Gulf Cooperation Council

Economic Prospects and Policy Challenges for the GCC Countries - 2021

Prepared by Staff of the International Monetary Fund

I N T E R N A T I O N A L M O N E T A R Y F U N D

*The views expressed herein are those of the authors and should not be reported as or attributed to the International Monetary Fund, its Executive Board, or the governments of any of its member countries.

CONTENTS

EXECUTIVE SUMMARY[1]

GCC policymakers moved quickly to mitigate the health and economic impacts of twin COVID-19 and oil price shocks. Infection rates have declined across the GCC to well below previous peaks, though countries have experienced successive waves of the virus, and economic recoveries have begun to take hold. Nevertheless, GCC policymakers must navigate a challenging and uncertain landscape. The pandemic continues to cloud the global outlook as countries are in different phases of recovery, with varied growth prospects and policy space.

Protecting public health and supporting the most vulnerable remain the top priority for GCC policymakers. Vaccination rollout for all residents should continue, while contingency health plans should be in place to respond to any recurrent virus outbreaks.

Macroeconomic policies should remain accommodative until recoveries are firmly established. Fiscal support has been critical and should be maintained as needed to avoid long-lasting crisis effects and mitigate social impacts, and increasingly targeted to ensure its efficiency and contain fiscal burdens. Where policy space is more limited, targeted support should be maintained, while identifying fiscal savings from cutting or reallocating non-priority spending. Macro-financial policies to ensure liquidity and spur credit growth should be extended, as needed, while increasingly targeted to viable firms and complemented by close monitoring of financial stability risks.

As the COVID-19 crisis abates and economic recoveries are well-established, policies should address medium- and long-term challenges made more pressing by the pandemic:

Fiscal policy should be geared toward achieving growth friendly consolidation with the aim to ensure long-term fiscal and external sustainability. To this end, priority should be given to strengthening fiscal frameworks, further mobilizing non-oil revenues, and increasing spending efficiency. With higher oil prices, procyclical spending should be avoided, and the windfall used to rebuild policy space.

Ensuring financial stability and a dynamic financial sector is key for a smooth recovery and sustained strong economic growth. Overall, financial sectors appear sound and able to support the recovery and structural transformation, but current stress, legacy risks and emerging vulnerabilities need to be managed, including by strengthening the insolvency and resolution frameworks, reinstating some prudential measures eased during the crisis, and stepping up supervisory efforts

Sustained economic growth and diversification will be as central as ever. Economies are vulnerable to risks of scarring from the COVID-19 crisis and over the longer-term declining oil global demand as the world confronts climate change. Ongoing reforms to drive productivity and diversification should be accelerated, including raising female labor force participation, increasing flexibility for expatriate workers, improving education quality, further leveraging technology, enhancing regulatory frameworks, deepening regional integration, and addressing climate change.

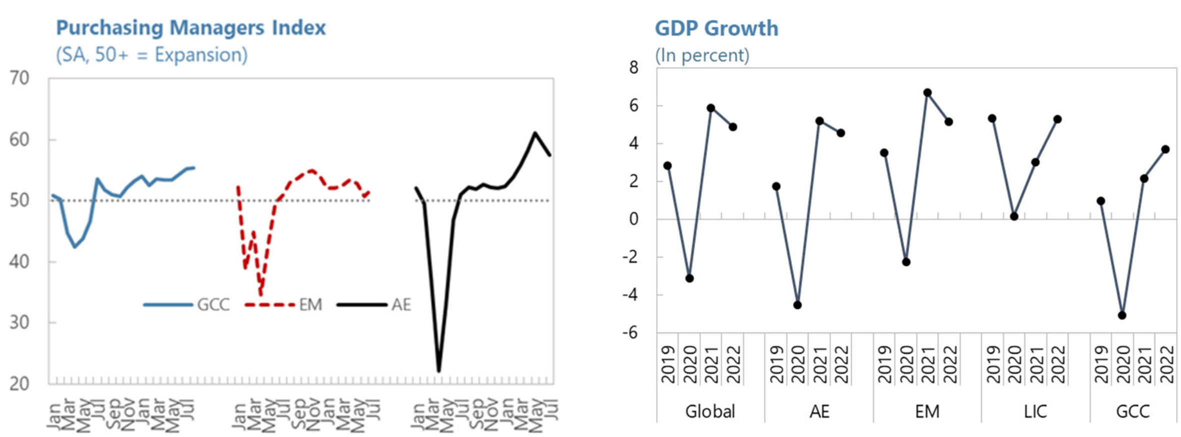
[1] Prepared by Erik Lundback (Lead), Abdullah AlHassan, Imen Benmohamed, Haytem Troug, Yang Yang, and Dalia Aita under the guidance of Ali Al-Eyd. Editorial support was provided by Esther George.

A. Global Developments and Outlook

1. Considerable progress has been made in the global fight against COVID-19, but new variants have emerged and vaccine coverage remains uneven. Although vaccinations have helped mitigate the health and economic effects of COVID-19, access to vaccines in not universal, leaving many people at risk including from the spread of new, more infectious variants. In advanced economies where vaccines are generally available, hesitancy to take them is the main obstacle to increasing vaccination rates. For much of the rest of the world, particularly among low-income countries and fragile states, limited vaccine supply and distribution are the main reasons for substantially lower vaccination rates.

2. The global economic recovery is progressing, though the pace of growth is diverging across countries. Overall, the recovery is projected to bring global output growth to 5.9 percent in 2021 and 4.9 percent in 2022, before moderating to around 3.3 percent over the medium term (Figure 1).[2] Continued large policy support in the United States is projected to boost advanced economies' medium-term output levels beyond expectations from the pre-pandemic period. Emerging market and developing economies, on the other hand, are projected to face lasting output losses due to lower vaccination rates and less policy support.

