Gulf Cooperation Council

Annual Meeting of Ministers of Finance and Central Bank Governors

October 25, 2020

Virtual Meeting

Economic Prospects and Policy Challenges for the GCC Countries

Prepared by Staff of the International Monetary Fund

INTERNATIONAL MONETARY FUND

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EXECUTIVE SUMMARY[1]

The COVID-19 pandemic is having far-reaching consequences for the global economy. Measures to contain the spread of the virus have led to sharp declines in economic activity across the globe, particularly in 2020Q2. The hardest hit sectors have been those requiring intensive human contact, such as tourism, transportation, services, and construction, while, in general, IT-intensive activities have fared better. The economic contraction is most significant in advanced economies.

The GCC countries face a double impact from the coronavirus and lower oil prices. GCC authorities have implemented a range of appropriate measures to mitigate the economic damage, including fiscal packages, relaxation of monetary and macroprudential rules, and the injection of liquidity into the banking system, and there are recent signs of improvement. Low oil prices have caused a sharp deterioration of external and fiscal balances, and fiscal strains are evident in countries with higher debt levels.

The immediate priority is to continue to meet the health and economic needs arising from the COVID-19 pandemic. Countries should continue to implement the health measures necessary to contain the pandemic, treat those infected, and support households and firms. Fiscal and monetary policy should remain accommodative until the recovery is well-established, although the focus of support measures should move from being broad-based to targeting households and businesses most in need (and for the latter those likely to be viable in the post-COVID environment). Careful planning will be needed to gradually withdraw support without disrupting the recovery.

Once the recovery is established, substantial and sustained fiscal consolidation will be needed. Credible medium-term adjustment will help rebuild buffers and reduce vulnerabilities to future shocks. Adjustment speeds will have to balance the strength of the fiscal position with the need to avoid excessively dampening growth—those with high debt levels will need to adjust more quickly. Phasing out subsidies, reforming public wage bills, ensuring high efficiency of spending on infrastructure, and creating space for additional social spending will be critical. Diversifying sources of government revenues will also be essential. Reducing the procyclicality of fiscal policy with respect to oil price swings will be a key part of the reforms.

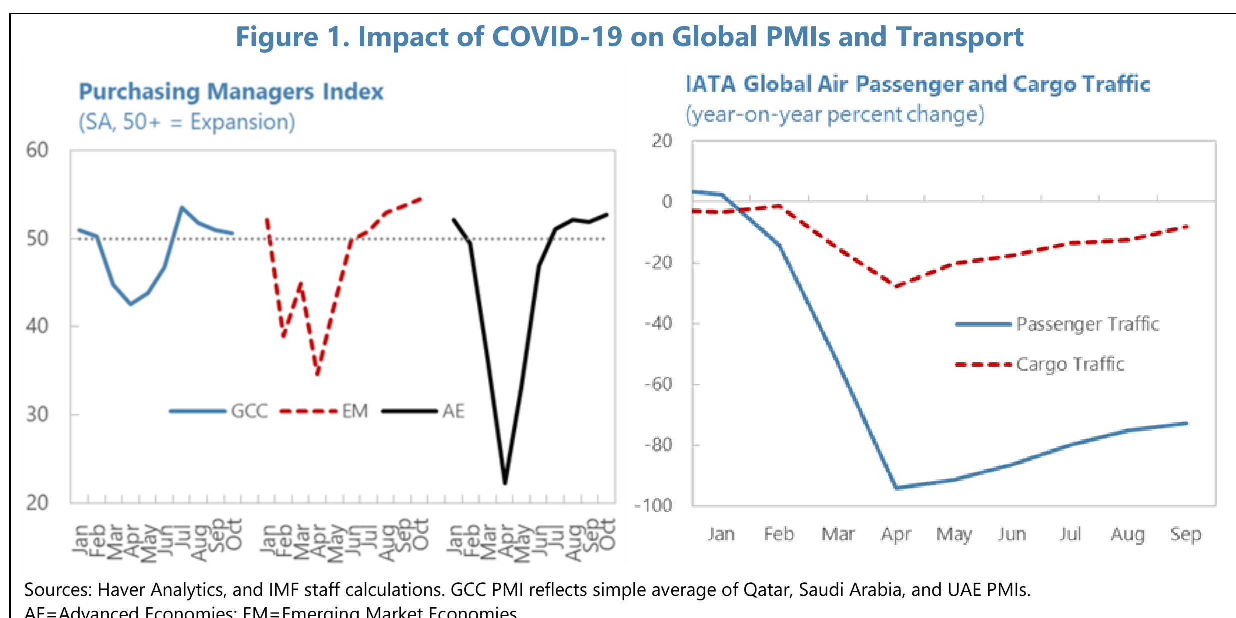
Further structural reforms are needed to strengthen private sector led growth and job creation. Labor market reforms will need to reduce large public sector wage premiums to encourage more nationals to work in the private sector while enhancing education and skills. Continuing to increase female labor force participation is essential. Addressing constraints on access to credit for SMEs is critical. Governments could promote well-designed credit guarantee schemes, strengthen the availability of information needed for assessing credit risks, and continue to support the adoption of digital technologies to enlarge financing options.

[1] Prepared by Daniel Kanda (Lead), Nooman Rebei, Yang Yang, Moayad Al Rasasi, Hatim Bukhari, and Tian Zhang. Editorial support was provided by Esther George and Nataliya Bondar. The paper builds on the analysis in the IMF's October 2020 *Regional Economic Outlook for the Middle East and Central Asia* and *IMF World Economic Outlook*. The paper has been updated with data available as of November 4.

A. Global Developments and Outlook

1. The COVID-19 pandemic has resulted in the deepest global recession since the Great Depression.[2] Lockdowns, social distancing, and other measures to contain the spread of the disease implemented since March led to an estimated 8 percent (y/y) contraction in global growth in 2020Q2 with advanced economies contracting by 11.1 percent and emerging market economies by 5.4 percent. Purchasing Managers Indices (PMIs) suggest the biggest impact was in March/April (Figure 1). The hardest hit sectors have been those requiring intensive human contact, such as tourism, transportation, services, and construction, while, in general, IT-intensive activities have fared much better.

Figure 1. Impact of COVID-19 on Global PMIs and Transport



Sources: Haver Analytics, and IMF staff calculations. GCC PMI reflects simple average of Qatar, Saudi Arabia, and UAE PMIs.
AE=Advanced Economies; EM=Emerging Market Economies.

2. Since May, most countries have relaxed lockdown measures (Figure 2). However, these moves have led to increases in new infections in many countries which in turn has undermined confidence and dimmed prospects for a sharp growth rebound. Global travel, tourism, and mobility remain crippled. At this juncture, the intensity of spread differs significantly by country and region. Some countries have been better able to control the pandemic, but a resurgence of cases has complicated efforts to get to a new normal in many others. Thus, in 2020Q3, while economic activity rebounded, it remained below the pre-pandemic level in most countries and renewed lockdowns in some countries raise questions about the strength of growth going forward.

[2] IMF World Economic Outlook, October 2020

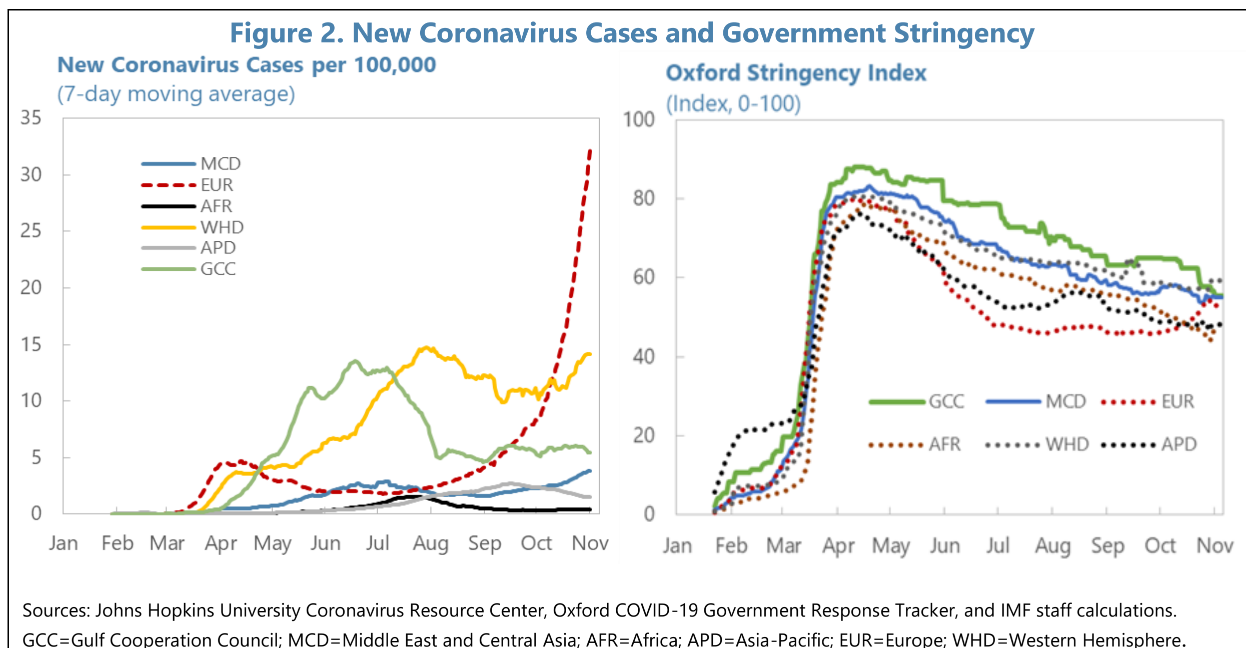


Figure 2. New Coronavirus Cases and Government Stringency

Sources: Johns Hopkins University Coronavirus Resource Center, Oxford COVID-19 Government Response Tracker, and IMF staff calculations. GCC=Gulf Cooperation Council; MCD=Middle East and Central Asia; AFR=Africa; APD=Asia-Pacific; EUR=Europe; WHD=Western Hemisphere.

3. Substantial fiscal and monetary policy measures have been initiated globally to address health care challenges arising from the pandemic and to mitigate its impact on economic activity (Figure 3). Fiscal stimulus packages have typically included higher spending on healthcare, relaxation of tax obligations particularly for employers, and increased spending on social safety nets to support incomes among the rapidly rising numbers of unemployed world-wide. Monetary and financial measures have included lowering policy interest rates, the relaxation of macroprudential rules, micro prudential guidance (e.g. encouraging banks to accept delays in interest payments on outstanding loans), and liquidity support for financial sectors to sustain credit flows.

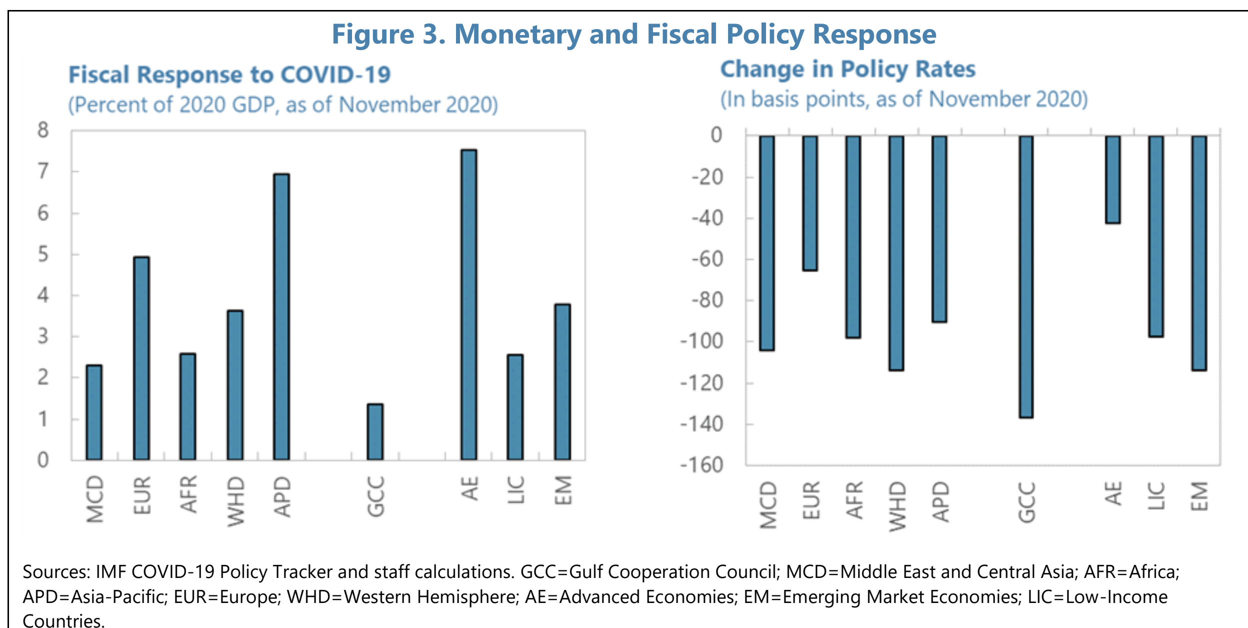


Figure 3. Monetary and Fiscal Policy Response

Sources: IMF COVID-19 Policy Tracker and staff calculations. GCC=Gulf Cooperation Council; MCD=Middle East and Central Asia; AFR=Africa; APD=Asia-Pacific; EUR=Europe; WHD=Western Hemisphere; AE=Advanced Economies; EM=Emerging Market Economies; LIC=Low-Income Countries.

4. After sharp drops in 2020Q2, global financial markets have reacted positively to the central bank and fiscal support measures (Figure 4). As discussed in the IMF's October 2020 *Global Financial Stability Report*, central banks' swift and forceful response to market dysfunction earlier in the year reduced uncertainty and boosted investor risk appetite. These measures have helped in maintaining the flow of credit to the economy. As a result, debt issuance by both firms and sovereigns has remained strong. The buoyancy in financial markets, however, stands at odds with the fragility still evident in the real economy.

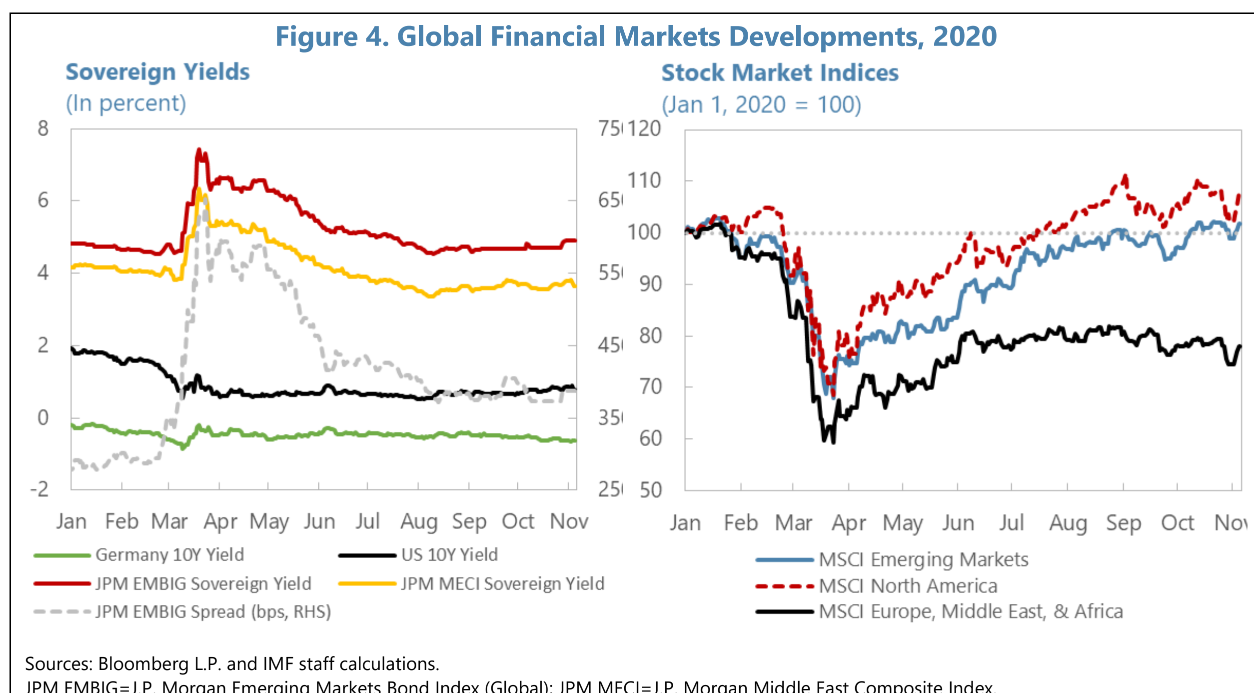


Figure 4. Global Financial Markets Developments, 2020

Sources: Bloomberg L.P. and IMF staff calculations.
JPM EMBIG=J.P. Morgan Emerging Markets Bond Index (Global); JPM MECI=J.P. Morgan Middle East Composite Index.

