reform programs and the UAE really stands out as being an early leader – for instance it has been the first to dismantle energy subsidies. The Kingdom of Saudi Arabia, although it has started late, has also begun to vigorously rethink its economic model and its economic policies in the form of Vision 2030. Progress has been slower in Kuwait, but the government is keenly aware of the challenges.

But, overall, despite much progress, there is much left to do as well. Transforming from an oil-dependent economy to a self-propelled, human capital oriented one requires some fundamental changes in the mindset; some also call this a new social contract.

What type of changes in the social contract are crucial in ensuring the sustainability of the new economic paradigm in GCC countries?

First, keep in mind that GCC countries do not need to discard their existing social contracts but rather to upgrade them to reflect new realities of low-for-long oil prices, increasing global competition and the long-term threats from climate change.

Public spending must shift away from its current role of transferring oil rents to citizens in the form of public employment, subsidies and transfers. It should be aligned with the long-term goals of policy makers and citizens, in terms of investing in human and physical capital and capabilities of these countries, and ensuring a level playing field for all participants in the private sector.

The other important area of reform is public employment. The bloated public sectors have created segmented labor markets -- the public sector attracts nationals through high wages, the private sector employs mainly low-skilled foreigners - in Qatar, the excessive import of low-skilled foreign laborers to work on public investment and construction projects has created a huge demographic imbalances and put pressure on government infrastructure and public services. To develop the private sector and encourage nationals to seek private sector employment, governments need to reduce the incentives favoring public over private sector employment, including by: decreasing the public-private sector wage gap; investing in education that supports the skills needed by private industry; reducing the ready availability of government jobs; and moderating the growth of public wages.

I would also like to emphasize that the GCC citizens should be protected during these reform processes. Authorities should ensure a basic minimum safety net, while encouraging citizens to work. In this edition of the Gulf Economic Monitor, we talk about how pension and social protection systems also face considerable challenges. Pensions and social insurance schemes are fragmented (e.g. Oman has ten institutions and ten schemes), and need to be integrated (Bahrain has started administrative integration). By and large, pensions systems have low coverage - e.g. number of contributors plus beneficiaries as percent of the total population are 10 percent for Saudi Arabia and Oman, and 3 percent for UAE and Qatar - and need to be expanded.

GCC economies are already very open in many ways and many have good infrastructure. But they need to make sure that the infrastructure supports private sector activity, for instance by increasing the connectivity of firms to export markets. They also need to strengthen domestic business environments. Aside from the UAE which is ranked 21 (out of a 190 countries), World Bank Doing Business Indicators, which span areas such as the ease of starting a business, getting permits, paying taxes etc. show that the other GCC countries score very poorly. Qatar, the Kingdom of Saudi Arabia and the Kuwait are ranked 83, 92 and 96 respectively which is about par with Botswana, Zambia, Guatemala and Tonga. Firm-level surveys in Kuwait for example, show, that small and medium sized enterprises (SMEs) are most concerned by excessive business regulations, regulatory uncertainty, inadequate skills of the workforce and corruption. All these factors combine to hinder not just domestic investment but also FDI.

Where the quality of their workforce is concerned, it is not just a matter of spending more, but rather spending well to get better outcomes. This includes, for example, investing in early childhood education, investing in teacher training and certification, educational standards and testing.

Do you think the recent surge in oil prices will reduce the region's commitment to reform and transformation?

I do not think it will, and there are several reasons for that. First, the countries themselves realize that even if oil prices have recovered somewhat, they are far lower than they were prior to 2014, so they cannot do business as usual as was the case when oil prices were over \$100 a barrel. So, they must adjust their policies to live with low-for-long oil prices. Second, I think these countries have put a lot of effort into preparing strategies to structurally adjust their economies, and they are just beginning to implement those strategies. I think they're starting to see some gains in terms of broadening their tax base, getting the private sector a little more involved in the economy than before, getting non-oil exports growing more than before, and I think people in these countries are excited to see a more vibrant jobs market than they had previously, a jobs market not so reliant on public sector job creation. So, I think the combination of realizing that it still a very different environment for oil prices, but a lot of work has been put into strategies to reform the economies, and the people are hungry for kind of job creation that would come with these strategies. These give them sufficient incentives to continue with the reforms despite the partial recovery in oil prices.

In focus

Reforming Pension Systems

The pension and social insurance systems of the GCC countries, as those of many other Arab nations, face sustainability, equity, and welfare challenges. By and large, GCC pension systems are among the most generous in the world, but are insufficiently funded so that they have increasingly relied on general budget funding rather than on contributions or on returns on assets. Allowances for early retirement in some countries, meanwhile, has further undermined financial sustainability of pension schemes and also served as a disincentive to work effort (including for women). In addition, none of the GCC countries provide pensions for expatriate workers, while some nationals working in the private sector (notably the self-employed) are covered on a voluntary basis.