Figure 1. Impact of Covid-19 on Global PMIs and GDP Growth



Sources: Haver Analytics, and IMF Staff Calculations. GCC PMI reflects simple average of Qatar, Saudi Arabia, and UAE PMIs.

AE= Advanced Economies; EM= Emerging Markets; LIC=Low-income Countries.

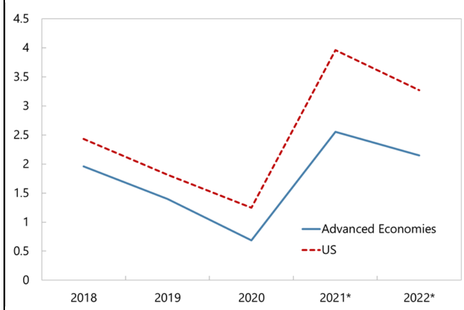
3. Divergent economic outlooks reflect differences in disruptions caused by the pandemic and varied policy support. Substantial fiscal policy space in advanced economies has allowed for large and durable support measures. However, many emerging market economies faced with narrowing policy space and a need to rebuild fiscal buffers, are withdrawing support before recoveries firm. Major advanced economy central banks are assumed to keep policy rates low in the

[2] *World Economic Outlook*, October 2021

near-term (though in some cases asset purchases are to be scaled back), while some major emerging market central banks have shifted to a less accommodative stance.

4. **Higher global inflation is projected to remain transitory.** Inflation has increased rapidly in the United States and in some emerging market and developing economies (Figure 2). This mostly reflects disturbances to supply and demand from the pandemic as well as a rebound in commodity prices from depressed levels in 2020 (Box 1). For the most part, inflation pressures are expected to abate. However, the outlook for inflation remains very uncertain due to the path of the pandemic, the duration of supply disruptions, the speed of labor market recovery, and how inflation expectations may evolve.

Figure 2. CPI Inflation

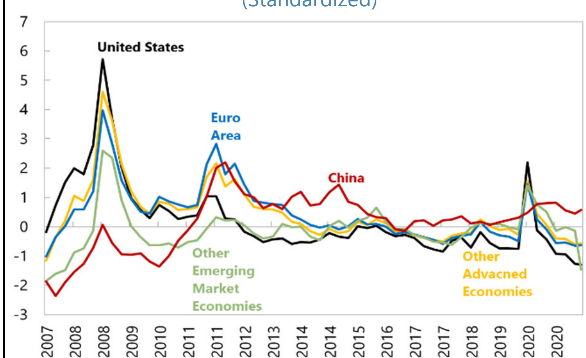


Sources: World Economic Outlook. *Projected

5. **Despite the depth of the global crisis, financial stability risks appear contained and financial conditions are generally supportive** (Figure 3).[3] This relatively benign picture stems from the substantial global monetary and fiscal policy support, which has supported favorable market sentiment. However, there is still great uncertainty about how the pandemic may develop and about the strength of the global economy which have resulted in global long-term yields first declining and then most recently increasing somewhat as markets are sensitive to news, including about inflation in advanced economies with possible implications for the monetary policy stance.

Figure 3. Global Financial Conditions Indices

(Standardized)



Sources: Bloomberg L.P, Haver Analytics; and National Authorities.
Note: The Financial Conditions Indices capture the price of risk based on a range of variables (see Online Annex 1.1 of the October 2018 GFSR). An increase (decline) in the index denotes tighter (looser) financial conditions.
*2021 figure is as of 2021Q3, up until August 2021.

6. **The global outlook is very uncertain and risks are tilted to the downside.** The threat of new variants makes the future path of the pandemic, and the resilience of the recovery, highly uncertain. Financial conditions could tighten, for instance from a reassessment of the monetary policy outlook in advanced economies if inflation expectations increase more rapidly than anticipated. A combined shock of worsening pandemic developments and tighter external financial conditions for some emerging market and developing economies could have adverse economic and financial consequences. Countries dealing with debt sustainability concerns would be especially vulnerable and, globally, public debt levels are historically high, while large purchases of

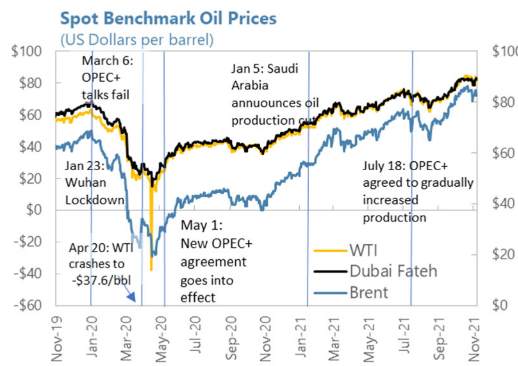
[3] *Global Financial Stability Report*, October 2021

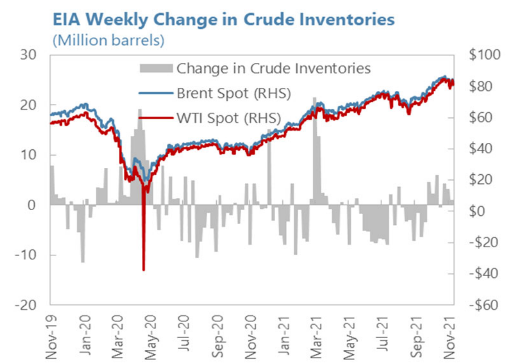
government debt by central banks, especially in advanced countries and by commercial banks, have kept financing costs down.[4]