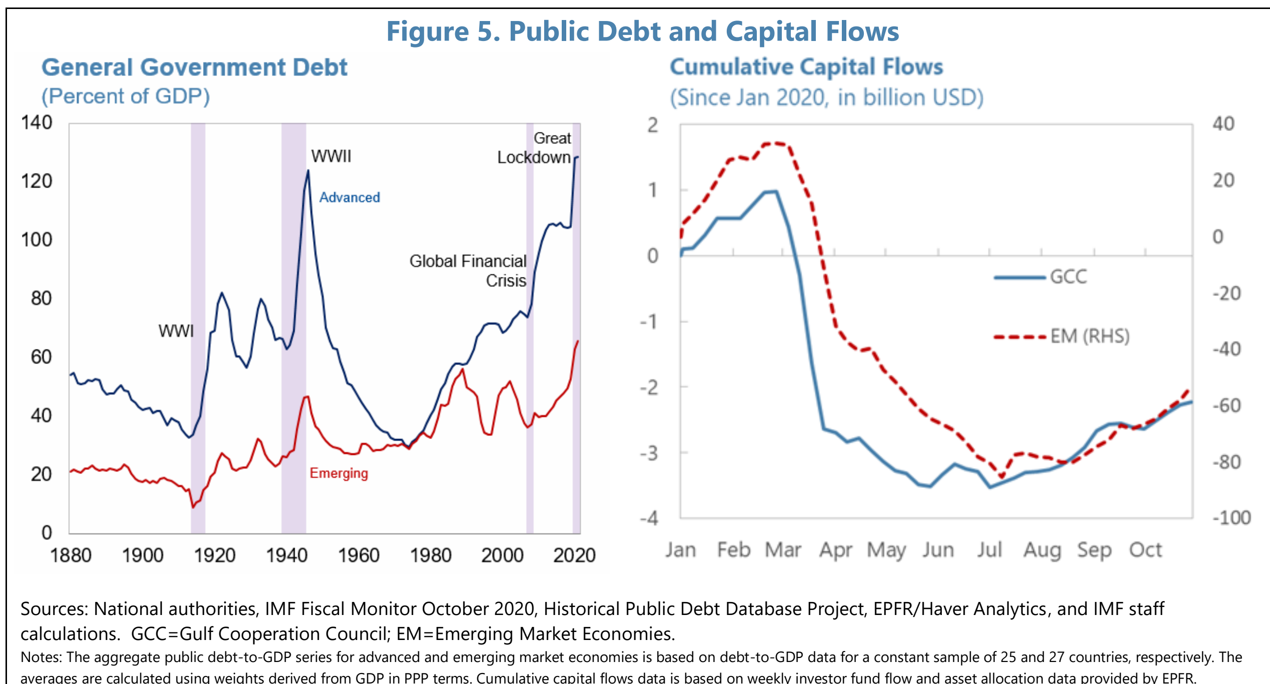
5. The sharp contraction in global activity and the abrupt decline in travel and transportation has strongly reduced global demand for oil and oil prices fell sharply in March and early April. While actions by OPEC+ to reduce supply and some recovery in demand have seen oil prices recover, the Brent price remains over 30 percent below its end-2019 level (Box 1).

6. Fiscal relaxation and economic contraction have caused public debt ratios to reach all-time highs in advanced and emerging market economies (Figure 5). High debt has increased the vulnerability of many economies to future shocks. While monetary interventions have eased borrowing costs in advanced economies, and many emerging market economies have been able to issue new debt, capital outflows from emerging economies at the onset of the crisis have not reversed.

7. While global economic activity is expected to strengthen in the second half of 2020 relative to the Q2 trough, the outlook remains weak, with high margins of uncertainty

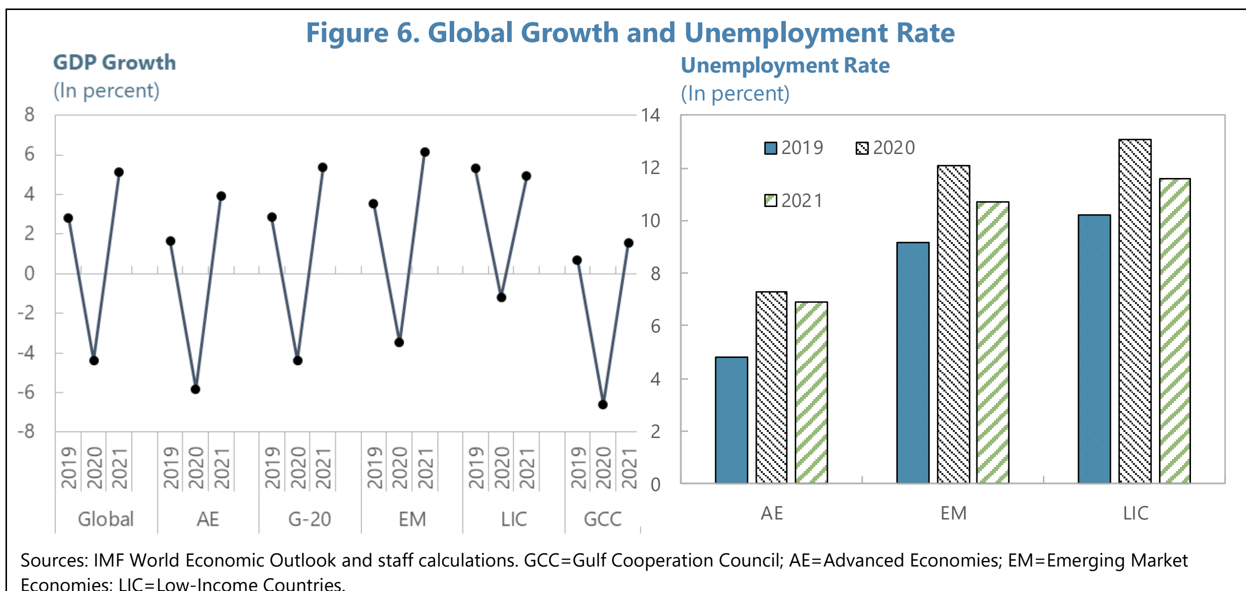
(Figure 6).[3] Global GDP is projected to contract by 4.4 percent in 2020, with a rebound expected in 2021 with growth of 5.2 percent. Advanced economies are projected to be the hardest hit, with a contraction of 5.8 percent projected in 2020 and a rebound to 3.9 percent in 2021. Emerging market economies are projected to contact by a less severe 3.1 percent in 2020 and to rebound more strongly in 2021 (6.1 percent).

Figure 5. Public Debt and Capital Flows



Sources: National authorities, IMF Fiscal Monitor October 2020, Historical Public Debt Database Project, EPFR/Haver Analytics, and IMF staff calculations. GCC=Gulf Cooperation Council; EM=Emerging Market Economies.
Notes: The aggregate public debt-to-GDP series for advanced and emerging market economies is based on debt-to-GDP data for a constant sample of 25 and 27 countries, respectively. The averages are calculated using weights derived from GDP in PPP terms. Cumulative capital flows data is based on weekly investor fund flow and asset allocation data provided by EPFR.

Figure 6. Global Growth and Unemployment Rate



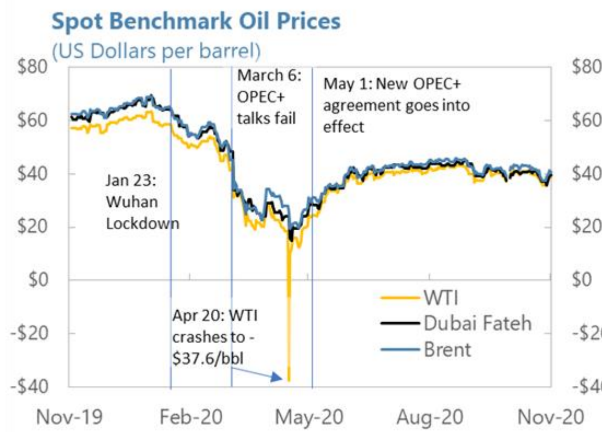
Sources: IMF World Economic Outlook and staff calculations. GCC=Gulf Cooperation Council; AE=Advanced Economies; EM=Emerging Market Economies; LIC=Low-Income Countries.

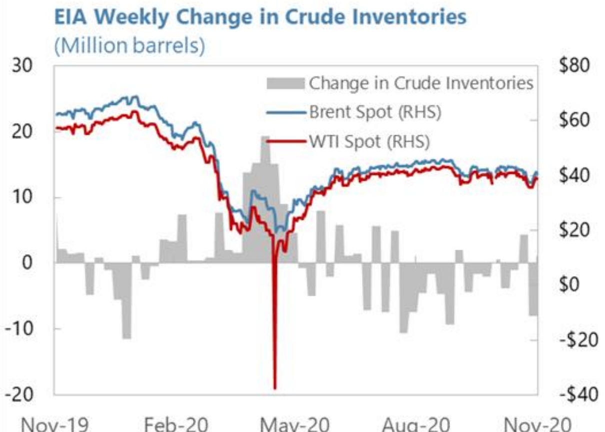
[3] All forecasts are from the October 2020 World Economic Outlook and MCD Regional Economic Outlook reports and are based on information available as of end-September. Information may have become available subsequently that would change these forecasts if they were updated now.

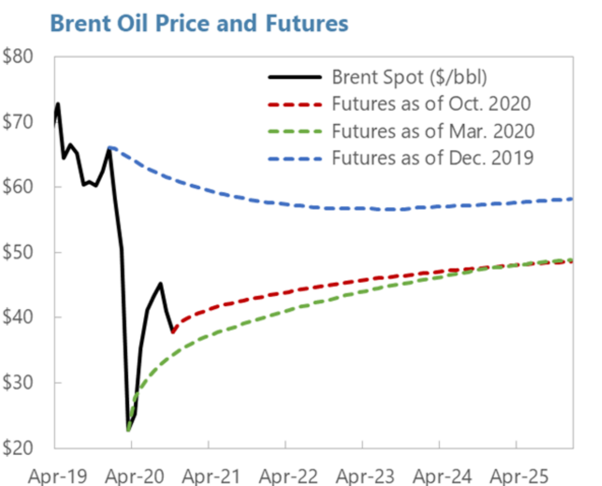
Box 1. Oil Market Developments

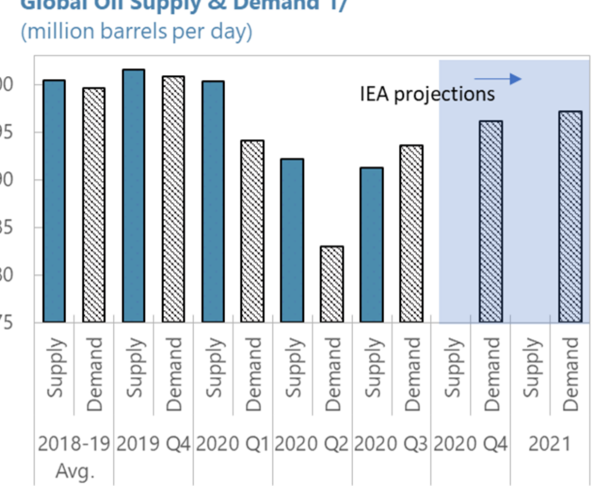
The coronavirus outbreak brought about an unprecedented decline in global oil demand in 2020Q2 as lockdowns put a break on many petroleum-intensive economic activities. According to the IEA, global oil demand fell from 100 million barrels per day in 2019Q4 to 83 million barrels per day in 2020Q2. This sharp fall along with the breakdown of the OPEC+ talks in early March resulted in a glut of oil that caused record volatility and low prices. As lockdowns were eased and economic activity restarted, oil demand began to recover in 2020Q3 and is expected to continue to do so in the fourth quarter but will still stay well below 2019 levels.

Oil markets have stabilized since the lows in April and prices have increased since the OPEC+ agreement came into effect in May but remain volatile. However, while the Brent oil price has doubled from its low in April, it is still more than 30 percent below its end-2019 level. Low prices have curtailed production from higher-cost producers. Compared to April, OPEC crude oil production has fallen by 20 percent and Russian and U.S. output is 12 and 8 percent lower, respectively. Despite the cuts, spot and futures prices remain below the pre-pandemic level, and global oil demand remains susceptible to weaker economic activity that could result from the resurgence of infections.









Sources: Bloomberg L.P., EIA, OECD/IEA, and IMF staff calculations.
1/ Includes crude oil, non-conventional oils, condensates, and NGLs.

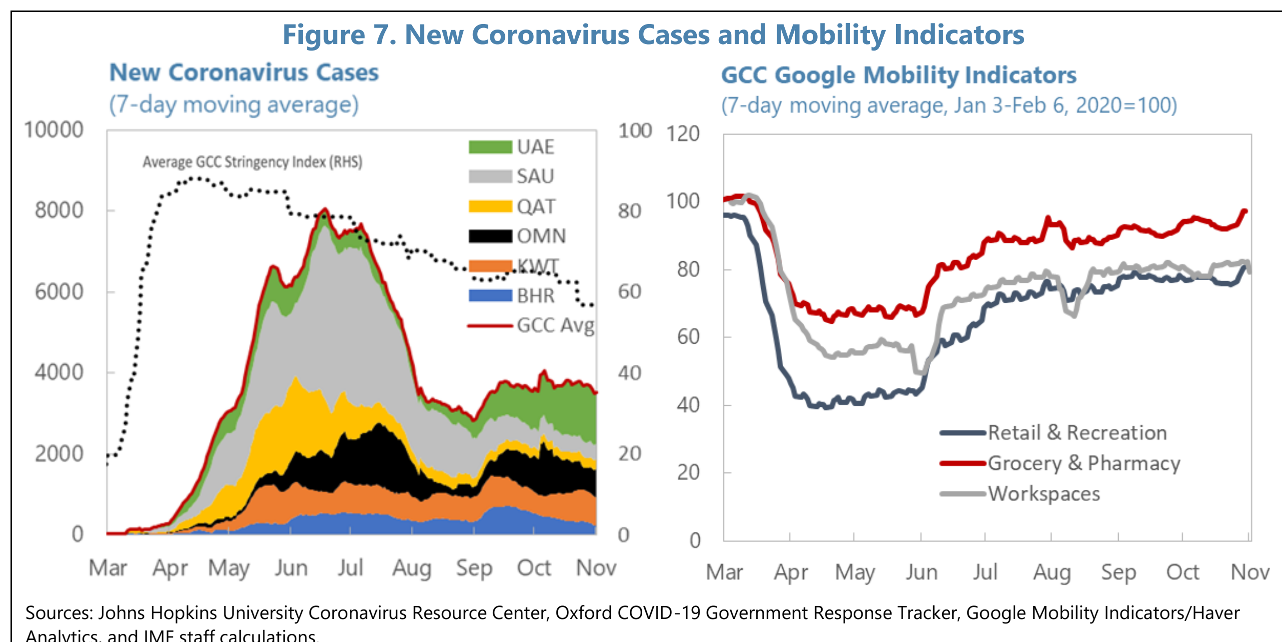
8. Risks to the forecast are substantial. There are rising risks of long-lasting damage (scarring) to economies as high and prolonged unemployment, bankruptcies, and associated economic dislocation erode human capital, reverse gains in poverty reduction, and raise social uncertainty. Some hard-hit sectors may shrink permanently, requiring deep reforms to facilitate the reallocation of resources. Despite encouraging reports, uncertainty remains about when safe and effective vaccines will be available and how rapidly they can be deployed globally.