All these issues need to be addressed urgently if they are not to be a drag on economic growth, fiscal sustainability, and labor market stability. The pension reform agenda is particularly important for the GCC countries in view of efforts to diversify their economies, raise private sector activity, and develop their labor markets. This Special Focus broadly describes the pension landscape in GCC countries, and sets out potential solutions and proposals that policy makers could adopt to improve their pension outcomes. International best practice suggests that policy makers focus on key principles when considering the design of their pension systems, including financial sustainability, affordability, equity, predictability, robustness, and economic and administrative efficiency. While it may not be possible to extend pension coverage to expatriates, it will also be important to provide solutions for

expatriates that address their long-term financial security needs. This will, in turn, help GCC countries attract and retain highly skilled global talent that is needed to help build knowledge-driven economies.

The pension industry landscape

The GCC countries, have variants of mandatory contributory earnings-related social insurance system for citizens. Coverage of workers in the private sector activities (notably self-employed) tends to be low, mainly reflecting the fact that these are expatriate workers that are not included in national pension systems. The insurance systems are mostly financed on a pay-as-you-go basis, with pensions calculated using a formula (defined benefit). The most common programs provide old age, disability, and survivors' pensions (Figure 39). Some countries provide benefits for work injuries, and occupational diseases, and unemployment, if not for sickness and maternity, and family allowances. System design varies widely across the GCC, in law and in practice.

Generally, pension spending is high since benefits are among the highest in the world. The contributory systems were designed to be financed through contributions of employers and employees, but they have largely and increasingly relied on general budget funding rather than on contributions or on returns on assets. The additional use of

FIGURE 39

The GCC pension systems commonly cover for old age, disability and survivors' pensions (social insurance programs in the GCC countries)

Source: World Bank Group. Pension database.

Note: Yellow circle indicates availability of an insurance program.



government budget funds, in this context, represents a large implicit subsidy (that comes at the cost of other priority spending), one that is becoming increasingly unaffordable given the fall in oil prices in recent years and prospects that they will likely remain low over the medium to long-term. In addition, there is much room for improvement in the governance of social security institutions and pension departments. The sustainability issues confronting the Arab pension systems are similar to those confronting other countries globally.

Sustainability issues facing the pension system are heightened by demographic and labor market dynamics. The GCC countries have relatively young populations, but old-age dependency ratios are projected to rise rapidly over the next 30 years from under five percent in 2015 to over 20 percent by 2050. Fertility rates are expected to continue to decline while survival rates are projected to improve further. An expected increase in female participation rates will also have dramatic effects on the size of the labor force going forward. It is not certain, however, given the current construct of pension systems, that the expansion of the labor force and of employment in the formal sector will be matched by an increase in the size of the population covered by social insurance and pensions.

Challenges for the pension schemes

Most countries in the GCC, as in the Arab region, have fragmented pension systems, with more than one scheme covering different groups of workers. The pension systems mostly cover civil servants and formal private sector workers (Table 2). The different schemes have different qualifying conditions, different benefit formulas, and other different characteristics. Some countries have been integrating (or have been

trying to integrate) their different schemes gradually into a unified national scheme, with the objective of having the same social insurance system cover all employees in the country. Bahrain, for example, has integrated administrative, but civil servants and private sector employees are still subject to different rules.

The fragmentation of pension systems in the region produces considerable economic and operational inefficiencies. Transparent and efficient rules to transfer rights across schemes are rarely in place, so the mobility of the labor force is restricted, preventing the efficient allocation of resources in the economy. Fragmentation is also viewed as a source of labor market and social inequity, with some segments of the labor force receiving preferential treatment from the public pension system. Moreover, fragmentation increases administrative costs.

While social insurance and pension coverage rates in the Arab region are relatively modest, on average approximately 35 percent of the labor force, the coverage in the GCC countries is even lower. The number of contributors and beneficiaries of social insurance programs do not exceed 10 percent of the population in Saudi Arabia and Oman and three percent in the UAE and Qatar (Figure 40). Coverage is usually limited to national workers in the public sector and part of the private sector. While high rates of informality explain the low coverage rates in most Arab countries, the explanatory factor is entirely different in the GCC countries – their large numbers of expatriate workers.

Very generous survivorship, disability and early retirement pension provisions add to the high costs of the pension programs discussed in previous section. The programs were intended to be pay-as-you-go schemes, in which current contributors pay for current beneficiaries, and the pension is calculated following a formula that relates retirement income benefits

TABLE 2

**Pension schemes in the GCC are generally fragmented
(pension and social insurance schemes in the GCC countries)**

Source: World Bank Group. Pension database.

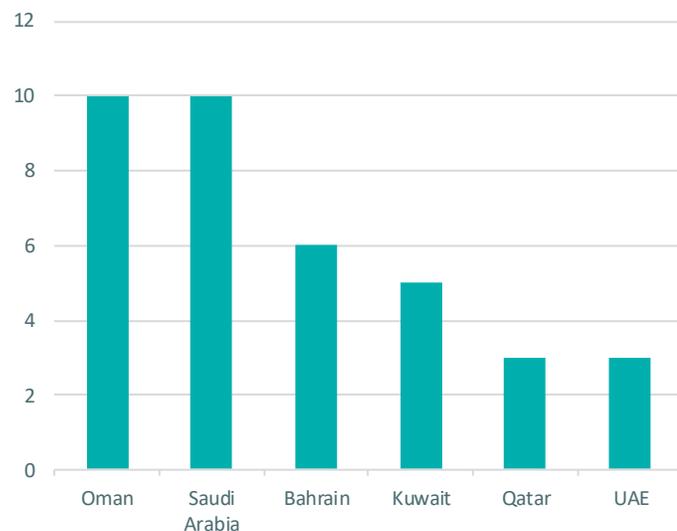
Note: The World Bank lists five components (or pillars) of a pension system: a non-contributory Pillar 0; a mandatory earnings-based publicly-managed Pillar 1; a mandatory savings-based privately-managed Pillar 2; a complementary voluntary privately-managed Pillar 3; and a non-financial Pillar 4 that includes access to informal support, other formal social programs, and other financial and non-financial assets. The classification scheme does not imply that all pensions systems should have all five components (or pillars).