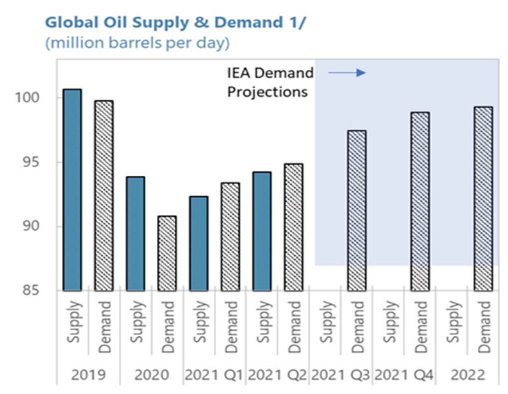
Box 1. Oil Market Developments

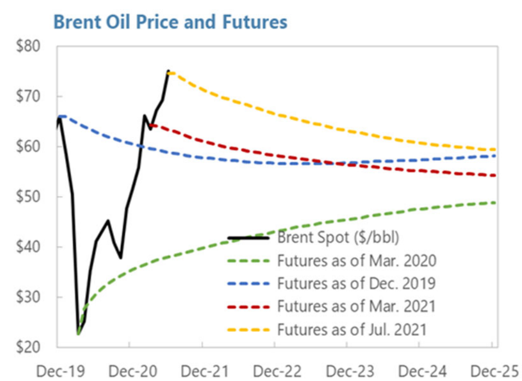
Increasing availability of vaccinations and an easing of containment measures since the beginning of 2021, particularly in advanced economies, have supported global oil demand in 2021Q2. Following the unprecedented decline in global oil demand in 2020Q2, in which demand fell from 100 million barrels per day in 2019Q4 to 83 million barrels per day in 2020Q2, according to IEA, global oil demand has increased to 94 million barrels per day in 2021Q2. However, oil demand has not recovered to its pre-pandemic 2019 levels. According to OPEC and IEA projections, Global oil demand is only expected to reach pre-pandemic levels by end of 2022.

Oil markets have continued to stabilize, and prices have so far remained relatively stable throughout 2021 with an upward trend as the global recovery continues. The Brent oil price has surpassed its pre-pandemic level by around 14 percent. This comes as OPEC+ recently decided to boost oil production and ease production curbs that were put in place in 2020. Despite the recovery of global oil demand, it remains susceptible to further potential global shocks, aggravated by slow vaccination rollouts in developing economies and further possible travel restrictions from the spread of the Delta virus.









Sources: Bloomberg L.P., EIA, OCED/IEA, and IMF Staff Calculations.
1/ includes crude oil, non-conventional oils, condensates and NGLs.

[4] *Fiscal Monitor*, October 2021

B. The Economic and Financial Outlook in the GCC Countries

7. GCC policymakers moved quickly to mitigate the impacts of twin COVID-19 and oil price shocks. Swift and well-coordinated policy responses helped limit the initial spread of the virus, deliver rapid and widespread access to vaccines, and target income and liquidity support to those most in need. Despite experiencing successive waves of the virus, infection rates across the GCC have declined to well below previous peaks and the number of fatalities has remained comparatively low (Box 2). Combined announced fiscal measures (averaging 2.3 percent of GDP) and a range of macro-financial support measures provided relief to hard hit sectors, businesses, and financial systems (Appendix I).[5] While there are variations in the size, fiscal measures across GCC countries have proven to be significant in easing the burden on households and firms.

8. Nevertheless, GCC economies experienced deep but temporary recessions in 2020. Growth in GCC economies is estimated to have contracted by 4.8 percent in 2020, reflecting declines of 5.9 percent in oil GDP and 3.9 percent in non-oil GDP. As in other countries, necessary containment measures and travel restrictions severely dampened non-oil economic activity in key job-rich sectors (tourism, hospitality, real estate, retail trade). At the same time, declines in global oil demand and oil prices tipped GCC fiscal and external balances into deficits of 8.8 percent of GDP and 0.4 percent of GDP and reinforced headwinds to growth. Weak activity and uncertainty over banks' asset quality underscores financial system vulnerabilities.

Economic Activity and Outlook

9. A gradual economic recovery is underway. Vaccine-driven normalization and supportive policies have contributed to a partial rebound in non-oil sectors alongside an easing of containment measures (Box 1). Non-oil GDP in the GCC is expected to grow by 3.8 percent in 2021. Real oil GDP growth is recovering on the heels of higher global oil demand and agreement at the July OPEC+ meeting to gradually increase monthly oil production starting in August this year (Figure 4). As a result, real oil GDP for the region is expected to grow by 0.3 percent in 2021 before increasing to 5.3 percent in 2022. Overall real GDP growth for the GCC is projected at 2.5 percent in 2021.

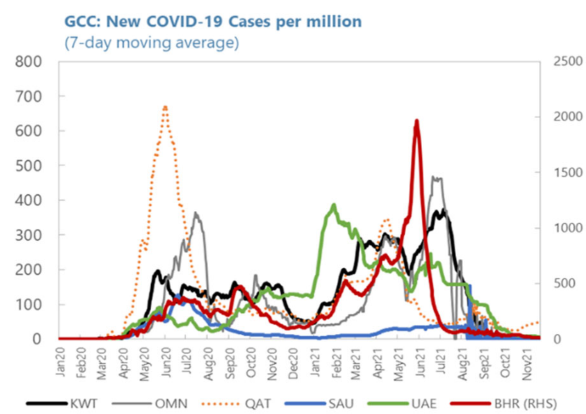
10. The extent and pace of the recovery vary across GCC countries. Saudi Arabia rebounded strongly after COVID-19 restrictions were eased, with high-frequency indicators pointing to a resilient non-oil recovery. Other GCC countries experienced second waves of virus outbreaks, which either delayed reopening schedules or resulted in renewed containment measures. Countries (Bahrain, Qatar, UAE) that have a larger share of contact-intensive sectors in non-oil GDP are experiencing slower non-oil recoveries this year (Figure 5). In particular, hard-hit sectors such as wholesale and retail trade, restaurants, hotels, finance and real estate account for around 34-36 percent of non-oil GDP in Bahrain, Qatar, and UAE, compared to 26 percent in Saudi Arabia. Non-oil