B. The Economic and Financial Outlook in the GCC Countries

9. The GCC countries acted quickly to slow the spread of the coronavirus (Figure 7).

- As of November 1, 2020, the number of confirmed COVID-19 cases in the GCC had reached 938,000 with 8,400 deaths. Total number of cases per 100,000 in the GCC range between 1,000 in Saudi Arabia and 5,400 in Bahrain, with an average of 1,580 cases per 100,000 within the GCC. Since peaking in mid-June, the number of new daily COVID cases has fallen by 50 percent. Mortality rates in the region are far below the rates experienced in emerging and advanced economies.

Figure 7. New Coronavirus Cases and Mobility Indicators

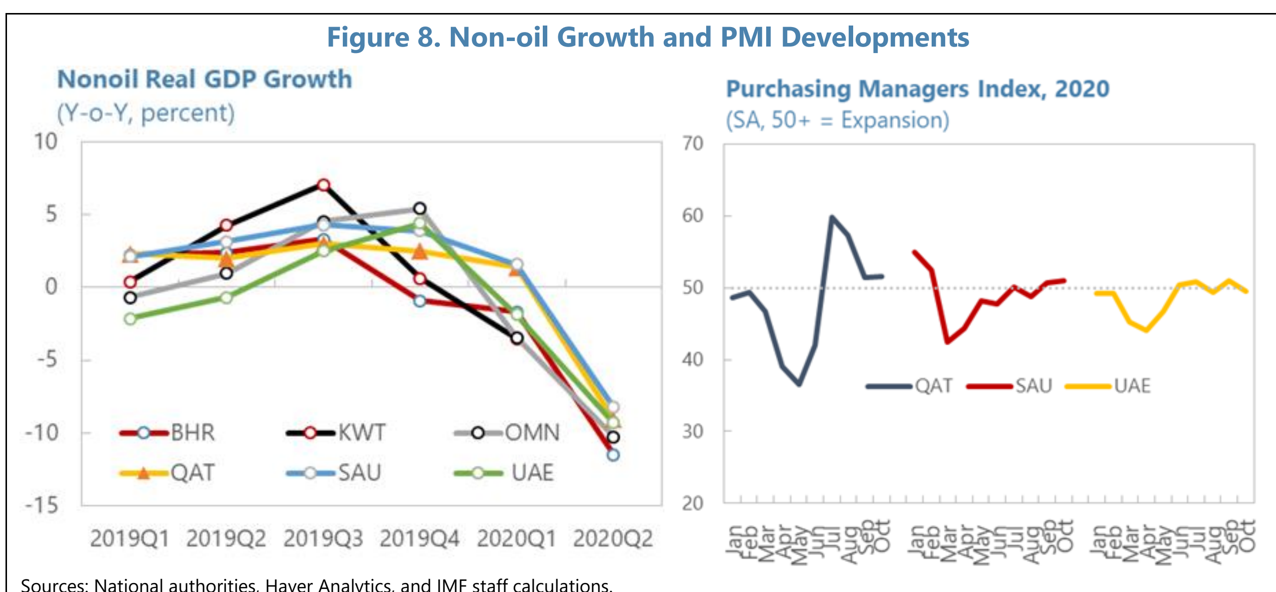


Sources: Johns Hopkins University Coronavirus Resource Center, Oxford COVID-19 Government Response Tracker, Google Mobility Indicators/Haver Analytics, and IMF staff calculations.

- The GCC authorities implemented a range of containment measures to limit the spread of the virus. These included curfew and travel restrictions; closures of schools, universities, shopping malls, retail outlets, mosques, and public parks; social distancing measures; a mandatory quarantine after travel; and the suspension of employee attendance in private and public work. Mobility declined sharply in March and while recovering more recently as the lockdown measures have eased, it remains well below pre-pandemic levels. Containment measures implemented in the GCC as measured by the Oxford Lockdown Stringency Index have been stricter than the global average which likely has helped control the spread of the virus.

10. The containment measures have weighed on non-oil growth (Figure 8). GCC non-oil GDP grew by 0.1 percent (y/y) in 2020Q1 and contracted by 9.7 percent (y/y) in 2020Q2 (excluding Kuwait for which Q2 data is not yet available).[4] In Saudi Arabia, data shows that the retail and wholesale, accommodation, and transportation sectors were hit particularly hard. PMI indicators (where available) declined in March/April and while they have recovered from these lows, they remain at multi-year lows in Saudi Arabia and UAE. Other monthly indicators point to a similar pattern of gradual recovery in recent months.

Figure 8. Non-oil Growth and PMI Developments



Sources: National authorities, Haver Analytics, and IMF staff calculations.

11. GCC oil production grew modestly in 2020Q1 but fell sharply in 2020Q2 with the renewal of the OPEC+ agreement before recovering in 2020Q3. Crude oil production in GCC countries was little changed in the first quarter but jumped sharply to 21.1 mb/d in April (from 18.5mb/d in March) following the ending of the OPEC+ agreement in early March. However, with the new OPEC+ agreement, GCC oil production dropped to 14.7 mb/d in June and was around 16.3 mb/d in September. Real oil GDP contracted by 1.7 percent (y/y) in the first quarter of 2020 and will have contracted sharply in 2020Q2. In Saudi Arabia, real oil GDP fell by 5.3 percent (y/y) in Q2.

12. With declining activity, earnings of GCC corporates deteriorated in the first half of 2020 (Figure 9). Corporate performance weakened in the first quarter and many firms experienced losses in the second quarter. Out of 565 firms for which data is available, 36 percent experienced losses in 2020Q2 compared to 26 percent in 2019Q2 (40 percent and 27 percent, respectively, if the financial and real estate sectors are excluded).

[4] For Oman, the nominal non-oil GDP was deflated by the Producer Price Index for non-oil products to approximate the real non-oil GDP due to the lack of quarterly data for non-oil GDP deflator.

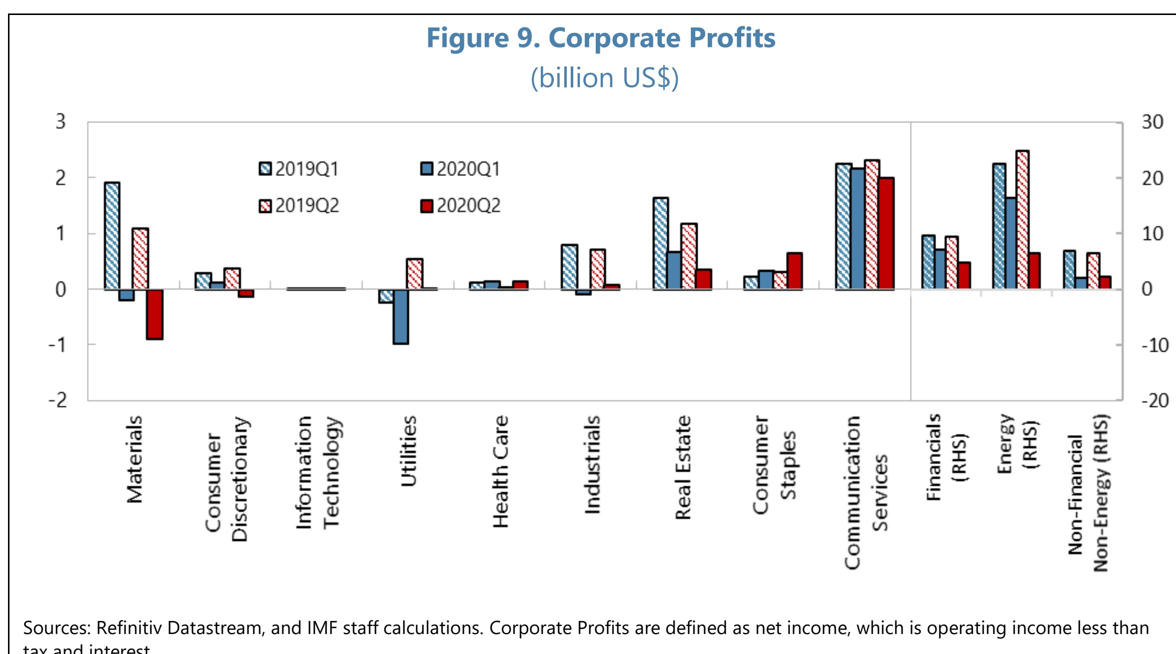


Figure 9. Corporate Profits

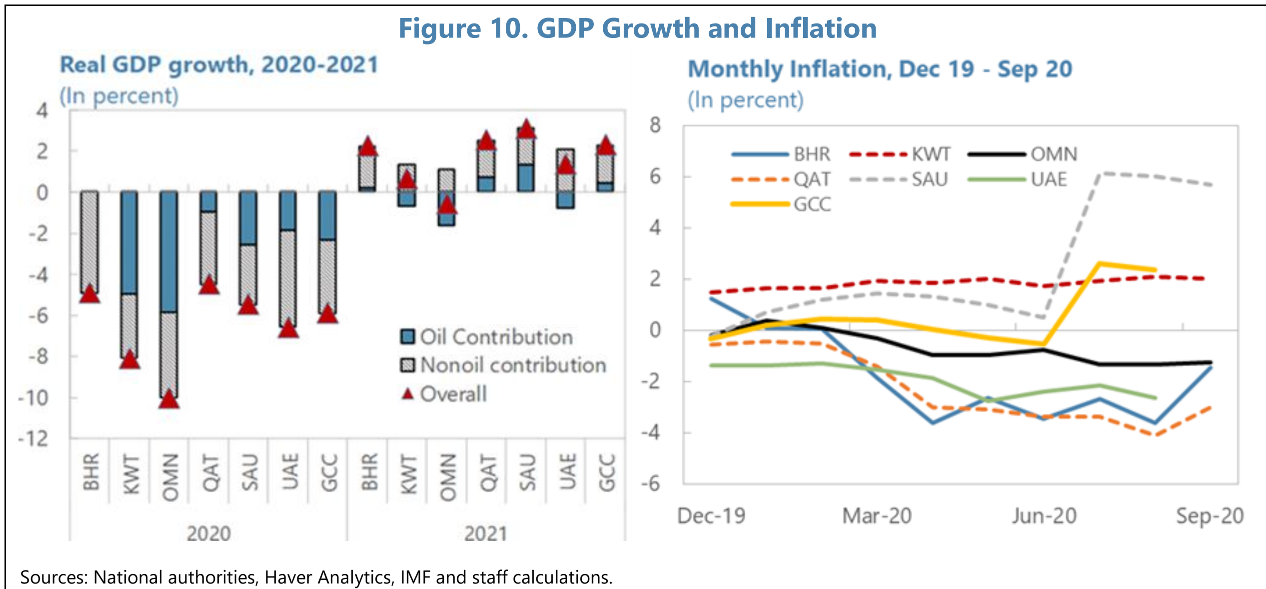
(billion US$)

Sources: Refinitiv Datastream, and IMF staff calculations. Corporate Profits are defined as net income, which is operating income less than tax and interest.

13. GCC governments have enacted a range of economic policy measures to mitigate the damage to activity (Appendix 1). These include the deferral or exemption from taxes and fees (mostly aimed at businesses) and job support and other social benefits (aimed at households), cuts in policy interest rates as the Federal Reserve reduced rates, deferral of loan repayments for bank customers, relaxation of macroprudential rules, and the injection of liquidity into the banking system. At the same time, with lower oil prices resulting in large fiscal deficits, some governments moved to cut expenditure, reprioritize spending within existing budget envelopes so that new health and social priorities could be met without increasing overall spending, or raise additional non-oil revenues. Overall, while monetary easing (measured by the reduction in the policy rate) in the GCC has exceeded the global average, the aggregate fiscal response has been smaller than in many other regions (Figure 3). This can be attributed to the already large size of government spending as a share of the non-oil economy in the GCC and because the majority of GCC nationals work in the public sector where there have not been job losses.

14. The GCC economies are expected to contract this year before recovering in 2021 (Figure 10, Table 3). The non-oil economy is projected to contract by 5.7 percent this year, with a recovery to 2.9 percent growth forecast for 2021. Real oil GDP is projected to contract by 6.2 percent in 2020 and grow by 1.2 percent in 2021 as countries produce in line with the OPEC+ agreement through end-2021. Overall, real GDP is projected to contract by 6 percent in 2020 compared with the pre-COVID-19 October 2019 projection of 2.6 percent growth. In 2021, assuming progress in containing COVID-19, overall GDP growth is anticipated to strengthen to 2.3 percent, somewhat slower than in other emerging market economies due to the subdued growth of the oil sector under the OPEC+ agreement and assumed stronger fiscal consolidation in the GCC.