Country	Modalities of pillars			Is civil service pension scheme integrated?	Fragmented pension systems: pension schemes and institutions
	Pillar 0	Pillar 1	Pillar 2		
Bahrain		Defined benefit		Partially integrated	<ul style="list-style-type: none"> • One institution • Two schemes
Kuwait		Defined benefit		Integrated	<ul style="list-style-type: none"> • One institution • One scheme
Oman		Defined benefit		Separated	<ul style="list-style-type: none"> • Ten institutions • Ten schemes
Qatar		Defined benefit		Separated	<ul style="list-style-type: none"> • One institution • Two schemes (but, one scheme being phased out)
Saudi Arabia		Defined benefit		Separated	<ul style="list-style-type: none"> • Two institutions • Three schemes
United Arab Emirates		Defined benefit		Integrated	<ul style="list-style-type: none"> • Two institutions • Two schemes (one for Abu Dhabi, one for Dubai and other emirates)

FIGURE 40

**The GCC pension systems have low coverage rates
(number of contributors plus beneficiaries of social insurance programs, in percent of the total population)**

Sources: World Bank Group and Arab Monetary Fund.



to individual earnings. In practice, however, benefit promises at various retirement ages have generally been misaligned with contribution rates. In addition, in some countries such as Qatar, not only are normal retirement rules very generous, but early retirement rate is allowed with low penalties. This can serve as a disincentive to work (specially for women), including to seek other jobs, hampers labor market mobility and also results in the loss of workers that have accumulated valuable on-the-job skills and experience during their time in the labor market.

The high spending rates raise questions of affordability and sustainability. Affordability pertains to the costs of the pension benefits. And, sustainability is a function of retirement benefits and the contributions made to earn pension rights. With most schemes covering civil servants running deficits, resources to fund the pension systems are often drawn from the general budget. But the use of public resources to subsidize the pensions of formal sector workers, civil servants, and the military is inequitable and highly questionable, even in resource abundant countries, where other public spending also compete for (high yet) limited resources for optimal allocation. The international best practice is to use general revenues to provide targeted benefits to the poor or to those with little or no capacity to save.

A distinctive feature of labor markets in the GCC countries is their large number of expatriate workers --- up to 90 percent of the labor market in some. These workers will predominantly retire in their home countries rather than in the host countries where they are employed. Contributions during the entire active life, however, are essential in any pension scheme to produce adequate pensions upon retirement. Special arrangements in pension systems in the home countries could allow these workers to contribute directly to their home country pension systems. These workers could send remittances to their home country pension accounts so that the windfall from temporarily higher wages would help secure their old-age income security and that of their families. However, while this possibility exists in some countries, it is neither generalized nor exempt from implementation difficulties. Nevertheless, addressing the pension needs of these expatriates remains important, particularly if GCC countries, which aim to become knowledge-driven economies in the long-term, wish to attract and retain the best of global talent.

Options for reform

Reforms should be driven by a clear objective for the pension system in the coming decades. This should focus on ensuring sustainable, adequate and equitable pensions, with broad coverage that are delivered in an efficient and secure way. Pension systems can and should redistribute income but it is important that the mechanisms be transparent. A pension system is affordable only if it can be financed without heavily compromising other social or economic objectives, and sustainable only when it has the capacity to pay current and future benefits over a long horizon under reasonable assumptions without shifting substantial burdens to future generations. Benefits are adequate when they provide sufficient income to protect participants from falling into poverty, if they become disabled or after they have retired, and provide a reliable mechanism for smoothing consumption. Progressively broader coverage of a country's labor force should be gradually targeted through: the formalization of the labor market; better enforcement of contribution compliance of employers and self-employed individuals, including informal sector workers; increases in behavioral incentives; and, by making access and contributions as simple and automatic as possible to workers in the informal sector through developments in national identification (ID), information technology (IT), and through improvements with financial inclusions and in payment systems.

An efficient pension system achieves social protection objectives without creating adverse behavioral incentives for participants or employers, delivers the best-possible net-of-fee returns, meets reasonable standards for service delivery and enforcement at reasonable administrative costs, and delivers a supply of long-run stable capital. A well-run pension system will have a clear set of legal requirements that explains how pensions will be designed and delivered. It is also important to ensure that there is a clearly identified regulator and supervisor

which will be legally required to monitor at least the private pension system and ideally social security institutions as well when they are investing assets. These supervisors should be independent and have clear goals and the powers and resources to safeguard pension promises that are made each day but may not be paid out for many decades.