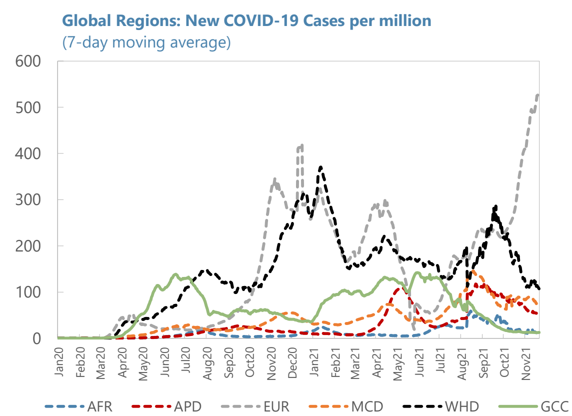
[5] See GCC Economic Prospects and Policy Challenges prepared for the GCC Annual Meeting of Ministers of Finance and Central Bank Governors, October 25, 2020.

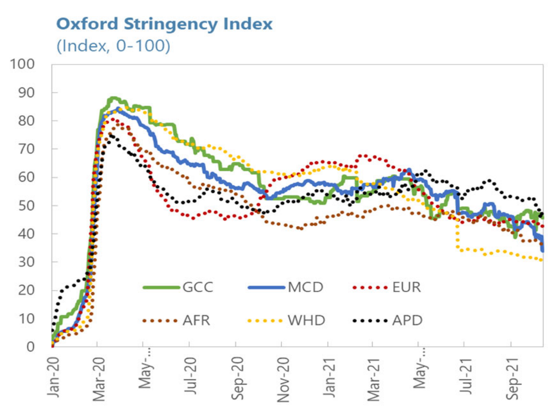
GDP is projected to grow by 4.7 percent in Saudi Arabia in 2021 and by around 3 percent in Bahrain, Kuwait and UAE. Non-oil growth is projected to be 1½ percent in Oman and 2 percent in Qatar.

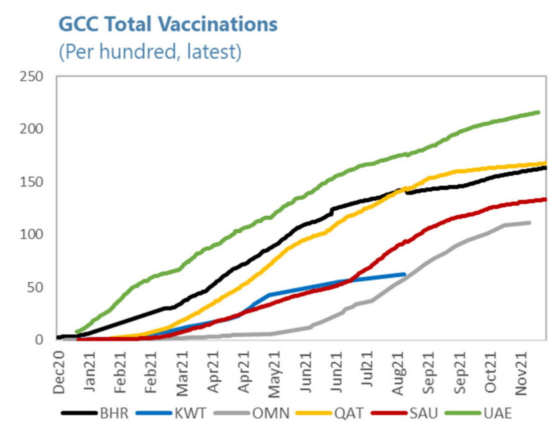
Box 2. COVID-19 in the GCC

The number of COVID-19 cases in the GCC is currently relatively low compared to other regions, despite recent waves of infections. The COVID-19 pandemic was quickly contained in the GCC through swift policy measures that helped sharply reduce the number of cases by mid-2020. However, as containment measures began to ease across the GCC, most countries (Bahrain, Kuwait, Oman, and UAE) experienced new waves of infections in 2021, with cases surpassing those in 2020, forcing renewed restrictions. These efforts have complemented strong ongoing vaccination efforts to reduce new infections rates to well below previous peaks across the GCC, while fatality rates have remained comparatively low and domestic restrictions have been eased again.