Figure 10. GDP Growth and Inflation



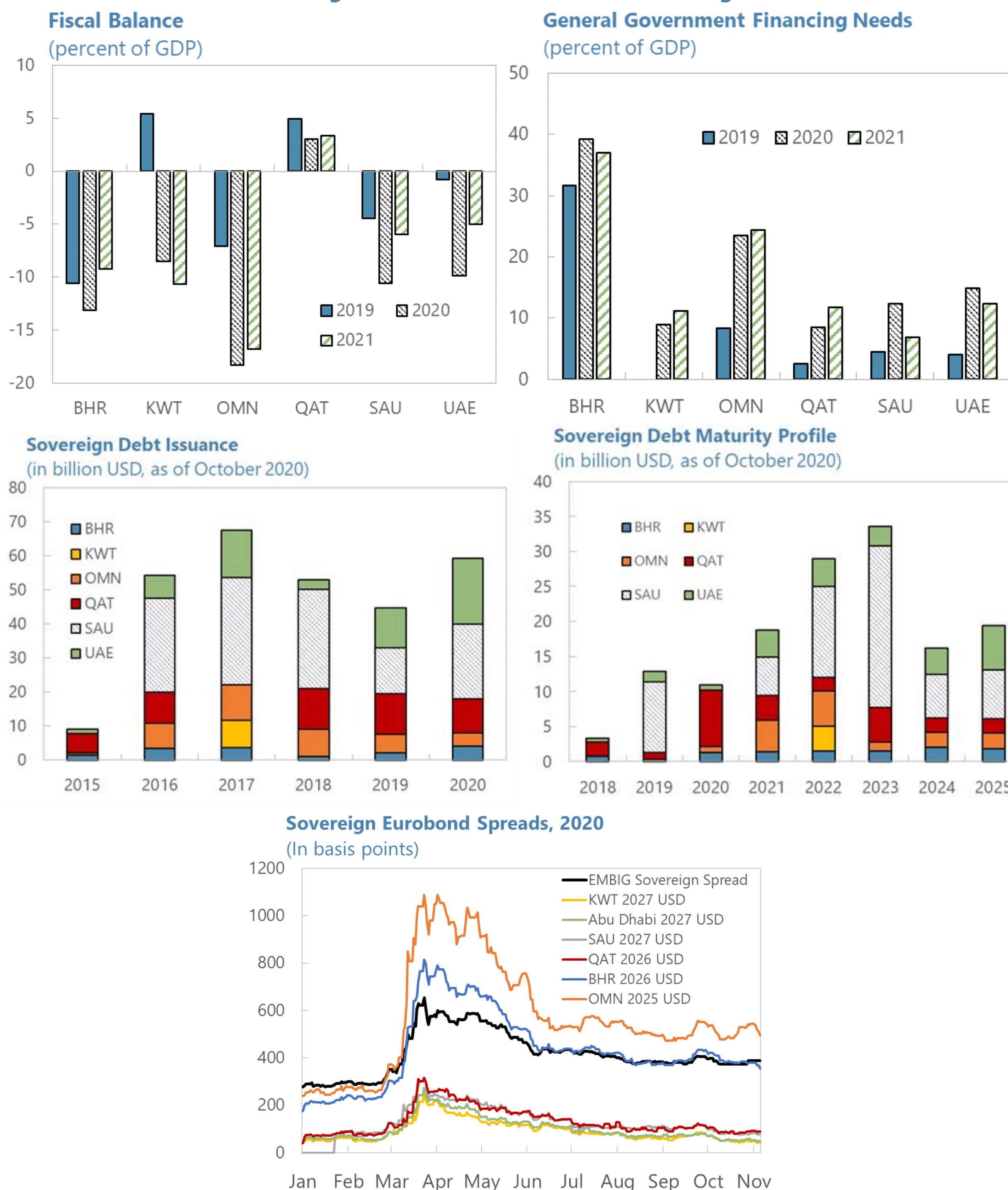
Sources: National authorities, Haver Analytics, IMF and staff calculations.

15. CPI inflation has remained subdued while credit growth has generally remained robust. Inflation has been on a downward trend across GCC countries, dropping from an average of 0.2 percent (y/y) in January 2020 to -0.5 percent (y/y) in June 2020; however, it increased sharply in July and August to reach 2.4 percent (y/y) (driven by inflation in Saudi Arabia which jumped to over 6 percent as a result of the increase in the VAT rate from 5 percent to 15 percent at the beginning of July). GCC inflation is projected at 1.5 percent in 2020 before rising to 2.9 percent in 2021 as domestic demand recovers. Credit growth to the private sector has mostly remained positive in 2020, but developments have not been uniform. Credit growth in Saudi Arabia and Qatar has been robust but has been near zero in Oman and UAE.

16. Lower oil exports have weakened external balances in the region despite reduced imports. Oil exports are projected to shrink by around $150 billion (37 percent) in 2020 compared to 2019 while imports are projected to drop by 14 percent due to weaker domestic demand and lower import prices. The current account balance is projected to decline sharply from a surplus of 5.8 percent of GDP in 2019 to a deficit of 1.8 percent of GDP in 2020. The financial account is also expected to drop from a surplus of $26.5 billion in 2019 to a deficit of $92.2 billion in 2020, although this partially reflects increased overseas investments by some GCC Sovereign Wealth Funds.

17. Lower oil revenues, economic contraction, and fiscal support measures have led to large fiscal deficits in the region (Figure 11). The decline of oil revenues, the drop in non-oil revenues due to the deferral of some government's taxes and fees, and increased government expenditures on health care and to support households and businesses have resulted in increased fiscal deficits. The aggregate fiscal deficit in the GCC is projected to increase to 9.2 percent of GDP in 2020 from 2 percent of GDP in 2019 before narrowing to 5.7 percent of GDP in 2021.

Figure 11. Fiscal Balance and Financing



Sources: National authorities, Dealogic Limited, Bloomberg L.P., IMF World Economic Outlook and staff calculations.

18. As a result, fiscal financing needs have risen. Staff estimates suggest an increase of GCC fiscal financing needs by 8.7 percentage points of GDP to 13.5 percent of GDP in 2020. To meet these needs, GCC government debt issuance amounted to $59 billion in the year to October 2020, above the total issuance of $44 billion in 2019. Over $100 billion of debt is projected to be maturing between 2021-2025, which would further increase financing needs. Meanwhile, Bahrain and Oman have seen significant increases in their bond spreads compared to other GCC countries. Government net financial assets have declined. While financial buffers remain ample in Kuwait, Qatar, Saudi Arabia and the UAE, they are significantly weaker in Bahrain and Oman. Although a lower-for-longer interest-rate environment moderates the cost of borrowing in general, bond yields have increased in GCC countries with limited buffers (Figure 11).

19. GCC financial systems were in a robust position before the crisis, but credit risks could rise if current conditions persist (Table 1). Banks are well capitalized and liquid and have relatively low NPLs. GCC banks have strengthened their risk management standards and applied countercyclical capital buffers and loan loss provisions to mitigate financial sector risks. However, recent measures to encourage banks to postpone loan payment installments for up to six months to support hard-hit businesses and households could temporarily conceal the true extent of bank asset quality deterioration. Moreover, continuation of the current low oil price environment or resurgence of COVID-19 infections could ultimately cause a deterioration in banks' asset quality and capital that may intensify financial stress in some banks. To avoid such an outcome, banks and supervisors need to be proactive in ensuring appropriate provisions to mitigate any risks from worsening assets quality.

Table 1. Financial Soundness Indicators

	Capital Adequacy (Tier 1)		NPLs to Total Loans		Loans to Deposits		Return on Assets	
	2019	**2020 Q2**	**2019**	**2020 Q2**	**2019**	**2020 Q2**	**2019**	**2020 Q2**
BHR	18.1	17.1	4.8	4.5	71.5	69.5	1.1	0.4
KWT	18.5	N/A	1.5	N/A	106.0	108.9*	1.2	N/A
OMN	18.9	18.3	3.4	4.0	109.2	109.9	N/A	N/A
QAT	17.5	N/A	1.8	N/A	122.4	121.5*	1.6	N/A
SAU	18.1	17.7	1.9	2.3	77.1	75.4	1.8	1.0
UAE	16.5	16.4	6.5	7.4	94.0	95.9	1.6	0.9

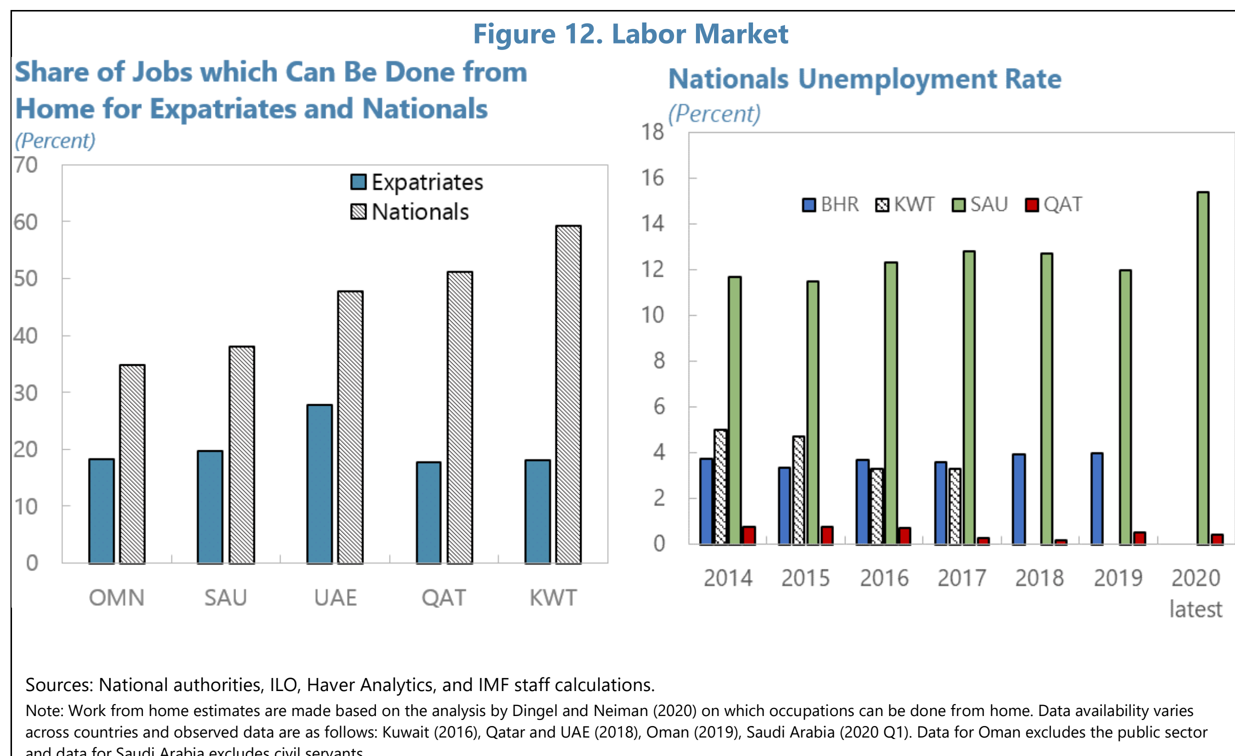
Sources: National authorities

(*) Indicates that these ratios reflect 2020 Q1 data.

20. The COVID-19 outbreak will intensify labor market challenges. In Saudi Arabia, the unemployment rate for nationals rose by 3.6 percentage points to 15.4 percent in 2020Q2. For other countries, available data, which pre-dates the pandemic, indicate lower unemployment rates for nationals, but these are likely to increase in view of the severe economic contraction (Figure 12). Recent IMF staff analysis suggests that GCC nationals have greater ability to work from home compared to expatriates as nationals tend to occupy managerial and professional positions while

expatriates usually work in low-skill jobs. To prevent job losses for nationals working in the private sector, several measures have been taken by some authorities, including the use of unemployment funds to finance salaries. The situation for foreign workers who are not generally entitled to such support is less clear.[5]

Figure 12. Labor Market



Sources: National authorities, ILO, Haver Analytics, and IMF staff calculations.
Note: Work from home estimates are made based on the analysis by Dingel and Neiman (2020) on which occupations can be done from home. Data availability varies across countries and observed data are as follows: Kuwait (2016), Qatar and UAE (2018), Oman (2019), Saudi Arabia (2020 Q1). Data for Oman excludes the public sector and data for Saudi Arabia excludes civil servants.

21. Risks to the outlook remain skewed to the downside. Considerable uncertainty surrounds the evolution of the coronavirus pandemic as well as the oil market outlook. Weaker-than-expected global growth due to the resurgence of the pandemic or other factors could weaken oil demand and either drive oil prices lower or require additional actions from OPEC+. Changes in global risk appetite could limit external borrowing for some governments and the private sector, notably Bahrain and Oman. Geopolitical developments could ultimately weigh on investor and consumer confidence, investment and growth. Delays in implementing necessary fiscal adjustments and structural reforms could weaken fiscal sustainability and dampen growth. Faster than expected adoption of safe and effective COVID-19 vaccines would be an upside risk.

[5] In the UAE, measures taken to reduce job losses include encouraging employers and employees to explore scope for remote working arrangements and salary cuts. Measures taken to mitigate the impact of job losses include providing subsistence for workers in need irrespective of nationality, as well as offering grace periods on expired visas to allow expats to make alternative job arrangements.

C. Policy Priorities

The Short Term

22. Continuing to meet the health and economic support needs stemming from the COVID-19 pandemic is the immediate priority. Countries should continue to implement the health measures necessary to contain the pandemic, treat those infected, and support households and firms with increasingly well-targeted measures. Fiscal and monetary policy should remain accommodative until the recovery is well-established. Decisions will need to be taken on how to withdraw broad-based temporary support as the recovery takes hold and where more targeted support to households and businesses most in need would continue. Not all sectors have been equally affected by the lockdowns. While transportation and tourism remain significantly impacted, many IT-based sectors and grocery stores have seen strong growth in sales. Measures that were initially introduced for all businesses can therefore be tailored to sectors that continue to be affected. Further, within these sectors, greater efforts will be needed to distinguish between businesses that will be viable in the post-COVID world and those that will not, with support only going to those deemed to be viable. Coordination across fiscal and monetary/financial sector policies is also needed. If fiscal and financial sector support are withdrawn simultaneously, this could put excessive stress on businesses who would have to make additional tax and loan payments at the same time.

23. Policymakers also need to be ready to respond to a potential second wave of COVID infections. A renewed surge in infections may necessitate the re-imposition of at least some of the restrictions previously in place. In such circumstances, continued more extensive policy support may be needed where fiscal and financial policy space is available, although on the fiscal side, lower oil revenues would reduce the space available. Once the impact of COVID-19 abates, the authorities need to embark on credible medium-term fiscal adjustments to avert growing financing challenges, put the fiscal position on a sound path, and to rebuild their financial buffers, while furthering structural reforms to boost sustainable growth in the non-oil sector.

24. Fiscal policy. Government spending should continue to reorient towards safety nets as well as timely temporary and targeted schemes to support credit-constrained SMEs, the most affected sectors, and individuals who have lost jobs. Supporting the basic consumption needs of expatriate workers who have lost their job but have been unable to exit because of travel restrictions is a priority. Once the health crisis wanes, policies should aim to strike a balance between supporting economic growth and achieving fiscal sustainability especially under softening growth prospects for oil revenues. For GCC countries with limited fiscal space, fiscal consolidation is an immediate priority.

25. Monetary policy. With recent statements by the Federal Reserve indicating that U.S. policy rates are likely to remain low for the foreseeable future, monetary policy in the GCC will remain accommodative. Central banks will need to continue to stand ready to provide liquidity, but the primary challenge will be on the timing of the withdrawal of existing liquidity support to ensure the banking system continues to function smoothly.

26. Financial sector policy. Temporary measures to support borrowers introduced early in the crisis have helped avoid disorderly deleveraging and value-destroying bankruptcies. But, as clarity about the post-COVID period increases, this support will need to be gradually withdrawn. Ensuring a return to the strong regulatory and supervisory approaches followed pre-COVID will ensure the financial sector remains resilient to the next shock. Banks and supervisory authorities need to ensure that provisioning levels are gradually increased and that loan classifications take a realistic view of borrower viability in the post-COVID world.

Medium and Long Run Fiscal Challenges

Fiscal Sustainability

27. Fiscal consolidation is needed over the medium and long term to reduce deficits, strengthen fiscal buffers, and ensure continued sustainability. As the impact of COVID-19 fades, strong fiscal consolidation plans anchored in credible medium-term frameworks will need to be put in place. Fiscal positions in all GCC countries are assessed to have substantial sustainability gaps in the long run, despite large asset buffers in most cases, unless further fiscal adjustment is implemented relative to 2020 (Appendix 2). Although subject to large margins of uncertainty, estimated sustainability gaps (in percent of nonoil GDP) range from about 16 percent in Bahrain to 65 percent in Kuwait. These results primarily reflect (i) large non-oil structural primary deficits at present, and (ii) expectations that in the coming decades oil revenues will trend down as a share of GDP even though GCC countries are low-cost producers (IMF 2020c). Fiscal consolidation, together with structural reforms, is also needed to support the pegged exchange rate regimes in the region.

28. Staff estimates (Appendix 2) suggest that announced plans for fiscal adjustment in the coming years in Qatar, Saudi Arabia, and UAE, will go a long way toward containing medium term fiscal pressures if they are fully implemented. Even then, these countries will need to do more over the long run to ensure fiscal sustainability. For the other countries, more ambitious consolidation plans are needed. The urgency for adjustment is most pressing for Bahrain and Oman, where fiscal buffers are low.