Multi-pillar schemes are sometimes adopted to reach adequate combination of conflicting objectives. The GCC countries have at least a mandatory, earnings-based, publicly-managed scheme for some workers (Pillar 1). They may consider developing other pillars, however (Figure 41). Mandatory and voluntary private pensions, for instance, have a strong role to play in diversifying a pension system. They can also help improve labor market efficiency, particularly if pensions are portable between the public and private sectors.

Moreover, GCC policymakers should be mindful that pension systems development and reform is linked with labor market reforms and capital market development. Delivering income in old age is not just a pension issue, but a retirement income issue. Workers can and should find multiple ways to earn income in old age – not only through public and private pensions, but also through continued work (if needed), through insurance products, and through the benefits of home ownership. Therefore, labor market reforms and capital market development are integral to the provision of income in old age.

Six actions are recommended to advance the GCC pension systems toward a sustainable, equitable and welfare-enhancing path:

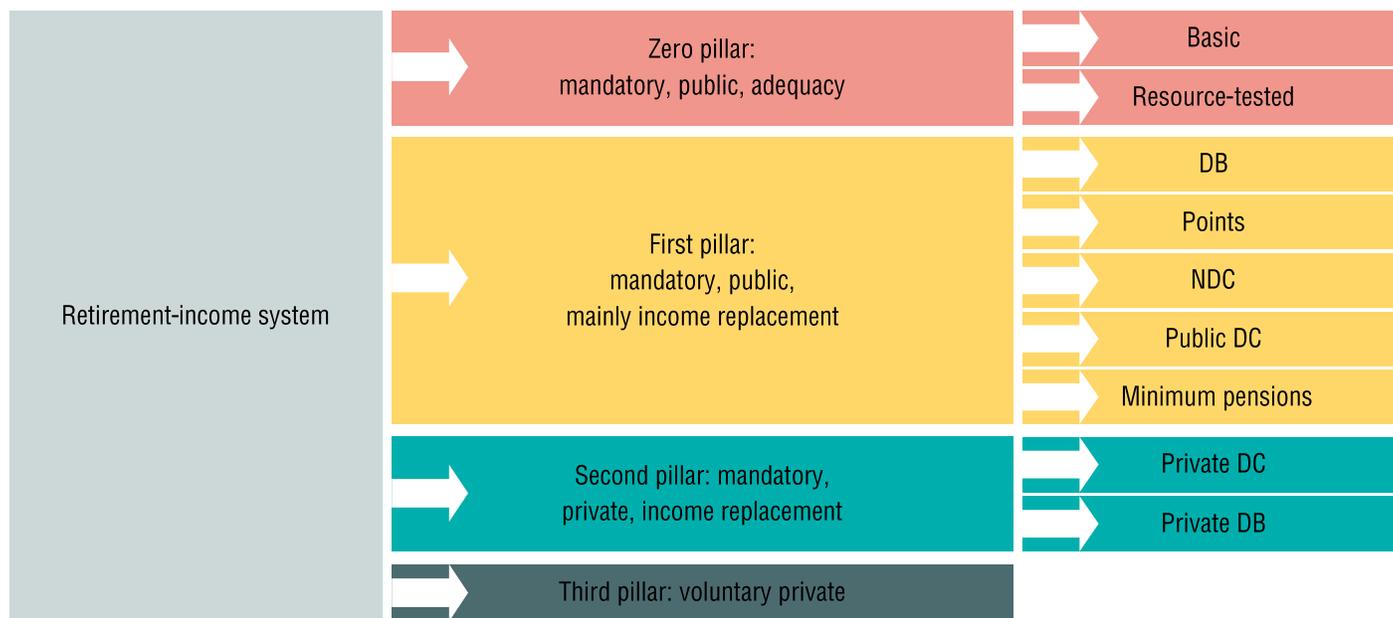
- Develop adequate data to understand the pension system. Absent quality data, it is not possible to conduct income distribution analysis and pension entitlements microsimulations to support equity in the delivery of pension benefits and to benchmark countries against their sub-regional, regional and global peers.
- Review national identification (ID) and information technology (IT) systems to support the delivery of public and private pensions. Without good ID and IT systems, even a perfectly designed pension scheme will fail to deliver on its mandate.
- Improve the sustainability, equity and affordability of pensions. The sustainability issues confronting the Arab pension systems are similar to those confronting other countries globally. For GCC, the pension systems face a peculiar sustainability challenge – while contributions to cover benefits have been augmented by government contributions, the era of lower oil prices render benefit payments increasingly unaffordable. Moreover, the continued use of budgetary transfers crowd out other priority fiscal spending. In all cases, there is a need for the GCC countries to review their pension system parameters including accrual rates, contribution rates, retirement ages, and survivorship benefits, and disability provisions.

FIGURE 41

The GCC may consider diversifying their pension systems to include public and private pensions and mandatory and voluntary pensions (retirement income pillars)

Source: World Bank Group.