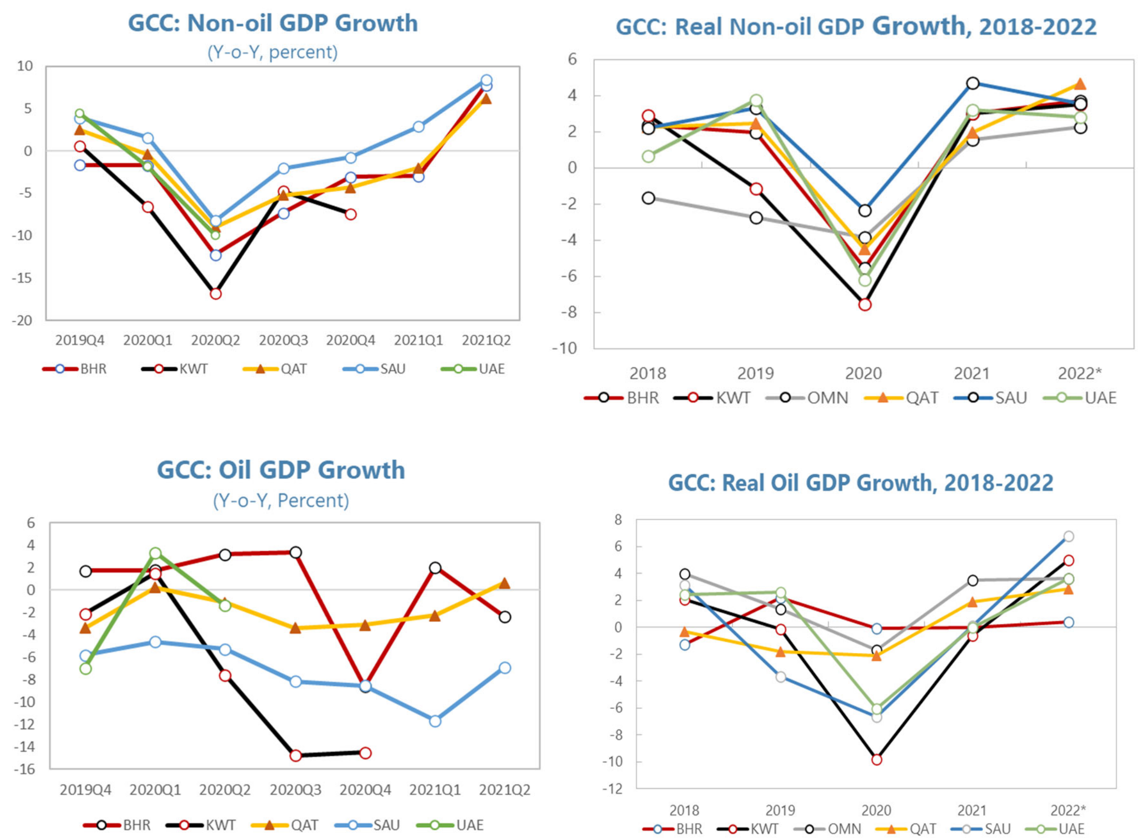






Sources: Our World in Data, John Hopkins University; and IMF Staff Calculations.

Figure 4. Real Oil and Non-Oil Growth and Oil Production[1/]



1/ Natural gas production for Qatar.
Source: Country authorities; and IMF staff estimates.

11. There will be long-lasting effects from the COVID-19 crisis on potential GDP and medium-term growth prospects. Previous pandemics in the modern era have been followed by output losses of magnitudes larger than those following typical recessions but smaller than those following financial crises (see World Economic Outlook April 2021, Chapter 2). Persistent output losses could occur through several channels, including sustained low oil demand, a protracted recovery in contact-intensive sectors, persistent labor market weakness, stretched corporate balance sheets, and a loss of human capital. In line with projections for many other emerging economies, growth in GCC countries is expected to remain some 4 percent below pre-pandemic trends throughout the forecast horizon, though with significant variation across countries and the expected rebound in growth is faster in some countries than in others (Appendix II, Table 1, Figure 5). In turn, output gaps are expected to close only gradually over the medium term.

Figure 5. Contribution to GDP[1/]

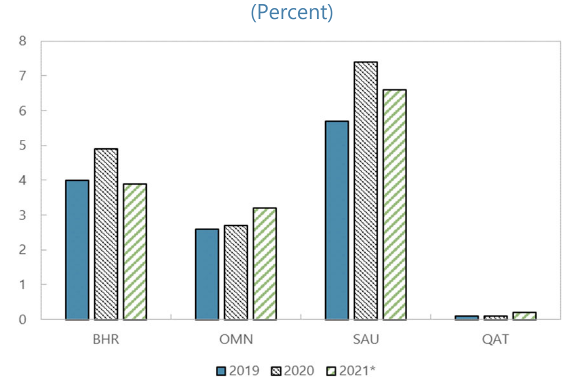
(Year-on-year, percent)

Sources: Haver Analytics, National Authorities; and IMF Staff Calculations.

1/ Low-contact sectors exclude crude oil, natural gas and mining & quarrying sectors.

Figure 6. Unemployment Rate

(Percent)



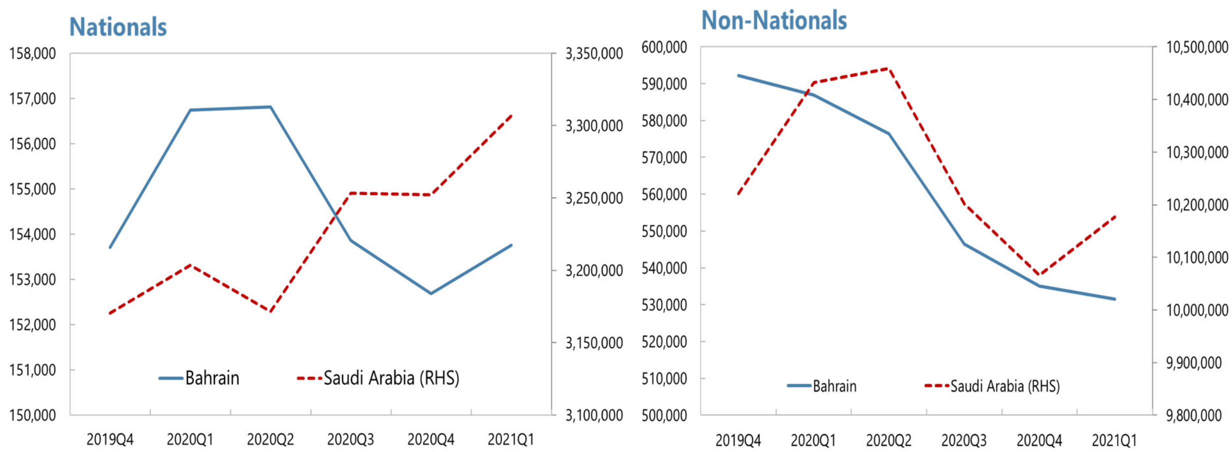
Sources: National Authorities, and CEIC Database.

*Based on latest observation.