29. Strengthening medium term fiscal frameworks will support consolidation efforts and reduce the procyclicality of fiscal policy with respect to oil prices. The introduction of medium-term fiscal frameworks, where still missing, will guide the pace of adjustment, set expenditure paths that are consistent with expected revenue developments, and help resist spending pressures and support intergenerational saving objectives during periods of rising oil prices. If spending is procyclical with the oil price, as it has been in the past, vulnerabilities will increase during periods of temporarily higher oil prices and medium-term fiscal adjustment objectives will be more difficult to meet. The urgency for adjustment is most pressing in Bahrain and Oman where fiscal buffers are low. Oman announced an ambitious medium-term fiscal adjustment plan in early November after the fiscal forecasts in this paper were finalized.

Key Areas for Fiscal Reforms

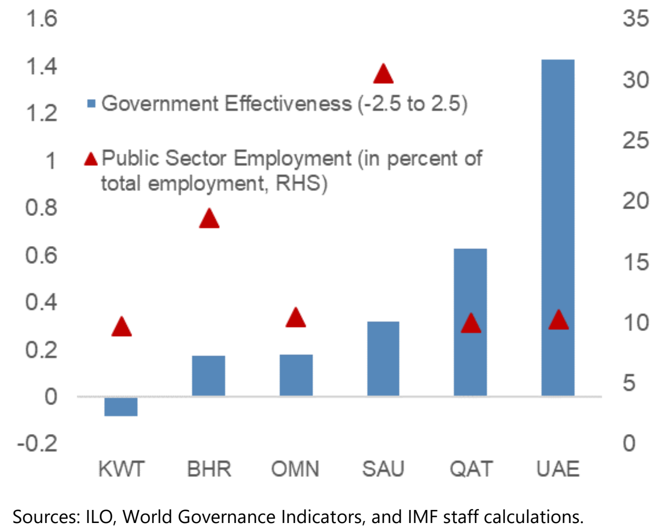
30. GCC countries need to continue to implement broad-based fiscal reforms to ensure sustainability while supporting a more inclusive and greener recovery. These will involve reducing the overall spending envelope while creating space for and improving the efficiency of social spending, continuing with reforms to domestic energy prices, increasing efficiency of infrastructure investment with increased focus on green projects, and broadening non-oil sources of revenue. These issues are discussed further in the following paragraphs

31. Public sector wage bills are large by international standards in some GCC countries (Figures 13-14).

- For many nationals, public sector employment is preferable to private sector employment. This is partly explained by the fact that several countries have large gaps between public and private sector compensation—for nationals it is typically about 30–50 percent. Despite a downward trend in the early 2000s—owing to strong GDP growth—most public wage bills are still high as a percent of GDP. In Kuwait, public wages rose to 14 percent of GDP during 2010–18, from an average of 11 percent during 2000–2009. Except for Oman, Qatar and the UAE, wage bills stand above 10 percent of total GDP (the average level observed in AEs).

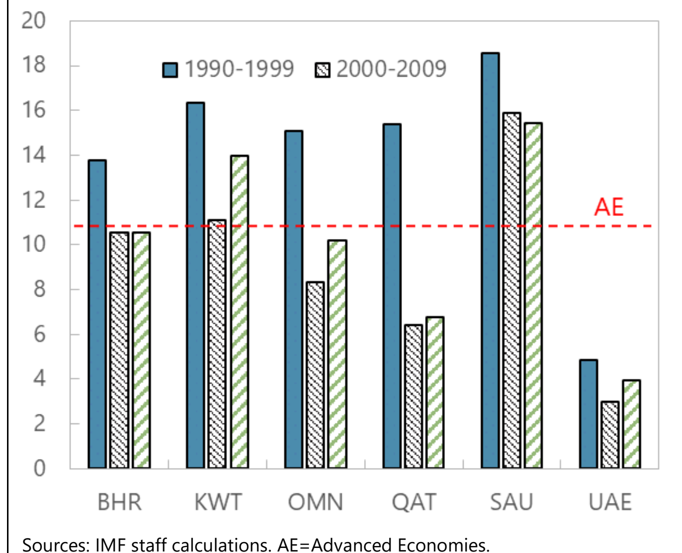
- Higher wage bills have on average not produced better service delivery, although public services are also affected by other considerations. Compared with their peers, most GCC countries are perceived to have lower government effectiveness—one of the World Governance Indicators that captures, among other things, perceptions of public service quality. Over the last five years, the index recorded an upward trend in the UAE and Saudi Arabia; all other countries witnessed a deterioration in the perceived quality of public services despite the significant increase in wage spending. The UAE is an outlier with an efficient

Figure 13. Public Sector Employment and Government Effectiveness



Sources: ILO, World Governance Indicators, and IMF staff calculations.

Figure 14. Public Wage Bill
(Percent of GDP)



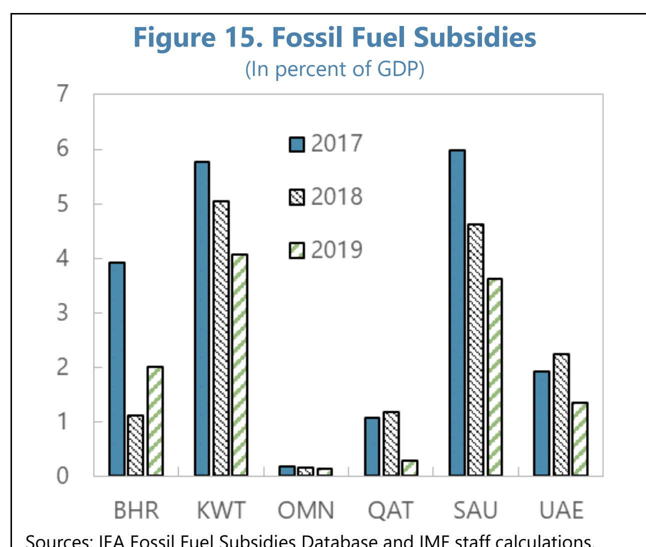
Sources: IMF staff calculations. AE=Advanced Economies.

implementation of a customer-centric public service delivery that has markedly improved the government effectiveness index to levels comparable with AEs. IMF, 2018, calls for ensuring that wage bill policies are fiscally sustainable by identifying drivers of wage bills and anchoring their growth in medium-term fiscal plans, in addition to focusing compensation and employment policies on providing quality public services effectively and equitably by undertaking sectoral expenditure reviews and strengthening mechanisms for public service delivery.

32. Additional efforts are needed to rationalize energy subsidy schemes that are not well targeted. Figure 15 shows that most countries have been gradually implementing energy subsidy cuts over the past few years, increasing the prices of electricity, gasoline, and other fuels sold in the domestic market. Saudi Arabia, for example, has increased gasoline prices and now has a monthly indexation mechanism to export prices and has increased electricity prices. Energy consumption per capita in the GCC region remains, however, very high. The current environment of low oil prices presents countries with a window for further reforming domestic energy pricing to reduce fuel subsidies, which would provide additional savings, as well as broader economic, social, and environmental benefits. Such reforms should be supported by stronger social safety nets to ensure the purchasing power of lower income households is not eroded (see below)

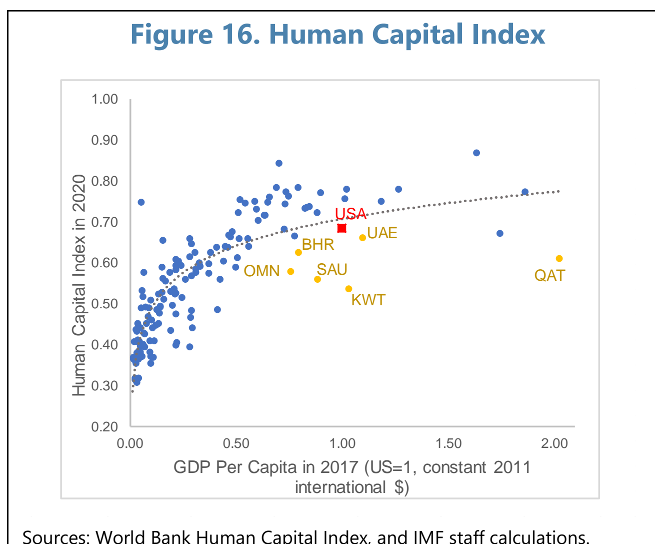
Figure 15. Fossil Fuel Subsidies

(In percent of GDP)



Sources: IEA Fossil Fuel Subsidies Database and IMF staff calculations.

Figure 16. Human Capital Index



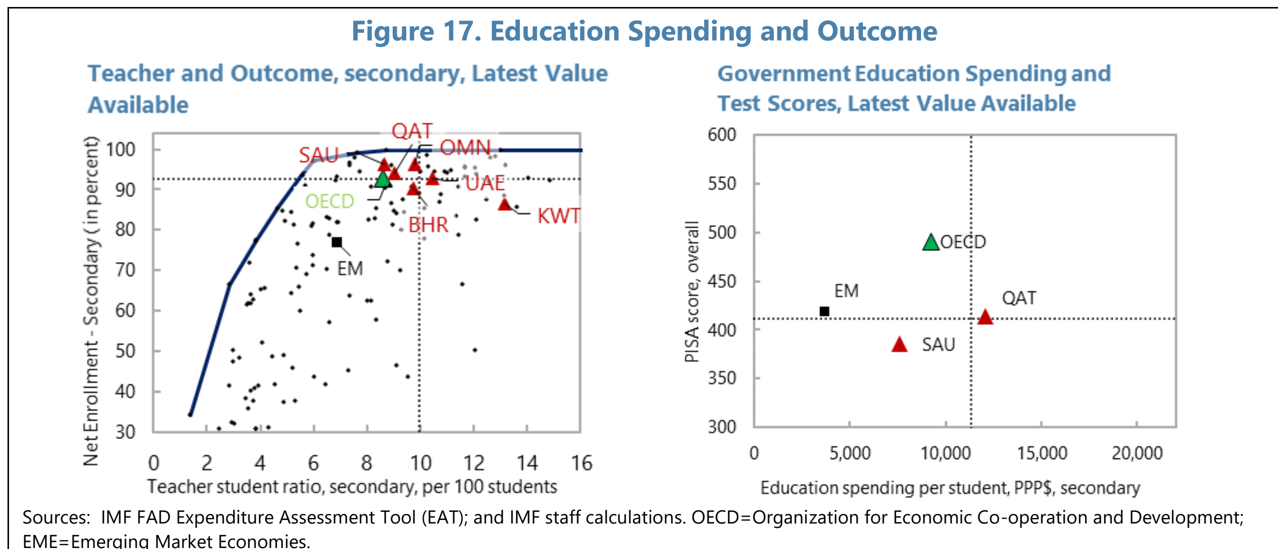
Sources: World Bank Human Capital Index, and IMF staff calculations.

33. There is a need to increase the efficiency of social spending to support diversification and inclusive growth. Governments in the region devote around 8 percent of GDP on average to social spending, but there is scope to increase the efficiency of this spending to help boost the quality of human capital (Figure 16).

- Strengthening education systems is key to ensuring nationals have the skills in demand in the private sector and to support diversification efforts (Figure 17). While school enrollment rates are broadly comparable to advanced country levels, standardized international test scores indicate significant room for improving the quality of education in the region. This would require increasing the efficiency of education spending.

- Despite comparable per capita income levels, the GCC's infant mortality rate is twice that of AEs, suggesting scope for further strengthening healthcare systems in the region. The COVID-19 pandemic has further magnified health challenges and brought into sharp focus the need for strengthening health systems.
- The crisis has exacerbated economic and human challenges for fragile households. Social safety nets should be permanently strengthened, with social assistance and social insurance systems featuring wider coverage and better targeting to support the most vulnerable. This should include support for expatriate low-wage workers, especially those who have lost their job and are unable to exit the region.

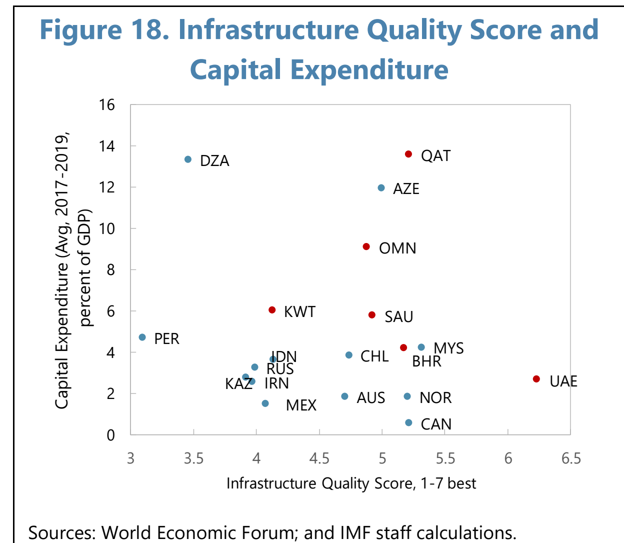
Figure 17. Education Spending and Outcome



Sources: IMF FAD Expenditure Assessment Tool (EAT); and IMF staff calculations. OECD=Organization for Economic Co-operation and Development; EME=Emerging Market Economies.

34. Most GCC countries have already attained a high quality of infrastructure relative to global peers (Figure 18). In terms of efficiency, all countries except Kuwait are well positioned internationally and rank better than the average AE. Given ambitious investment programs envisaged under national agendas in the region, higher efficiency in implementing public projects would increase the "value for money" of the sizable capital spending programs (Figure 19). Within this spending envelope, and consistent with efforts to improve public investment efficiency, investments could increasingly focus on green projects including the development of alternative energy sources and less energy-intensive buildings (to support ongoing reforms to raise domestic energy prices).[6]

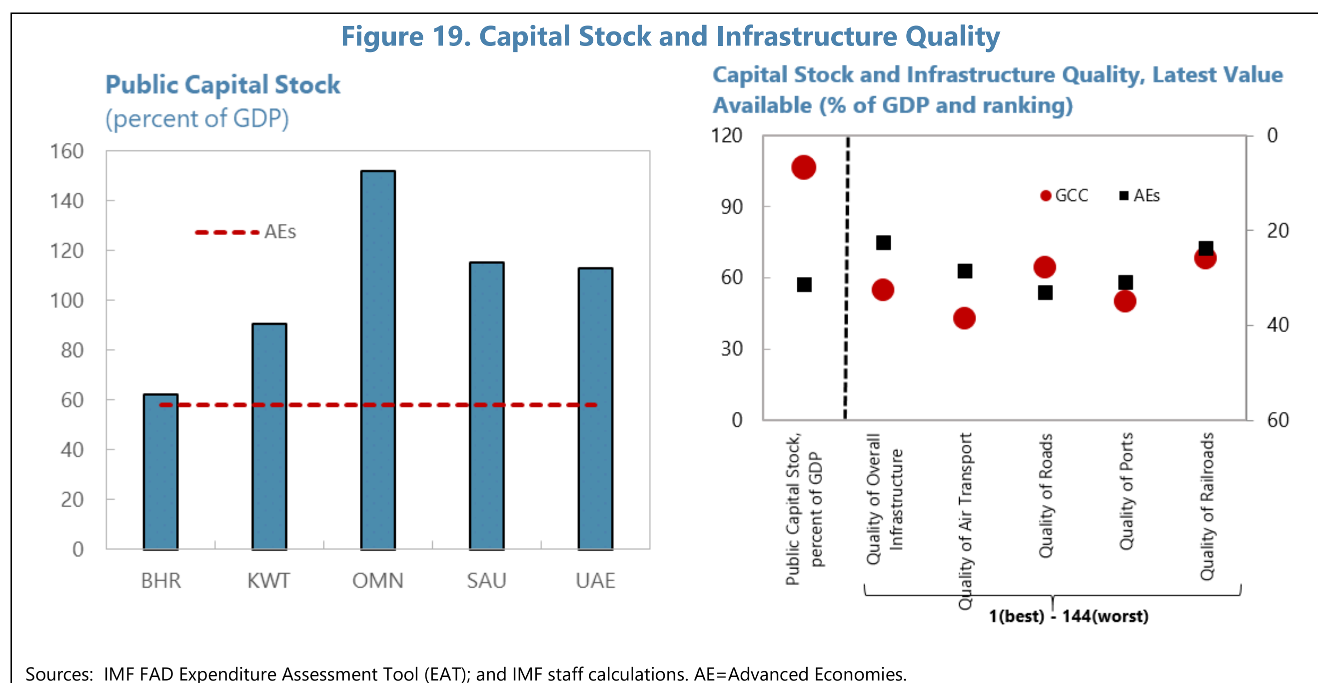
Figure 18. Infrastructure Quality Score and Capital Expenditure



Sources: World Economic Forum; and IMF staff calculations.