Note: The World Bank lists five components (or pillars) of a pension system: a non-contributory Pillar 0; a mandatory earnings-based publicly-managed Pillar 1; a mandatory savings-based privately-managed Pillar 2; a complementary voluntary privately-managed Pillar 3; and a non-financial Pillar 4 that includes access to informal support, other formal social programs, and other financial and non-financial assets. The classification scheme does not imply that all pensions systems should have all five components (or pillars).
DB = Defined Benefit. NDC = Notional Defined Contribution. DC = Defined Contribution.



- Expand the coverage of pensions in a way that improves the diversification of public and private pension provision. In all countries, the role of the employer is critical in improving access to pensions. For the GCC countries with their large number of expatriate workers, one option for addressing the pension needs of expatriate workers could be through the provision of mobility saving accounts (MSA). These are mandatory medium or long-term savings schemes for expatriate workers that are partially co-financed by employers. The goal is to provide a tool to expats to cope with contingencies usually covered by social insurance schemes but that are currently beyond the scope of available end-of-service benefits. The balance in this account might be used with more flexibility than normal pension products, but only upon exit from job or leaving the country. Upon termination of the work contract, employees may decide to leave the country and use their savings in their home country or they may use the savings/balance to extend their stay in the country while searching for another job. Upon retirement, an expatriate worker would be able to use the balance as a source of financial support during old-age. Such a scheme, accordingly, would reduce the economic vulnerability through financial support during resettlement periods and transitions between jobs or into retirement. It could also help foster labor market mobility of expatriates within the host country,

supporting transitions from one job to the next, and therefore ensuring that human capital development in the host country through on-the-job experiences and training remain in the country. Finally, MSAs are also a tool to increase savings as more capital remains in the country for potential investments.

- Improve the efficiency of pension systems – by reducing costs and fragmentation, enhancing investment strategies and governance, and improving the capital market. It is important to address the fragmentation of pension schemes, strengthen the governance of pension institutions, and enhance the investment expertise and asset-liability management in pensions funds to improve returns to pension system participants. Developing the capital markets is an important task. Reforms are also needed to corporate governance, to help improve liquidity in the secondary markets.
- Enhance the security of pension systems through developing or creating regulators and supervisors who can successfully supervise pensions. An Outcomes and Risk Based Supervision (ORBS) system helps ensure that a regulator thoughtfully considers the long-run outcomes of a pension system. The introduction of an ORBS system in the GCC will help regulators and supervisors to prioritize actions, manage headline risks, and otherwise choose the

most effective tools for regulation and supervision --- new regulations, training, communications, on-site supervision, and enforcement.

Conclusion

Pension systems in GCC countries face a number of challenges, in particular with respect to financial self-sustainability and equity. These have become more urgent in the wake of the fall in global energy prices since 2014. While there is no best way to structure pension systems, policy makers should aim to keep a number of internationally accepted principles in mind. Financial sustainability is one such principle; others are affordability, adequacy, equity, and economic and administrative efficiency. However, there are tradeoffs between these principles. For example, current very high pensions in GCC countries prioritize adequacy but compromise long-term sustainability of pension schemes and may create disincentives to work if early retirement allowances are too generous.

Pension reforms should be driven by a clear objective for the pension system in the coming decades. This should focus on ensuring sustainable, adequate and equitable pensions, with broad coverage that are delivered in an efficient and secure way. This will require more than just a comprehensive review of system parameters including accrual rates, contribution rates, retirement ages, and survivorship benefits, and disability provisions. Strengthening the governance framework for pension systems, for instance through the formation of supervisory bodies, enhancing the investment expertise and asset-liability management in pensions funds to improve returns to pension system participants, and reforms to deepen domestic capital markets also go hand in hand. It will also be important to strengthen the capabilities of pension administration bodies, including the quality of data, IT and national ID systems. Finally, if the GCC countries are to attract the best of global talent, they will also need to consider potential solutions such as mobility savings accounts, that help meet the long-term pension and financial security needs of expatriates.

COUNTRY SUMMARY TABLES

BAHRAIN

SELECTED ECONOMIC INDICATORS	2010	2011	2012	2013	2014	2015	2016	2017e	2018f	2019f
Nominal GDP, \$ billion	26	29	31	33	33	31	32	34	..	..
Real GDP, % change	4.3	2.0	3.7	5.4	4.4	2.9	3.0	2.5	1.7	2.1
Hydrocarbon ¹	0.1	3.6	-8.5	15.3	3.0	-0.1	-0.1	0.0	..	..
Non-hydrocarbon ¹	5.5	1.6	7.1	3.1	4.7	3.6	3.7	3.2	..	..
CPI Inflation Rate, average, %	2.0	-0.4	2.8	3.3	2.7	1.8	2.8	0.9	3.4	2.4
Government Revenues, % GDP	22.7	26.3	26.4	24.6	25.0	18.2	17.7	21.6	22.0	23.2
Government Expenditures, % GDP	28.5	27.8	31.9	34.3	28.4	36.6	35.4	34.8	33.5	33.4
Fiscal Balance, % GDP	-5.8	-1.5	-5.5	-9.7	-3.4	-18.4	-17.8	-13.2	-11.5	-10.2
General Government Gross Debt, % GDP ²	29.7	32.8	36.2	43.9	44.4	66.0	82.3	90.6	98.6	106.8
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % change ³	2.6	21.7	3.7	14.1	-3.4	-10.8	-16.6	9.0	2.6	2.2
Merchandise Imports, % change ³	6.7	-0.2	19.8	14.0	-3.3	-18.5	-13.0	12.4	6.8	6.4
Current Account, % GDP	3.0	8.8	8.4	7.4	4.6	-2.4	-4.7	-4.5	-4.1	-3.5
Official Reserves, \$ billion	5.1	4.5	5.2	5.3	6.1	3.4	2.5	3.4	..	..
MEMORANDUM ITEMS										
Hydrocarbon revenue, % of total revenue	85.1	87.9	87.2	88.3	86.2	78.1	75.7	..	..	..
Hydrocarbon exports, % of GDP ³	36.3	34.6	40.2	36.4	33.9	29.5	19.2	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2017.