12. Despite recent increases in unemployment rates, GCC labor markets have weathered the pandemic relatively well, but structural challenges remain (Figure 6). The large number of nationals working in the public sector and recent departure of expatriate workers helped labor markets to adjust to the pandemic. Where more recent data is available, employment of non-nationals has fallen during the pandemic, but may be rebounding somewhat where recoveries have been stronger, while employment of nationals has held up better or even increased (Figure 7). Nevertheless, GCC labor markets still suffer from long-standing structural issues. For instance, labor markets in the region continue to be fragmented, with large public sectors used as an employment vehicle for nationals, and a private sector dominated by expatriate workers. However, recent increases in participation rates among nationals, especially women, and large young populations underscore the need for continued efforts to modernize labor markets. Moreover, despite recent improvements, female labor market participation remains less than half of male participation (Appendix III). Labor reforms across the GCC are therefore welcome. For instance, Saudi Arabia, Bahrain and the UAE have passed legislations that prohibit gender-based discrimination in employment. Qatar has also announced measures including the introduction of a minimum wage and the abolishment of the sponsorship system for foreign workers, offering more flexibility and protection for expats.

Figure 7. Employment

(Persons)

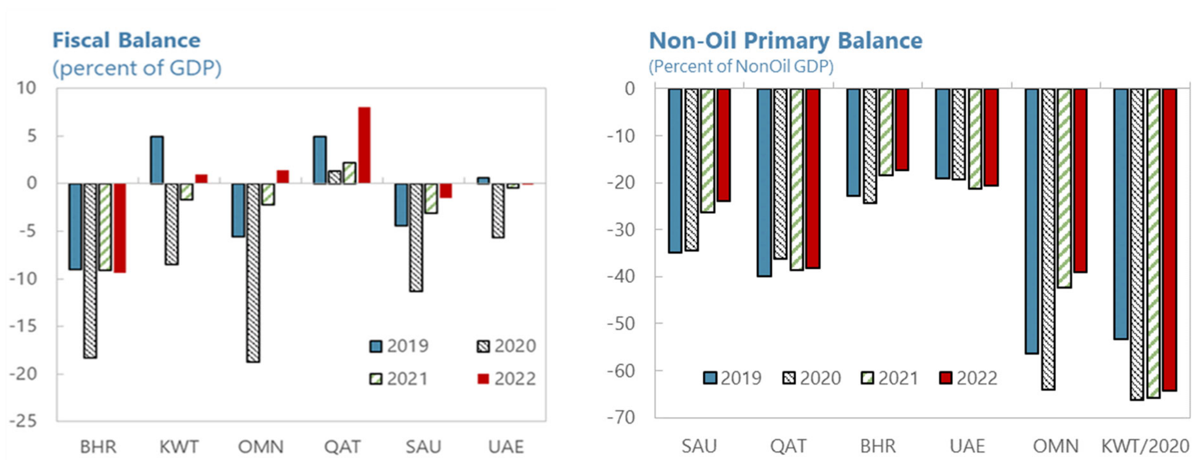


Sources: Haver Analytics, National Authorities; and IMF Staff Calculations.

Fiscal Developments and Outlook

13. Overall fiscal balances are expected to improve with higher oil prices. The combination of higher oil prices, economic recovery, and more targeted fiscal support in some countries will improve the GCC overall fiscal deficit to -1.8 percent of GDP in 2021, reaching balance by 2023. Non-oil fiscal balances are also expected to improve, but to a lesser extent. Non-oil primary balances deteriorated by about 3 percent of non-oil GDP in 2020, mainly reflecting fiscal support measures at the onset of the pandemic and a contraction of non-oil economic activity. With ongoing consolidation measures in some GCC countries (Oman, Saudi Arabia) and stronger economic activity, non-oil primary balances are expected to improve to a deficit of around 35 percent of non-oil GDP in 2021 (Figure 8). However, these results mask significant heterogeneity

Figure 8. Fiscal and Oil Balance



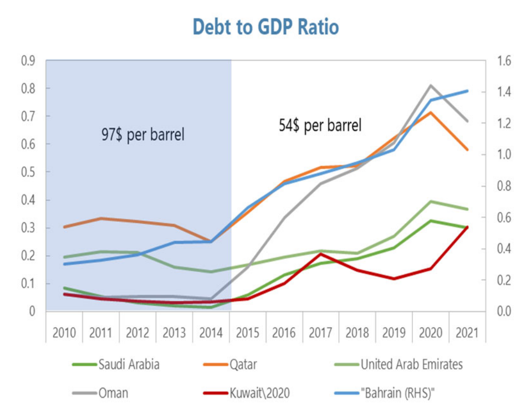
Sources: National Authorities; and IMF Staff Estimates.

in the conduct of fiscal reform measures across the region, with Oman and Saudi Arabia making recent notable progress.

14. The pandemic has generally weakened public debt positions, requiring commitment to fiscal adjustment once recoveries firm. GCC average public debt levels increased from 24 percent of GDP in 2015 to 60 percent of GDP in 2021, mainly reflecting countries not fully adjusting to lower oil prices during that period. Average debt service burdens have also increased, growing from about 7 percent of GDP in 2020 to about 10 percent of GDP in 2021. As a result, fiscal gaps are sizable with corresponding medium-term adjustment needs although with significant cross-country variation (Box 3). Although fiscal buffers remain healthy in most GCC countries, staff estimates suggest they could deteriorate over the medium term if fiscal reform measures are delayed, particularly given the challenges to future oil revenue growth from a shift to a low-carbon global economy.[6] Sustained improvements in economic activity and higher oil prices would offer an opportunity to undertake necessary fiscal adjustments. This would create more fiscal space to support economic activity and further diversification efforts, replenish foreign exchange reserves and fiscal buffers to protect the economy from fluctuations in oil prices, and set public debt on a downward path. Additional fiscal adjustment in countries with larger financing needs may be necessary to ensure continued access to adequate financing.