[6] Green investment is generally defined as the investment necessary to reduce greenhouse gas and air pollutant emissions.

Figure 19. Capital Stock and Infrastructure Quality



Sources: IMF FAD Expenditure Assessment Tool (EAT); and IMF staff calculations. AE=Advanced Economies.

35. **Additional revenue measures will be needed to expand fiscal space**. A comprehensive review of tax policy options is needed. GCC countries have agreed to introduce excises on tobacco and certain types of sugary drinks and a value-added tax. Not all have done so. Those countries still to implement these taxes should move to do so as soon as possible once the recovery is underway. Over time, there is scope to increase the VAT rate as has recently been done in Saudi Arabia where the VAT rate at 15 percent is now comparable to other Middle Eastern countries (15.6 percent) and countries in other regions (17.2 percent). However, potential distortions arising from substantial VAT rate differentials between countries in the GCC may need to be assessed in the interim. Taxes on property could also be considered. They are an efficient source of revenue mainly due to the immobility of the tax base when supported by an accurate valuation system. Property taxes can also target high-value properties by setting a high threshold, as an indirect way to target the higher-income groups if desired. In addition, further support to private sector development and public finances could be triggered by a more progressive tax system. Consideration should be given to replacing numerous business fees with a corporate income tax to further strengthen the ease of doing business. Over a longer horizon, there is also scope for progressive personal income taxation. As non-oil revenue mobilization efforts expand, it will be important that tax administration is strengthened as well.

Structural Reforms to Boost Non-oil Growth

36. **A broad range of reforms are needed to boost non-oil growth and help diversify away from the reliance on oil revenues**. With further growth in government employment no longer sustainable in view of the fiscal outlook, labor market reforms to facilitate job creation for nationals in the private sector are needed. Continued efforts to strengthen the business environment by filling

remaining gaps in the legal infrastructure, tackling corruption, and improving governance would support the expansion of the private sector. In addition, given the importance of SMEs, measures to support their development will be crucial to achieve higher private sector growth. Increasing the options for corporate financing, including through the development of capital markets and the financing options for start-ups, would also be desirable for long term growth. GCC countries are taking measures towards this end. In Saudi Arabia, the Vision Realization Programs that underpin Vision 2030 are moving from design to implementation.

Labor Market

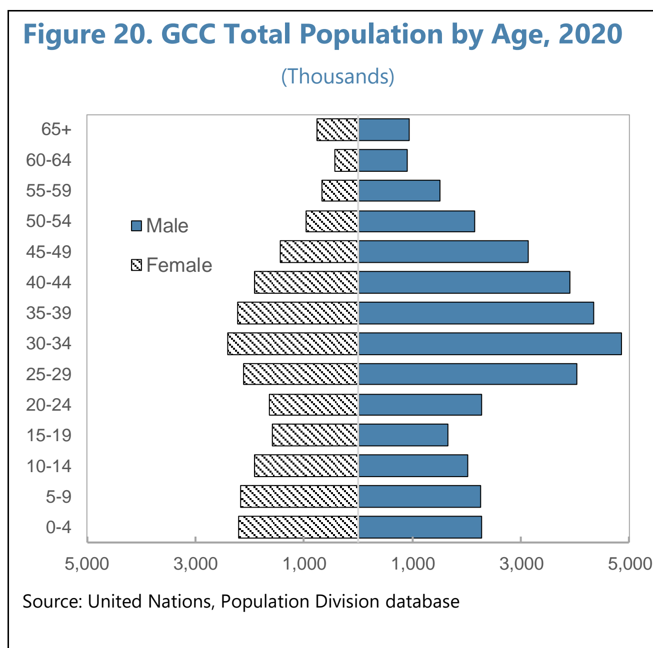


Figure 20. GCC Total Population by Age, 2020

(Thousands)

Source: United Nations, Population Division database

37. A young population and rising labor force participation rates will lead to a large number of new labor force entrants in the coming years that cannot primarily be absorbed by the public sector (Figure 20). Although the labor force participation rate of nationals remains low in the GCC (about 83 percent for men and 32 percent for women on average), it has risen over the past decade, with potential for further increases as highly educated nationals, especially women, enter the labor force. Depending on participation rates, the labor force could grow by an additional 2.5 million GCC nationals by 2025. This offers a huge opportunity to benefit from a growing and increasingly well-educated labor force, but will need to be accompanied by measures to strengthen the private sector employment of nationals, including:

- Strengthening education and training to provide the skills in demand in the private sector.
- Ensuring that any remaining impediments to female participation in the labor market are removed including ensuring adequate access to childcare facilities.
- Making unemployment assistance conditional on participation in job search and training activities to strengthen incentives for nationals to enter the private sector. Also, active labor market programs—e.g., targeted training, job search assistance, and time-limited wage subsidies—can support increased female and youth employment.
- Restrictions on the mobility of expatriate labor (through sponsorship programs) should be removed. These contribute to substantial wage differentials between nationals and expatriates and act as a disincentive for private employers to hire nationals. Progress has been made, and recently Qatar and Saudi Arabia have announced important reforms to increase the flexibility

and improve the functioning of the expatriate labor market. Qatar has also introduced minimum wage regulations for expatriates.

- More generally, restrictions on the length of residency and job opportunities of expatriates in turn limits their contributions to domestic savings, investment, consumption, and growth. Accordingly, some GCC countries have taken steps to ease such restrictions. In particular, the UAE has offered long-term residency visas for large investors and special talents and expanded majority expatriate ownership of businesses in non-strategic sectors.

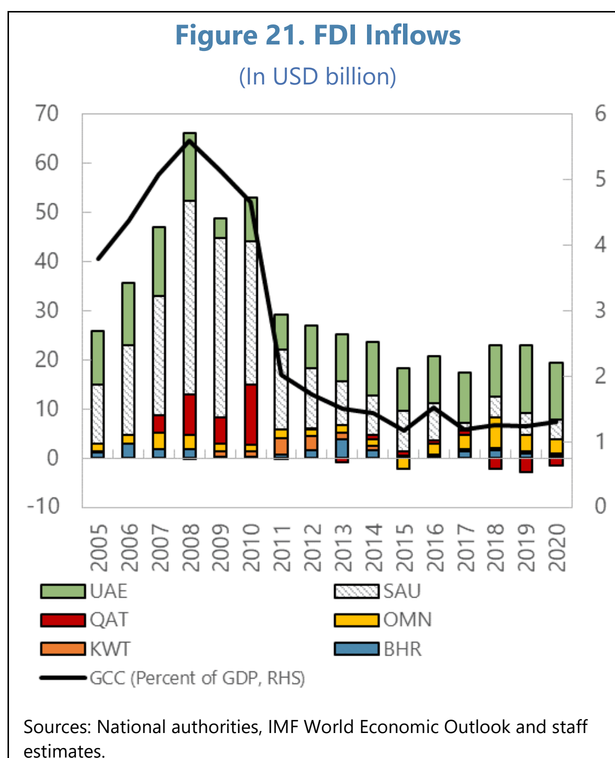
Business Environment

38. Strategies to foster the development of dynamic private sectors are needed to accelerate economic diversification. In addition to a stable macroeconomic environment, these strategies should aim to ensure that widely acknowledged pre-conditions for broad-based growth are in place, including: a predictable and simple legal framework, robust institutions, a favorable business climate for both domestic and foreign investment, appropriate incentives, low corruption, and a strong education system (Callen and others 2014, IMF 2016a, IMF 2018a). Well-developed domestic capital markets would promote growth by increasing private sector access to financing, provide finance for strategic infrastructure projects, and provide more options for savers and investors within the countries.

39. Further steps to support the development of a GCC-wide internal market would support private sector growth. Notwithstanding the low trade barriers under the GCC Customs Union Agreement signed in 2003, intra-GCC non-oil trade remains low, at around 10 percent of total non-oil trade. Moreover, after surging in the early 2000s, FDI inflows into GCC countries have stalled, remaining on average around 1.5 percent of regional GDP despite the announced ambitious diversification strategies across the GCC countries (Figure 21). Further reducing non-tariff barriers would help boost trade and investment.

Figure 21. FDI Inflows

(In USD billion)

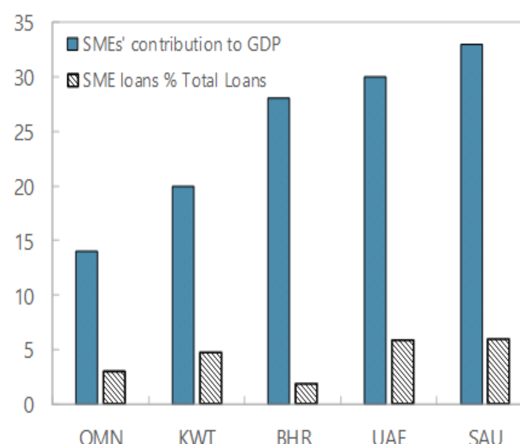


Sources: National authorities, IMF World Economic Outlook and staff estimates.

SME Development and Financing

40. Supporting SME development is vital for diversification and private sector led growth. Despite constituting a substantial part of GCC economies, SMEs face limited access to finance. SME share of total loans is much lower than its contribution to GDP in the GCC (Figure 22). To improve access to finance for SMEs, governments in the region have implemented various polices either through direct intervention or improved legal and regulatory environment to improve market functioning and bank competition, but there is room for more.

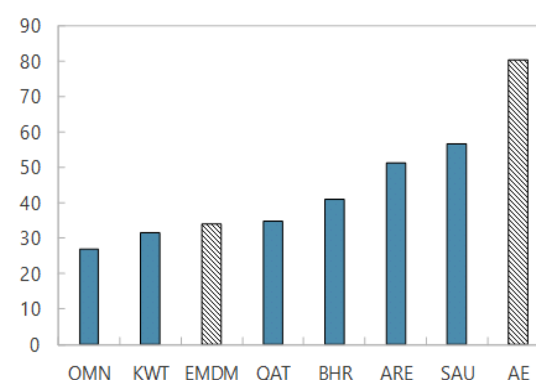
Figure 22. SME as a Share of GDP and Total Loans, 2019[1]
(Percent)



Sources: IMF 'Enhancing the Role of SMEs in the Arab World—Some Key Considerations'; Financial Stability Report by Central Bank of Oman, UAE, Kuwait and Bahrain and IMF staff estimates.

[1]Due to limited data availability, SME loans as a ratio of bank loans is shown instead of as percent of total loans by all financial institutions for Bahrain and Oman.

Figure 23. Percentage of Firms and Individuals Covered by PCBs and PCRs
(over Total Population)



Sources: World Bank; and IMF staff calculations. AE=Advanced Economies; EMDM=Emerging Market and Developing Economies.

- The design and operation of credit guarantee schemes (CGSs) as a major vehicle of direct government support for SMEs needs to build on a sound legal and operational basis, in alignment with a sound public finance management framework. Table 2 compares some key aspects of each country's CGSs against best practice principles to shed light on potential areas for improvement. In general, for countries where information is available, most CGSs have clearly defined eligibility criteria: only available to firms within certain size; different policies for start-ups and existing firms; exclude certain industries, mostly finance and real estate industries. However, there appears to be room to improve transparency of lending rate policies and improve their consistency with a risk-based pricing policy, thus limiting moral hazard. Detailed financial reports should be regularly published, including careful assessments of contingent fiscal costs of CGSs.

- Besides state programs, it is crucial to enable markets to function more efficiently in allocating financing resources. A key priority is to facilitate widespread availability of high-quality information on borrowers, so that lending institutions can conduct Know Your Customer (KYC) procedures and assess credit risks efficiently and with low cost. This requires expanding coverage of Public Credit Registries (PCR) and Private Credit Bureaus (PCB) and promoting open

and non-discriminatory access to PCR/PCB data. Despite some progress, the share of the population covered by PCBs and PCRs in the GCC is considerably lower than the average of AEs (Figure 23). For some countries PCRs/ PCBs provide data only for banks (World Bank, 2016) although financing companies contribute to a significant part of SMEs lending in GCC and face substantially higher NPLs than banks. Granting equal access to credit data for non-bank financial institutions will positively affect competition and potentially lower financing cost for creditworthy SMEs. Countries that have implemented VAT, including Saudi Arabia, Bahrain, and UAE, all experienced a surge of credit information coverage, and this is expected to be the case in other countries that adopt the VAT.

Table 2. Key Aspects of Countries' Credit Guarantee Schemes

	Best Practice [1]	Saudi Arabia	UAE	Qatar	Oman [2]	Bahrain	Kuwait [3]
Eligibility Criteria	The eligibility criteria should be defined to enhance additionality, reaching financially neglected SMEs. It is important that these criteria do not encourage banks to use the guarantee for large firms and loans.	Enterprises whose total sales under SAR 30 million per annum.	Enterprises whose annual turnover under AED 30 million.	Enterprises whose annual turnover under QAR 30 million.	Eligible for projects, capital investment of which not exceed RO 500 thousand and loan amount not exceed RO 250 thousand.		Enterprises that employs 1 to 50 Kuwaiti workers, with financing requirements not exceed KD 500 thousand.
Coverage ratio	Coverage rates should be high enough to encourage lender participation and yet low enough to limit moral hazard.	Pre-Covide: Up to 80% of the principle Post Covide: Up to 95% of the principle	Up to 85% of the principle, up to 5 million AED	Up to 85% of the principle, not exceeding 15 million QR	Up to 50% of the principle	Up to 50% of the principle.	Up to 80% of the principle
		Pre-Covid: 5~8% plus Sibor Post-Covid: Up to 4%		7%		Up to 4%	2%
Financial Reporting	Set rigorous financial reporting requirements and externally audit financial statements.	Financial report is published externally quarterly	Financial report is published externally annually		Financial report is published externally annually		

1/ Based on World Bank 16 Principles for Public Credit Guarantee Schemes (CGSs) for SMEs and Discussion Paper on Credit Guarantee Schemes.

2/ The information for Oman is as of 2016. The Credit Guarantee Scheme program launched by the Ministry of Commerce and Oman Development bank in 2012 has since been discontinued. Oman has an Export Credit guarantee scheme by the National Export Credit Agency, while Oman Development Bank and Alraffd Fund offer subsidized credit to SMEs and other sectors.