3/ Volume growth.

4/ U.N. Comtrade.

KUWAIT

SELECTED ECONOMIC INDICATORS	2010	2011	2012	2013	2014	2015	2016	2017e	2018f	2019f
Nominal GDP, \$ billion	115	154	174	174	163	115	111	126	133	142
Real GDP, % change	-2.4	9.6	6.6	1.1	0.5	0.6	3.5	-1.0	1.9	3.5
Hydrocarbon ¹	..	15.6	10.3	-1.8	-2.1	-1.7	2.3	-5.0	0.1	2.6
Non-hydrocarbon ¹	..	3.4	3.4	4.2	4.8	0.4	2.0	3.6	3.4	3.7
CPI Inflation Rate, average, %	4.5	4.9	3.2	2.7	2.9	3.3	3.2	1.6	3.0	3.4
Government Revenues, % GDP ²	60.7	68.6	65.5	65.4	57.5	39.8	37.8	39.6	39.9	39.2
Government Expenditures, % GDP	45.8	38.6	38.9	38.9	49.4	53.3	51.2	48.1	47.5	47.8
Fiscal Balance, % GDP ²	14.9	30.0	26.5	26.6	8.1	-13.5	-13.3	-4.5	-3.5	-4.6
Fiscal Balance, % GDP, excl. investment income and transfers to the sovereign wealth fund	9.6	24.7	10.1	12.2	-4.6	-17.4	-16.7	-8.5	-7.5	-8.6
General Government Gross Debt, % GDP ³	11.3	8.5	6.8	6.5	7.5	11.0	18.5	27.1	33.0	36.2
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % change	20.3	57.8	13.1	1.0	-11.5	-43.1	-14.2	..	..	..
Merchandise Imports, % change	13.6	6.8	10.0	8.9	6.3	5.5	-0.3	..	..	..
Current Account, % GDP	32.0	42.9	45.5	40.3	33.4	3.5	-4.5	5.9	5.3	4.5
Official Reserves, \$ billion	21.2	25.9	29.0	29.5	32.2	28.4	31.1	33.0	35.0	35.0
MEMORANDUM ITEMS										
Hydrocarbon revenue, % of total revenue	92.8	94.5	93.6	92.1	90.3	88.6	89.2	..	..	..
Hydrocarbon exports, % of GDP ⁴	59.8	63.2	66.3	63.3	62.7	50.6	39.0	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ Excluding investment income.

3/ IMF, World Economic Outlook, October 2017.

4/ U.N. Comtrade.

OMAN

SELECTED ECONOMIC INDICATORS	2010	2011	2012	2013	2014	2015	2016	2017e	2018f	2019f
Nominal GDP, \$ billion	59	68	77	79	81	70	66	..	..	..
Real GDP, % change	4.8	-1.1	9.3	4.4	2.8	4.7	5.4	0.7	2.3	2.5
Hydrocarbon ¹	5.5	2.1	2.3	2.8	-1.7	5.2	2.1	..	..	..
Non-hydrocarbon ¹	4.1	-4.6	17.5	6.0	7.1	4.3	8.4	..	..	..
CPI Inflation Rate, average, %	3.2	4.1	2.9	1.2	1.0	0.1	1.1	1.5	2.2	1.8
Government Revenues, % GDP	39.4	40.7	45.7	45.7	45.1	34.5	28.1	27.4	35.4	..
Government Expenditures, % GDP	33.9	41.1	46.0	46.1	48.7	51.0	48.4	41.3	44.6	..
Fiscal Balance, % GDP	5.5	-0.4	-0.3	-0.4	-3.4	-17.5	-20.6	-13.0	-11.2	-10.1
General Government Gross Debt, % GDP ²	5.7	5.2	4.9	5.0	4.9	15.3	33.6	44.5	50.8	54.2
General Government Net Debt, % GDP ²	-29.2	-29.7	-29.0	-43.8	-44.1	-42.5	-27.1	-9.8	2.3	11.4
Merchandise Exports, % change	9.1	4.9	10.3	10.1	1.0	-1.7	-12.8	-5.3	4.7	..
Merchandise Imports, % change	2.7	12.2	19.2	29.4	-11.1	1.2	-16.8	6.1	4.8	..
Current Account, % GDP	8.3	13.0	10.2	6.6	5.2	-15.5	-18.4	-11.6	-10.3	-8.5
Official Reserves, \$ billion	13.0	14.4	14.4	16.0	16.3	17.5	20.3	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon revenue, % of total revenue	80.8	84.4	84.7	85.7	84.3	78.7	68.2	..	..	..
Hydrocarbon exports, % of GDP ³	54.4	65.4	63.9	67.5	61.9	46.2	38.0	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2017.