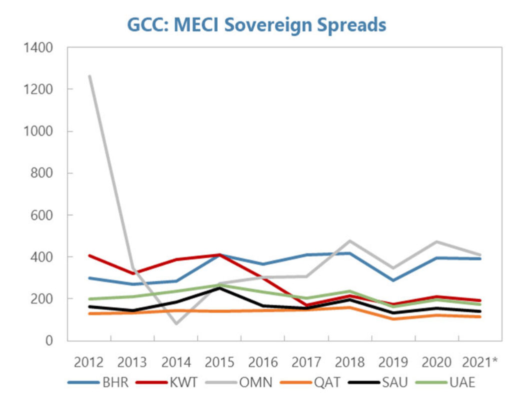
Box 3. Debt and Fiscal Sustainability

GCC economies not fully adjusting to lower oil prices experienced since 2015 has contributed to increased levels of government debt. Some countries with larger foreign exchange reserves were better able to contain the increase in gross debt at the expense of reducing reserves. Those perceived as having weaker fiscal positions have seen higher external borrowing costs.



Sources: National Authorities; and IMF Staff Estimates.

* The above oil prices represent the average oil price for each period.



Sources: Bloomberg L.P.; and IMF Staff Estimates.

* 2021 figures are calculated using daily spread values up until August.

Although fiscal positions in most GCC countries are projected to improve in 2021 compared to 2020, they have worsened from their pre-pandemic levels. Debt levels increased by an average of 12.8 percent of GDP from their pre-pandemic levels, pushing overall debt levels to approximately 60 percent of GDP, on

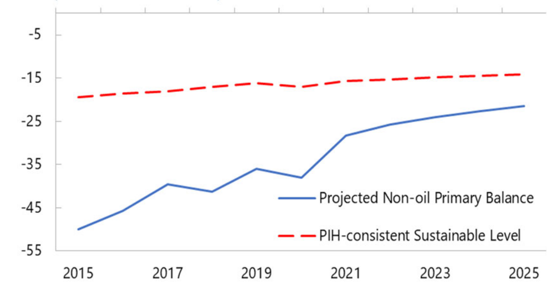
[6] See 2020 IMF Middle East and Central Asia Departmental Paper The Future of Oil and Fiscal Sustainability in the GCC Region.

Box 3. Debt and Fiscal Sustainability (concluded)

average, in 2021. Moreover, foreign reserves declined by an average of 5 percent in 2020 compared to 2019 levels, further steepening their decline since 2015 in most countries in the region. Although financing needs are projected to decline by 5 percent in 2021, they are expected to remain 3 percent above their pre-pandemic levels, on average. Primary fiscal balances are also projected to deteriorate from their pre-pandemic levels by an average of 2 percent of GDP in 2021.

Looking ahead, resumption of economic activity and higher oil prices should be utilized to further diversify GCC economies and ensure intergenerational equity. Applying the Permanent Income Hypothesis (PIH)[1] shows that the there is a need for further fiscal consolidation to reach sustainable fiscal paths. While the gap between actual non-oil primary balances and their sustainable counterparts has been declining over the past five years, it is still estimated to reach an elevated level of 17 percent of non-oil GDP in 2021. Although the gap is also estimated to further decline to 12 percent over the medium term, it will remain sizeable and need to be addressed.

Projected Non-Oil Primary Balance, 2015-2025
(Percent of non-oil GDP)



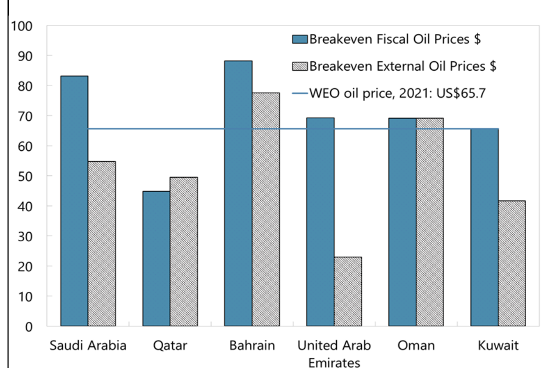
Sources: Country Authorities; and IMF Staff Estimates.

The volatility of hydrocarbon prices provides an incentive for GCC economies to accumulate more buffers than suggested by the PIH. Overall, results that take into account fluctuations in oil prices suggest lower deficits than those suggested by the PIH. In the long-run, and even for GCC countries with sufficient buffers, public debt trajectories remain vulnerable to risks. Moreover, relaxation or reversion of fiscal consolidation plans could further make GCC economies derail from sustainability paths.

Non-oil Debt Sustainability Analysis (DSA) is consistent with the PIH analysis. Staff analysis shows that there exists a 30 percent gap, on average, between the debt-stabilizing primary non-oil balance and projected medium-term non-oil primary balance as a ratio of non-oil GDP, underscoring the need for further fiscal reform and economic diversification, including broadening the revenue base. The gap is projected to decline in 2021 by an average of 19 percent from its 2014 level, mainly reflecting considerable adjustments in most GCC economies. Recent increases in oil prices should be utilized to step up, and not revert, ongoing fiscal reform efforts in the region.

Fiscal breakeven prices,[2] the prices that would achieve a zero fiscal balance given the level of hydrocarbon production, government expenditure and non-oil revenue, exceeded observed oil prices in 2021, highlighting the existing vulnerability of fiscal balances in the region to declines in oil prices. Spending pressure after the recent increase in oil prices could be a clear risk to further increase fiscal and external breakeven prices over the medium term and could undermine existing fiscal reform measures.

Fiscal and External Vulnerabilities



Sources: National Authorities; and IMF Staff Estimates.