3/ To our best knowledge, there is no credit guarantee scheme in Kuwait. Instead, there is a shared funding scheme of 80/20 percent between Kuwait National Fund for SME Development (NFSD) and banks

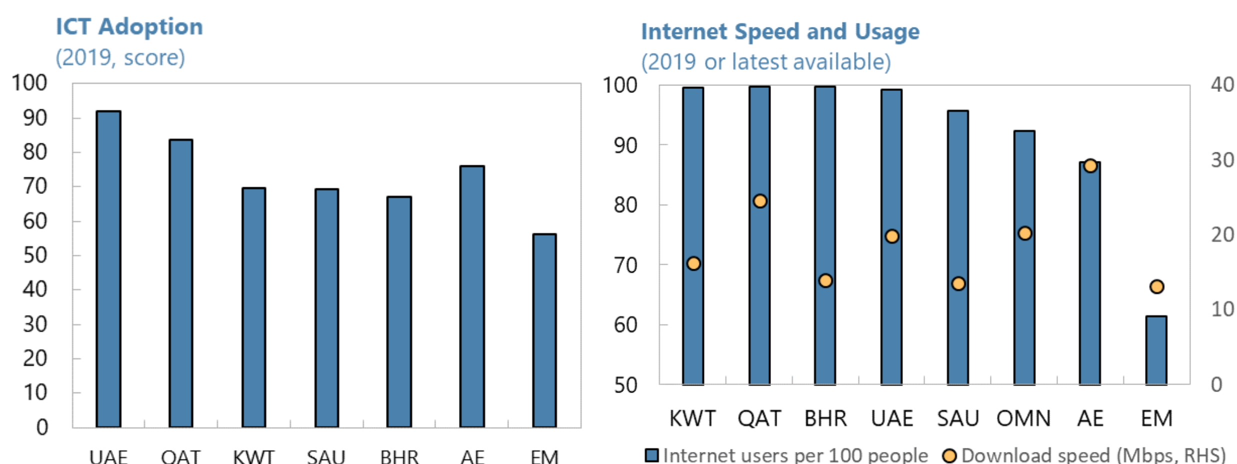
- Embracing digital technology would help close the credit information gap. Adoption of open banking, a service that offers licensed third parties' access to customers' financial data with the consent of the customer, is a promising area. This will equip lenders with reliable real-time visibility into a customer's liquidity and solvency condition based on transactional data which used to be a unique asset of the customer's primary bank. It would enhance SMEs' ability to switch banks to access more suitable financing options while also lowering financial institutions' cost of establishing new customer relationships overall. The Central Bank of Bahrain mandated the adoption of open banking by all banks by 30th June 2019. Emirate NBD took the lead in

open banking in UAE by launching an application programming interface (API) Sandbox, which is a platform open to certified Fintech with a goal to co-create and build new business models that offer innovative financing solutions for customers. UAE is also working on developing a common regulatory framework covering areas like stored value facilities and payment systems. In Saudi Arabia, digital finance is being promoted by Fintech Saudi, SAMA, and the Capital Markets Authority. More broadly, steps to promote the digital economy could yield significant growth dividends (Box 2).

Box 2. Digitalization in GCC

Technology is changing the economic and financial landscape in profound ways. During the COVID-19 pandemic, technology has created new opportunities for the digital economy. An example of an emerging cluster of growth opportunities relates to the accelerated shift to e-commerce, increasing digitalization of the economy, and possible innovation of new data-enabled services (e.g., telehealth, online education, and working remotely).

Average ICT adoption in the GCC is close to that of AEs. Still some countries had to adjust to the economic fallout and mobility restrictions by lifting bans on some popular teleconferencing applications. Given the strong digital infrastructure (e.g., the rollout of 5G and the expansion of fiber networks), enhanced digital de-regulation could promote internet-based businesses in the region. A continued increase in E-government is evident in the region with the UAE ranking 21 in the 2020 UN E-government survey, while most of the remaining are among the top-50.



Source: WEF Global Competitiveness Report 2019; World Bank; Opensignal, The State of Mobile Network Experience, and IMF staff calculations. Note: AE = Advanced Economies, EM = Emerging Market Economies; ICT = Information and Communication Technology.

D. Concluding Remarks

41. The COVID-19 pandemic is an unprecedented global shock. In the GCC, the adverse effects on growth and fiscal and external balances will take years to overcome and bring to the fore the need for continued reforms to ensure future prosperity. In the short run, the priority remains to respond to the impact of the virus. This requires increased healthcare and social safety net spending, tax relief for employers, and supportive financial conditions to help companies and households overcome the shock, although this needs to become increasingly targeted to those most in need.

However, with fiscal strains intensifying, there is a need to focus on fiscal and structural reforms over the medium and long term to strengthen macro stability and growth.

42. Notwithstanding substantial fiscal buffers in most countries, consolidation is needed over the medium to long run to ensure continued fiscal sustainability while supporting a more inclusive and greener recovery. The speed of adjustment should balance fiscal needs against the adverse impact of consolidation on economic activity and depends on country circumstances. Adjustment is particularly urgent for Bahrain and Oman, where debt is elevated, and financing pressures are rising. In all countries, fiscal adjustment will require reforms to both expenditure and revenue policy. Spending needs to be reoriented away from public employment, and energy subsidies in favor of social spending—including education, health care, and the social safety net. Spending efficiency also needs to be improved and more focus to be given to climate-friendly infrastructure. Taxation of the non-oil sector is still relatively light, and there is scope to increase taxes. In countries that have not yet introduced the VAT, they should move ahead to do so. Property taxation can also raise revenues with minimal distortions. Replacement of a multiplicity of business fees with corporate income taxes would also strengthen the ease of doing business.

43. Structural reforms are needed to increase private sector-led inclusive growth, which is critical for diversifying away from oil. These should focus on boosting female participation rates, strengthening education and training to equip nationals with skills in demand in the private sector, removing restrictions imposed through sponsorship systems on expatriate workers (recently done by Qatar), continuing with reforms already underway to develop local financial markets, strengthening governance frameworks, and supporting young and dynamic SMEs.

Table 3. GCC: Selected Economic Indicators

	Average				Projections	
	2005-16	2017	2018	2019	2020	2021
Real GDP Growth	**4.5**	**-0.2**	**1.9**	**0.7**	**-6.0**	**2.3**
Percent						
Bahrain	4.7	4.3	1.8	1.8	-4.9	2.3
Kuwait	3.2	-4.7	1.2	0.4	-8.1	0.6
Oman	4.7	0.3	0.9	-0.8	-10.0	-0.5
Qatar	11.4	-1.5	1.2	0.8	-4.5	2.5
Saudi Arabia	3.9	-0.7	2.4	0.3	-5.4	3.1
United Arab Emirates	3.9	2.4	1.2	1.7	-6.6	1.3
Real Nonoil GDP Growth	**6.4**	**2.1**	**1.7**	**2.4**	**-5.7**	**2.9**
Percent						
Bahrain	6.3	5.5	2.5	1.7	-6.0	2.5
Kuwait	4.1	1.8	2.7	2.8	-7.0	3.0
Oman	7.5	2.4	-1.6	-2.8	-8.0	2.0
Qatar	13.7	-1.0	2.2	2.4	-5.7	3.0
Saudi Arabia	6.4	1.3	2.2	3.3	-5.0	3.0
United Arab Emirates	4.8	4.8	0.7	1.0	-6.7	3.0
Consumer Price Inflation	**3.8**	**0.2**	**2.2**	**-1.5**	**1.5**	**2.9**
Percent						
Bahrain	2.4	1.4	2.1	1.0	0.0	2.8
Kuwait	4.1	1.5	0.6	1.1	1.0	2.3
Oman	3.4	1.6	0.9	0.1	1.0	3.4
Qatar	4.8	0.5	0.2	-0.6	-2.2	1.8
Saudi Arabia	3.6	-0.8	2.5	-2.1	3.6	3.7
United Arab Emirates	4.3	2.0	3.1	-1.9	-1.5	1.5
General Government Fiscal Balance	**8.7**	**-5.6**	**-1.5**	**-2.0**	**-9.2**	**-5.7**
Percent of GDP						
Bahrain	-4.6	-14.2	-11.9	-10.6	-13.1	-9.2
Kuwait	26.2	6.3	9.0	5.4	-8.5	-10.7
Oman	3.4	-14.0	-7.9	-7.1	-18.3	-16.8
Qatar	11.4	-2.5	5.9	4.9	3.0	3.3
Saudi Arabia	6.0	-9.2	-5.9	-4.5	-10.6	-6.0
United Arab Emirates	7.0	-2.0	1.9	-0.8	-9.9	-5.1
Current Account Balance	**14.3**	**2.8**	**8.6**	**5.8**	**-1.8**	**0.4**
Percent of GDP						
Bahrain	5.9	-4.1	-6.5	-2.1	-8.0	-5.7
Kuwait	31.6	8.0	14.5	9.4	-6.8	-2.8
Oman	4.5	-15.6	-5.4	-4.6	-14.6	-12.9
Qatar	18.4	4.0	9.1	2.4	-0.6	2.6
Saudi Arabia	15.1	1.5	9.2	5.9	-2.5	-1.6
United Arab Emirates	10.5	7.1	9.6	8.4	3.6	7.5

Sources: National authorities, and IMF staff calculations and projections.

Note: Aggregate for GCC reflects weighted-average numbers.

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Appendix I. Summary of Policy Responses to COVID-19 in the GCC

(Percent of GDP, excluding reallocation)

Measure [1]	Bahrain	Kuwait	Oman	Saudi Arabia	Qatar	U.A.E.
Overall Fiscal Stimulus[2]	5.6% GDP ($2 bn) (BD737 million)	1.5% GDP ($1.6 bn) (KD500 million)	- 5% GDP (-$3.1 bn) (-OR1.2 billion)	3.8 percent of GDP ($26.1 bn) (SAR 98 billion)	0.2% of GDP	2% of GDP ($7.2 bn) (AED26.5 bn)
Revenue Measures (reduction in-)	0.3% GDP ($93 million) (BD35 million)	Exemptions on various government fees.	Various taxes and fees were temporarily suspended. Tax deadlines, fines, and penalties were also relaxed..[3]	Many taxes and fees were deferred for the period from March to end-September. 2% GDP ($13.3 bn) (SAR50 bn) VAT rate and customs tariff increases in 2020H2	0.2% of GDP (QR 1.2 billion)	N/A
Expenditure Measures	5.3% GDP ($1.8 bn) (BD702 million)	1.5% GDP ($1.6 bn) (KD 500 million)	- 5% GDP (- $3.1 bn) (- OR 1.2 billion)	(SAR 48 billion) 1.92.1% GDP & ($12.8 bn) (-SAR48 bn) Outside of budget, employment support also provided through unemployment benefit fund.	Nil	N/A
Cumulative Rate Cuts	125 bps	125 bps	170 bps	125 bps.	175 bps	125 bps
Other Monetary and Financial Measures[4]	Up to 27.9% GDP ($9.8 bn) (BD3.7 bn)	Easing of liquidity coverage, curtailing the regulatory liquidity ratio, releasing the capital conservation buffer, easing some LTV limits, and delaying payments up to six months.	Reduction of capital buffers and increase in maximum lending ratio, unlocking RO 8 billion worth of liquidity. Cutting the policy rate and other interest rates. Reduction of the required margin for Loan-to-Value ratio for housing loans.	1. Loan payment deferrals, lending facilities and loan guarantees mainly for SMEs and support to points of sales and electronic payment 3.4% GDP ($23.2 bn) (SAR87.2 bn) 2. Liquidity injection in banks 2.% GDP ($13.3 bn) (SAR50 bn)	QCB to provide liquidity support to banks.	7.6% GDP ($27 bn) (AED100 bn) consisting of zero-interest rate collateralized loans to banks (AED 50 billion) and allowing the use of banks' excess capital buffers (AED 50 billion); also, halving of banks' required reserve requirements from 14% to 7% and relaxation of the Net Stable Funding Ratio and the Advances to Stable Resources Ratio effective through end-2021.

[1] The information included in the table is not meant to be exhaustive on all measures taken by countries.

[2] The overall budget impact for some countries is not yet clear as some measures may come from reallocations and not extra spending.

[3] Estimates of the cost of these measures not available.

[4] Pledged stimulus, which may or not be used in full.

Appendix II. Long Run Fiscal Sustainability in the GCC

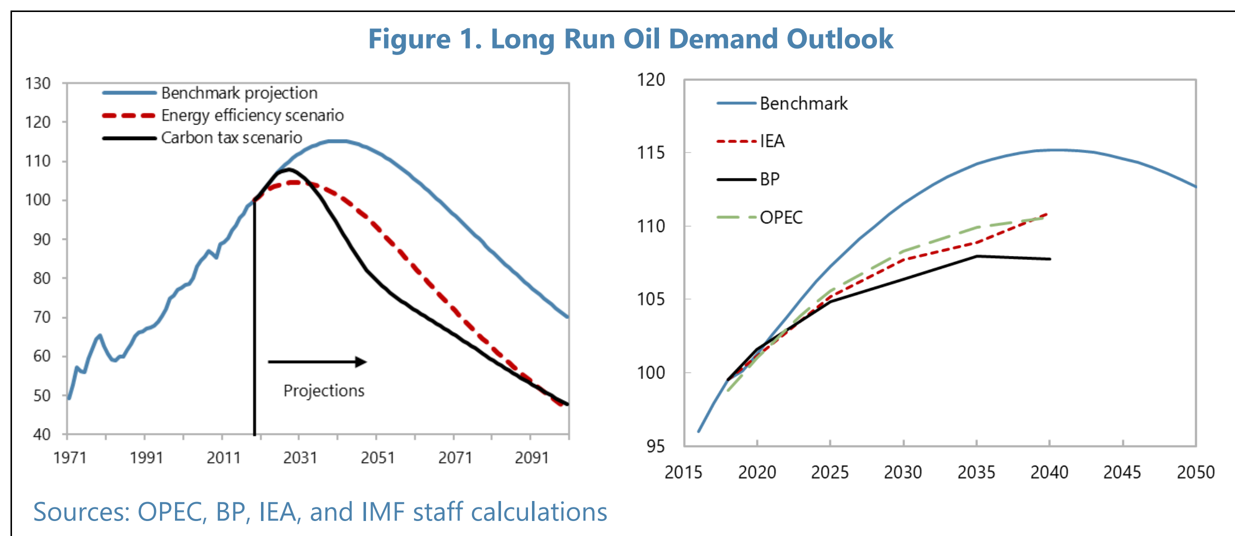
1. The concept of fiscal sustainability is the most comprehensive basis for measuring the fiscal health of a country. It poses the following question: if the authorities decide to take no further fiscal measures from now onward, can they maintain that posture over the long run? If they can do so, then the fiscal position is considered sustainable (and the sustainability gap is then zero). If this is not the case, however, then protracted inaction will lead to a situation where the debt-to-GDP ratio rises continuously without bound, implying that interest payments take an ever-increasing share of government expenditure, crowding out noninterest spending and increasing the difficulties associated with financing the debt until the government is forced to take major action to restore sustainability.

2. For GCC countries, as with many resource rich economies, assessments of fiscal sustainability often rely on application of the permanent income hypothesis (PIH). Here, the sustainable non-oil fiscal position is constrained to be no larger than the annuity value of the wealth of a country—which is the flow of income from oil wealth and financial assets that can be consumed each year while keeping the stock of wealth unchanged. Since wealth is maintained forever and budgets are fully financed under the PIH, it is evident that this fiscal position can be maintained forever and is therefore sustainable. Since the ratio of a constant stock of wealth to GDP will tend towards zero over time as GDP grows (thus offering less of a buffer to future generations), there are other variants of the PIH that take this into account, where, for example, the fiscal target is set to keep wealth constant as a share of GDP or in per-capita terms. The PIH target is often treated as a long-term anchor, since most countries would find it difficult to immediately move in one large step to the sustainable position and maintain it forever. The framework itself does not offer much guidance on alternative near and medium-term adjustment paths and their implications for ultimately achieving long run fiscal sustainability. IMF (2012) provides a detailed description of the PIH and other variants, such as the modified PIH where investment in physical capital is incorporated. In principle there are an infinite number of paths that are consistent with fiscal sustainability, of which PIH is only one of the many. It is also noteworthy that Mirzoev and Zhu (2019) find that in the presence of uncertainty the PIH may not be consistent with either fiscal sustainability or intergenerational equity.