3/ U.N. Comtrade.

QATAR

SELECTED ECONOMIC INDICATORS	2010	2011	2012	2013	2014	2015	2016	2017e	2018f	2019f
Nominal GDP, \$ billion	124	168	187	199	206	165	153	166	168	175
Real GDP, % change	19.6	13.4	4.7	4.4	4.0	3.6	2.2	2.2	2.8	3.3
Hydrocarbon ¹	28.5	15.0	1.2	0.1	-0.6	-0.5	-1.0	0.9	3.3	0.2
Non-hydrocarbon ¹	8.6	11.0	9.9	10.4	9.8	8.2	5.6	3.4	2.1	5.5
CPI Inflation Rate, average, %	-2.4	2.0	1.8	3.2	3.4	1.7	2.7	0.5	3.0	3.0
Government Revenues, % GDP	31.7	33.2	36.4	47.6	45.7	37.4	29.1	30.8	32.3	33.0
Government Expenditures, % GDP	26.7	28.1	22.9	28.3	33.4	39.3	38.1	35.7	36.1	34.6
Fiscal Balance, % GDP	5.0	5.2	13.5	19.3	12.3	-1.9	-9.0	-4.9	-3.8	-1.6
General Government Gross Debt, % GDP ²	41.8	36.0	37.2	33.1	32.3	34.9	56.5	54.4	54.4	55.2
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % change	56.2	52.7	16.2	0.3	-5.0	-39.0	-25.9	..	..	..
Merchandise Imports, % change	-6.7	28.6	14.3	2.2	-1.0	-8.5	12.1	..	..	..
Current Account, % GDP	19.4	31.1	33.2	30.4	24.0	8.4	-5.5	5.9	5.3	4.5
Official Reserves, \$ billion	113.3	60.8	120.3	153.1	156.6	189.8	158.5	33.0	35.0	35.0
MEMORANDUM ITEMS										
Hydrocarbon revenue, % of total revenue	85.2	81.3	93.6	92.1	90.3	88.6	89.2	..	..	..
Hydrocarbon exports, % of GDP ³	54.6	65.6	67.9	65.9	60.5	46.7	34.5	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2017.

3/ U.N. Comtrade.

SAUDI ARABIA

SELECTED ECONOMIC INDICATORS	2010	2011	2012	2013	2014	2015	2016	2017e	2018f	2019f
Nominal GDP, \$ billion	528	671	736	747	756	654	646	685	..	..
Real GDP, % change	4.8	10.3	5.4	2.7	3.7	4.1	1.7	-0.6	1.8	2.1
Hydrocarbon ¹	-0.1	12.2	5.1	-1.6	2.1	5.3	3.8	-3.8	..	..
Non-hydrocarbon ¹	9.5	8.2	5.5	6.4	4.9	3.2	0.2	1.5	..	..
CPI Inflation Rate, average, %	5.3	5.8	2.9	3.5	2.7	2.2	3.5	-0.1	4.9	1.9
Government Revenues, % GDP	37.5	44.4	45.2	41.3	36.8	25.3	24.0	27.1	30.5	..
Government Expenditures, % GDP	34.0	33.3	33.2	35.5	40.2	40.4	42.1	36.0	38.1	..
Fiscal Balance, % GDP	3.6	11.1	12.0	5.8	-3.4	-15.8	-16.9	-9.0	-7.6	-4.9
General Government Gross Debt, % GDP ²	8.4	5.4	3.0	2.1	1.6	5.8	13.1	17.0	20.7	24.3
General Government Net Debt, % GDP ²	-37.8	-37.7	-47.7	-50.9	-47.1	-35.9	-17.1	-7.7	-0.1	4.9
Merchandise Exports, % change ³	7.4	10.9	5.4	1.6	1.8	2.7	4.6	-4.7	2.3	..
Merchandise Imports, % change ³	3.8	13.6	18.1	12.7	6.0	6.5	-16.0	-8.3	1.9	..
Current Account, % GDP	12.7	23.6	22.4	18.1	9.8	-8.7	-4.3	1.7	2.1	2.3
Official Reserves, \$ billion	444.7	540.7	656.5	725.3	731.9	616.0	535.4	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon revenue, % of total revenue	90.4	92.5	91.8	89.5	87.5	72.5	64.2	63.9	..	..
Hydrocarbon exports, % of GDP ⁴	46.2	52.9	51.9	50.3	47.1	29.2	25.4	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, unless otherwise indicated.

Notes: f = forecasts, e = estimates.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2017.

3/ Volume growth.

4/ U.N. Comtrade.