3. An alternative methodology for assessing fiscal sustainability is based on directly evaluating the long run budget constraint of a country. Details of this approach can be found in Kanda and Mansilla (2014) and Kanda (2011). Here, a fiscal position is considered sustainable if the present value of all future non-oil structural primary balances equals the initial net debt position of the country, i.e. if the long run intertemporal budget constraint is satisfied. The fiscal sustainability gap is then calculated as the change in the non-oil structural primary balance that (if maintained forever) would ensure that the condition for sustainability is met. In general, the fiscal sustainability gap depends on several factors including the country's fiscal stance, its initial net debt position, the outlook for its future oil revenues, and parameter values such as the assumed nominal discount rate, the long-term non-oil GDP growth rate, and inflation. Long run projections are subject to a

significant margin of error. The calculations in the following paragraphs assume the following: (i) global demand for oil slows in the coming years and peaks around 2040 (given the effects of COVID-19, this may now be too optimistic; (ii) real oil prices average $51 a barrel and higher cost producers exit the market to ensure demand and supply balance; (iii) absent fiscal adjustment, government primary spending increases in line with non-oil growth (i.e. the ratio of spending to non-oil GDP remains unchanged).

Figure 1. Long Run Oil Demand Outlook



Sources: OPEC, BP, IEA, and IMF staff calculations

4. Fiscal positions in all GCC countries are assessed to have substantial sustainability gaps in the long run, despite large asset buffers in most cases, unless further fiscal adjustment is implemented (relative to 2020). Table 1 presents the key indicators. The fiscal sustainability gap based on the long run budget constraint is estimated at 32.7 percent of nonoil GDP on average across GCC countries, but with significant variability across countries, ranging from about 16 percent in Bahrain to a high of 65 percent in Kuwait—where a large nonoil structural deficit and high current reliance on oil revenues implies that without consolidation large overall fiscal deficits will emerge as oil revenues trend downward in coming decades. Estimates using the PIH are similar.

5. These baseline results primarily reflect large non-oil structural primary deficits and assumed long run trends in oil markets. These in turn will generate large fiscal financing needs and fuel rapid debt accumulation. While some of the widening of fiscal deficits this year is temporary and will improve as the impact of COVID-19 fades, the underlying structural primary non-oil deficits in the GCC remain very high according to staff estimates. Moreover the long run outlook for the oil market suggests that in the coming decades oil revenues will trend downward as a share of GDP in the GCC countries (Figure 1, IMF 2020c), reflecting a transition to a less fuel-intensive global economy, which will require consolidation—and a buildup of assets using fiscal surpluses—to maintain fiscal sustainability. Fiscal adjustment strategies anchored by each country's long-term fiscal sustainability gap are critical for GCC countries to respond appropriately to the changing outlook.

Table 1. Projected Fiscal Indicators in 2020 1/

(percent of non-oil GDP)

Country	Oil revenue	Non-oil primary balance	Gross debt	Gross assets	Fiscal gap (Long run budget constraint)	Fiscal gap (PIH, constant wealth as percent of non-oil GDP)
Bahrain	12.6	-19.6	143.4	54.2	16.3	18.8
Kuwait	55.4	-92.2	30.2	858.9	65.2	69.3
Oman	32.3	-57.5	121.4	81.5	48.9	50.9
Qatar	36.7	-34.2	97.8	317.7	21.2	24.6
Saudi Arabia	17.1	-32.8	42.9	89.2	22.4	21.1
UAE	15.7	-27.1	45.4	296.7	21.2	24.7

1/ Fiscal gaps are estimated based on forecasts of long-term oil demand that is consistent with IMF 2020c, a nominal interest rate of 6 percent, an inflation rate of 2 percent and a non-oil real GDP growth of 3 percent in the long term.

Sources: Country authorities and IMF staff estimates. Gross assets are IMF staff estimates.

Table 2. Fiscal Gaps Under Alternative Scenarios 1/

(percent of non-oil GDP)

Country	Baseline	Higher oil demand	Lower oil demand	Lower interest rate	Higher interest rate
Bahrain	16.3	13.1	17.0	17.1	15.6
Kuwait	65.2	42.9	70.5	74.0	56.5
Oman	48.9	41.1	51.0	51.3	46.6
Qatar	21.2	5.0	24.7	25.4	17.1
Saudi Arabia	22.4	8.1	25.3	24.8	20.2
UAE	21.2	13.9	23.0	24.2	18.4

1/ High oil demand scenario assumes global oil demand grows 3 percentage points more per year than assumed in the baseline. Low oil demand scenario assumes global oil demand grows 3 percentage points less per year than assumed in the baseline. Lower interest rate scenario assumes the interest rate is 0.5 percentage point lower than assumed in the baseline. Higher interest rate scenario assumes the interest rate is 0.5 percentage point higher than assumed in the baseline.

Sources: IMF staff estimates

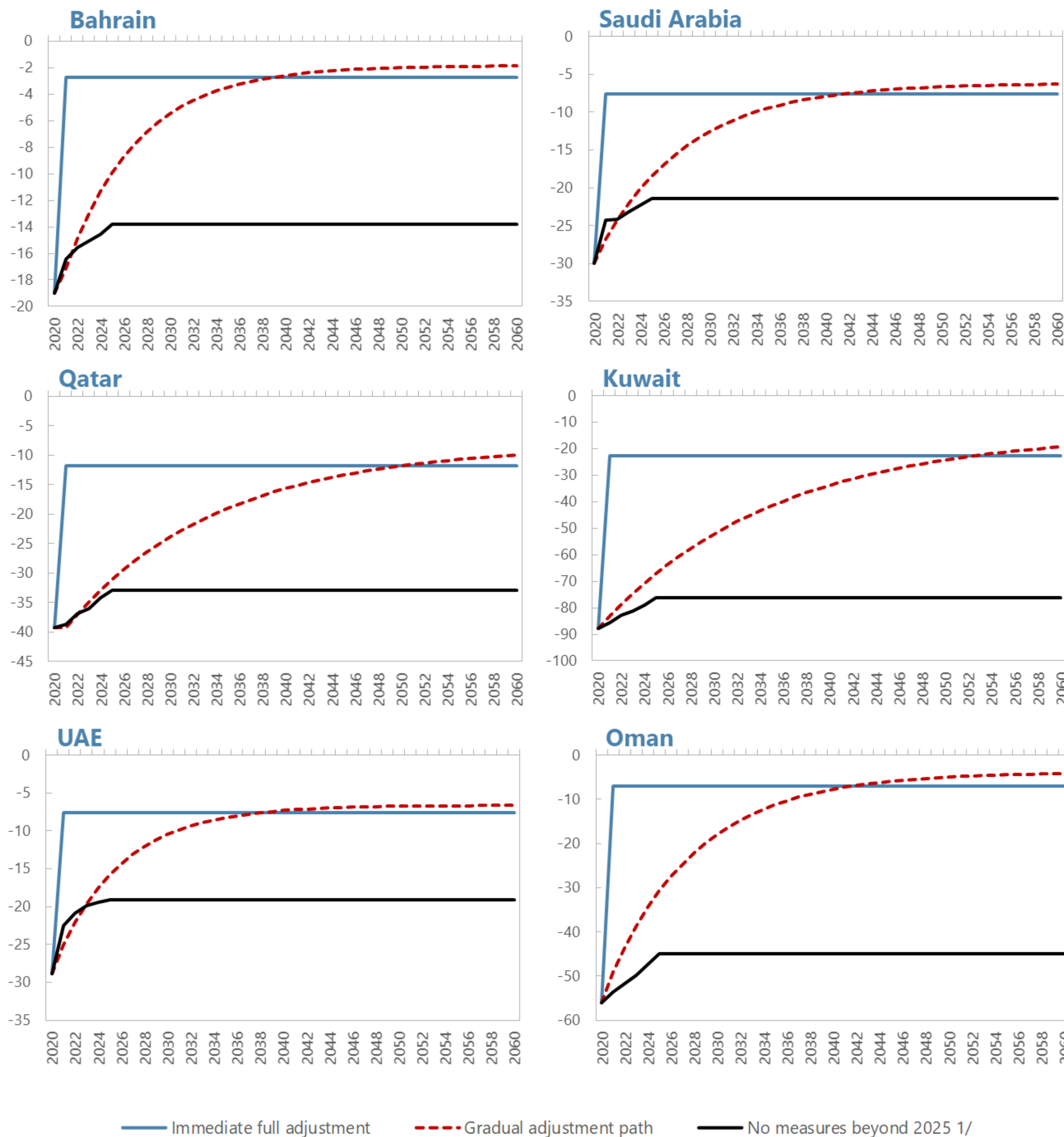
6. It should be noted, however, that long run projections are inherently subject to large margins of uncertainty. In GCC countries there are significant margins of uncertainty regarding total oil deposits in the ground, the volatility of oil prices, investment returns from public assets, and nonoil growth which will affect the assessment of sustainability gaps over time. Table 2 presents the results of a sensitivity exercise which show sustainability gap estimates under different assumptions on oil revenue outlook and the interest rate. In most cases sustainability gaps remain large. Higher oil revenue assumption is associated with a lower fiscal gap, and vice versa. Also, higher interest rate implies a higher return on government assets which lowers the fiscal gap, and vice versa. Given the margins of uncertainty, periodic re-evaluations of long run fiscal sustainability gaps would be needed over time to ensure that near- and medium-term adjustment targets remain appropriately anchored.

7. Achieving long run fiscal sustainability will require balancing competing priorities, taking account of the costs and benefits associated with the chosen pace of adjustment. Figures 2 and 3 present illustrative adjustment scenarios in this regard. The "immediate full adjustment" scenario requires that the fiscal gap be closed immediately to reach the fiscal target that is consistent with the long run budget constraint so that sustainability can be maintained permanently. This path is clearly untenable as it would generate a very large and destabilizing economic contraction in the short run. However, delaying adjustment has costs—either additional debt financing will be needed for a longer period, with associated interest costs, or assets would be fun down faster, limiting investment income—that imply that countries will need more adjustment cumulatively than the estimated fiscal sustainability gap. Under the "gradual adjustment" scenario, which is more feasible, the pace of adjustments is much slower, but more adjustment is needed cumulatively to achieve fiscal sustainability. Moreover, it will take a long time (2-3 decades) for GCC countries to be fiscally sustainable under the "gradual adjustment" scenario, with attendant vulnerability to shocks to economic activity and market conditions during the transition period. The "no measures beyond 2025" scenario assumes IMF staff's projected baseline fiscal path until 2025 and no adjustment thereafter, which demonstrates the importance of making continued progress until sustainability is achieved.

8. Long run net debt levels are path dependent. They are highly influenced by initial net debt, the chosen fiscal adjustment path, and parameters such as borrowing costs and economic growth. In general, more rapid adjustment is associated with more rapid accumulation of assets over the long run, which in turn leads to lower net debt.

Figure 2. Illustrative Non-Oil Structural Primary Balance Adjustment Paths, 2020–2060

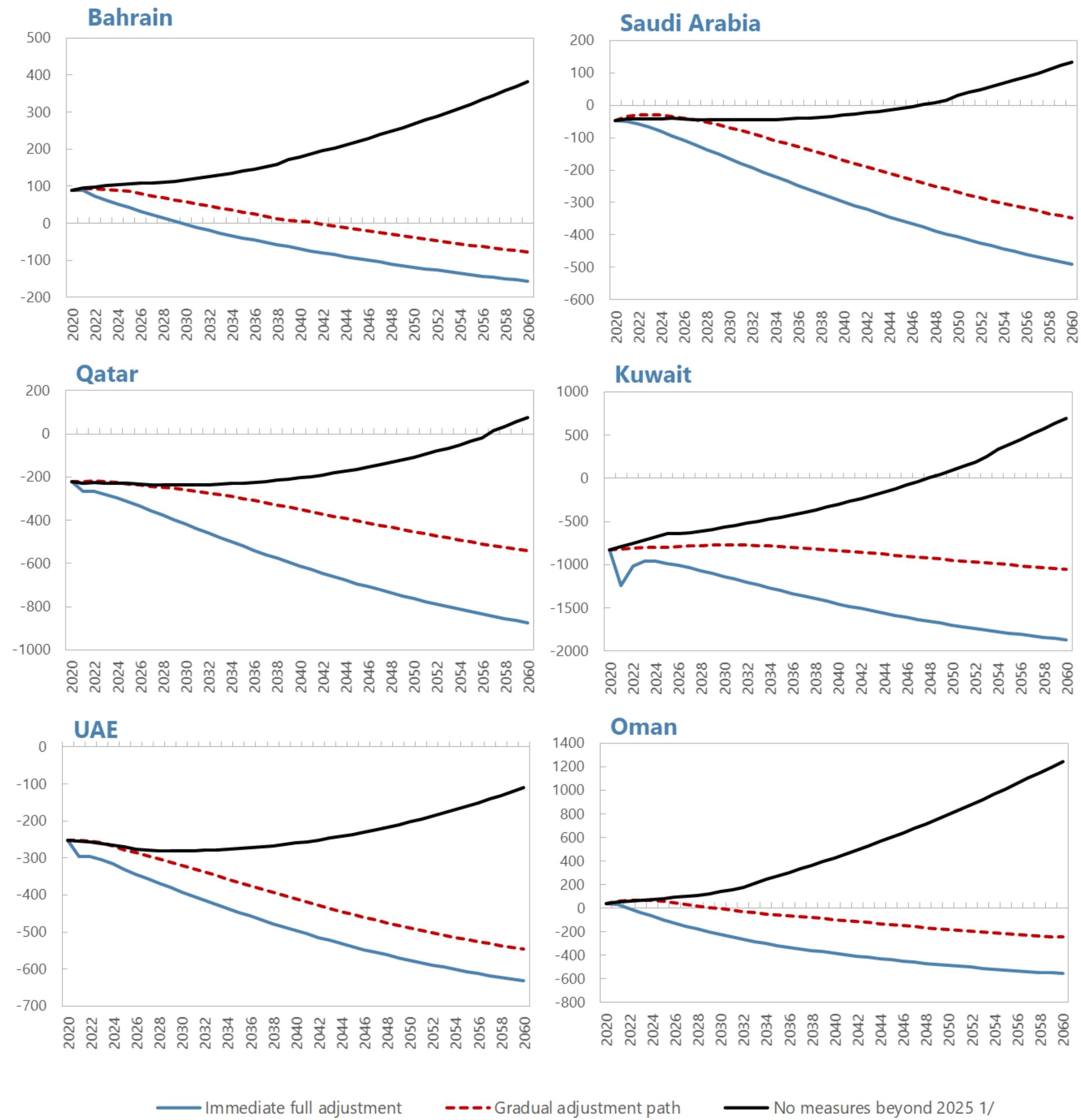
(percent of non-oil GDP)



1/ Latest staff projections are assumed for 2020-2025.
Source: IMF staff estimates.

Figure 3. Illustrative Net Government Debt Paths, 2020–2060

(percent of non-oil GDP)



1/ Latest staff projections are assumed for 2020-2025.

Source: IMF staff estimates.