UNITED ARAB EMIRATES

SELECTED ECONOMIC INDICATORS	2010	2011	2012	2013	2014	2015	2016	2017f	2018f	2019f
Nominal GDP, \$ billion	290	351	375	390	403	358	349	..	..	..
Real GDP, % change	1.6	6.4	5.1	5.8	3.3	3.8	3.0	2.0	2.5	3.2
Hydrocarbon ¹	..	10.7	4.0	3.1	0.4	5.4	3.8	..	..	..
Non-hydrocarbon ¹	0.7	4.4	5.6	7.0	4.6	3.2	2.7	..	..	..
CPI Inflation Rate, average, %	0.9	0.9	0.7	1.1	2.3	4.1	1.8	1.9	2.9	2.3
Government Revenues, % GDP	34.7	37.7	40.1	40.8	37.3	28.5	26.4	27.2	28.1	..
Government Expenditures, % GDP	32.7	31.4	29.2	30.4	32.3	30.6	29.9	29.3	29.9	..
Fiscal Balance, % GDP	0.6	5.3	9.0	8.4	1.9	-3.4	-4.3	-3.2	-1.9	-1.0
General Government Gross Debt, % GDP ²	21.9	17.4	17.0	15.7	15.5	18.7	20.7	20.7	20.8	20.8
General Government Net Debt, % GDP	..	..	..	..	..	..	..	..	..	..
Merchandise Exports, % change	2.3	16.8	17.5	7.6	-4.3	5.2	9.1	-0.7	3.9	..
Merchandise Imports, % change	-4.8	10.5	10.1	11.8	5.3	1.4	6.5	5.3	2.9	..
Current Account, % GDP	4.2	12.6	19.7	19.0	13.3	4.7	2.4	2.6	2.7	2.9
Official Reserves, \$ billion	32.8	37.3	47.0	68.2	78.4	93.7	85.1	..	..	..
MEMORANDUM ITEMS										
Hydrocarbon revenue, % of total revenue	60.2	69.1	67.7	63.6	62.9	45.3	40.8	..	..	..
Hydrocarbon exports, % of GDP ³	56.5	62.6	62.2	61.1	56.0	44.7	39.8	..	..	..

Source: World Bank Group, Macroeconomics, Trade and Investment Global Practice, unless otherwise indicated.

Notes: f = forecasts.

1/ Haver Analytics.

2/ IMF, World Economic Outlook, October 2017.

3/ U.N. Comtrade.

COMMODITY PRICES TABLES

NOMINAL US DOLLARS

ENERGY	Unit	2014	2015	2016	2017	2018f	2019f	2020f	2025f	2030f
Coal, Australia	\$/mt	70.1	57.5	65.9	88.4	70.0	60.0	55.0	57.4	60.0
Crude oil, average	\$/bbl	96.2	50.8	42.8	52.8	58.0	59.0	60.0	64.8	70.0
Natural gas, Europe	\$/mmbtu	10.1	7.3	4.6	5.6	5.7	5.8	6.0	6.9	8.0
Natural gas, U.S.	\$/mmbtu	4.4	2.6	2.5	3.0	3.1	3.3	3.4	4.1	5.0
Natural gas LNG, Japan	\$/mmbtu	16.0	10.2	6.9	8.0	8.3	8.5	8.6	9.3	10.0

Source: World Bank Group, "Global Economic Prospects", January 2018.

Notes: f = forecasts.

CONSTANT US DOLLARS, 2010=100

ENERGY	Unit	2014	2015	2016	2017	2018f	2019f	2020f	2025f	2030f
Coal, Australia	\$/mt	64.9	58.9	70.2	93.3	72.0	60.5	54.3	51.9	49.5
Crude oil, average	\$/bbl	89.1	52.0	45.7	55.7	59.6	59.5	59.3	58.6	57.7
Natural gas, Europe	\$/mmbtu	9.3	7.4	4.9	6.0	5.8	5.9	5.9	6.3	6.6
Natural gas, U.S.	\$/mmbtu	4.0	2.7	2.7	3.1	3.2	3.3	3.3	3.7	3.1
Natural gas LNG, Japan	\$/mmbtu	14.8	10.5	7.4	8.4	8.6	8.5	8.5	8.4	8.3

Source: World Bank Group, "Global Economic Prospects", January 2018.

Notes: f = forecasts.

OIL PRODUCTION TABLE

CRUDE OIL PRODUCTION

Unit 1000b/d	2010	2011	2012	2013	2014	2015	2016	Q1-2017	Q2-2017	Q3-2017
Bahrain	0.18	0.19	0.17	0.20	0.20	0.20	0.20	..	..	..
Kuwait	2.03	2.24	2.46	2.55	2.59	2.75	2.88	2.71	2.71	2.70
Oman	0.87	0.89	0.92	0.95	0.94	0.98	1.01	0.98	0.98	0.98
Qatar	0.74	0.74	0.74	0.73	0.70	0.65	0.65	0.60	0.62	0.60
Saudi Arabia	7.91	9.06	9.51	9.40	9.53	10.12	10.42	9.88	9.97	9.99
United Arab Emirates	2.31	2.51	2.65	2.76	2.77	2.93	3.05	2.96	2.93	2.94

Source: International Energy Agency, "Oil Market Report", December 2017.

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