[1] The baseline assumptions for the PIH are 5.5 percent for returns on NFA, population growth of 1 percent, 2.0 percent for the US dollar deflator, and 2.5 percent of real GDP growth.

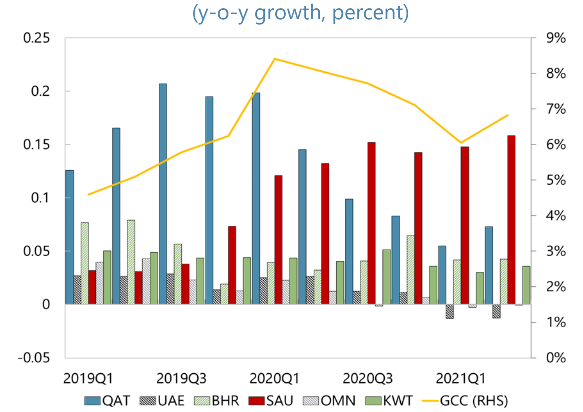
[2] Fiscal breakeven prices do not take into account the procyclical behavior of government expenditure in GCC countries or the counter cyclical behavior of non-oil revenue (Pieschacon (2012) and could be considered as a floor to achieving a zero-level fiscal balance.

Financial and Monetary Developments

15. GCC financial sectors have remained resilient through the crisis but vulnerabilities may yet emerge. The crisis put borrowers under immense pressure, but banking systems remain well-capitalized across the region[7] and the recorded deteriorations in banks' asset quality and profitability have been relatively modest although it varies across countries (Table 2). Although economic recoveries are gaining traction, fiscal and financial support measures have likely masked emerging vulnerabilities, including the soundness of borrowers (households, SMEs, corporations). Moreover, the COVID-19 crisis and oil price shocks have deepened the links between public, financial, and real sector balance sheets, pointing to potential sources of vulnerability and adverse feedback loops including through deteriorated asset quality.[8]

Figure 9. Credit to the Private Sector

(y-o-y growth, percent)

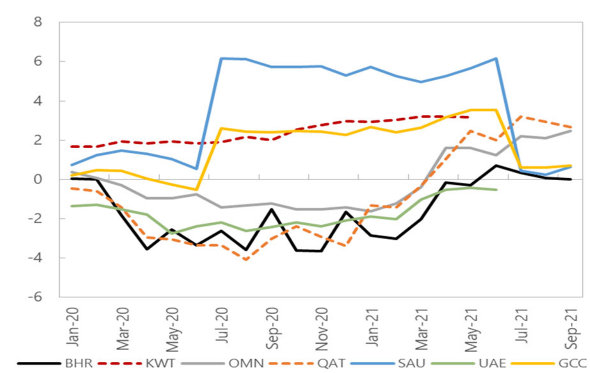


Sources: Haver; and IMF Staff Calculations.

16. Despite the stress on banks and borrowers private sector credit has generally held up through the crisis (Figure 9). Credit growth came to a halt in Oman but is expected to improve this year while in the UAE credit to the private retail segment has recovered but corporate lending continues to contract. In other countries it has remained positive and even accelerated in Saudi Arabia. This supply of credit has to a considerable extent been helped by the authorities' support measures and could be at risk if the eventual unwinding is not carefully timed and managed.

Figure 10. Monthly Inflation[1/]

(y-o-y, % change)



Sources: Haver, National Authorities; and IMF Staff Calculations.
1/ KWT as of April 2021 and UAE as of May 2021.

17. Inflation pressures have remained contained but could begin to rise with higher global inflation (Figure 10). Inflation in the GCC is expected to be contained below 3 percent on average this year (ranging from Kuwait at 3.2 percent to Bahrain at 1.0 percent) and moderate to 2-2½

---

[7] In Bahrain, several banks issued additional capital bonds to strengthen capital adequacy even though banking sector NPLs fell in 2020 unlike all the other GCC banking sectors.

[8] For in depth analysis see forthcoming IMF Departmental Paper "GCC: Assessing banking sector vulnerabilities in the wake of COVID-19," by AlHassan *et.al.*

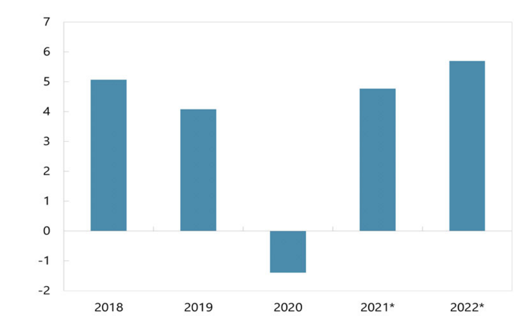
percent in 2022.[9] Despite the notable increases in import prices this year, headline inflation has so far remained moderate, mainly reflecting lower non-tradable inflation, as demand for non-tradable generally appears subdued in the region.

External Sector Developments and Vulnerabilities

18. The rebound in oil prices has improved external balances but some countries could be vulnerable to shocks (Figure 11). Current accounts are improving and expected to be substantially stronger in 2021 and onwards. However, the pandemic has taken a toll on service exports in the region, in particular tourism (measured as travel credit), which is expected to remain below pre-pandemic levels for most countries in the region. After increasing by an average of 28.7 percent of GDP in 2021, total external debt levels are projected to decline by an average of 11.9 percent of GDP in 2022, helped by the expansion in economic activity. GCC capital inflows rebounded in the second half of last year, following a sharp decline in the first half of 2020, mainly supported by favorable financing conditions in international markets and strong demand for debt securities (Figure 12). This is contributing to an improvement in GCC international reserves this year after a decline of 5.8 percent in 2020. Improvements in international reserves also reflect this year's disbursements of SDR allocations, which average 1.5 percent of GDP.

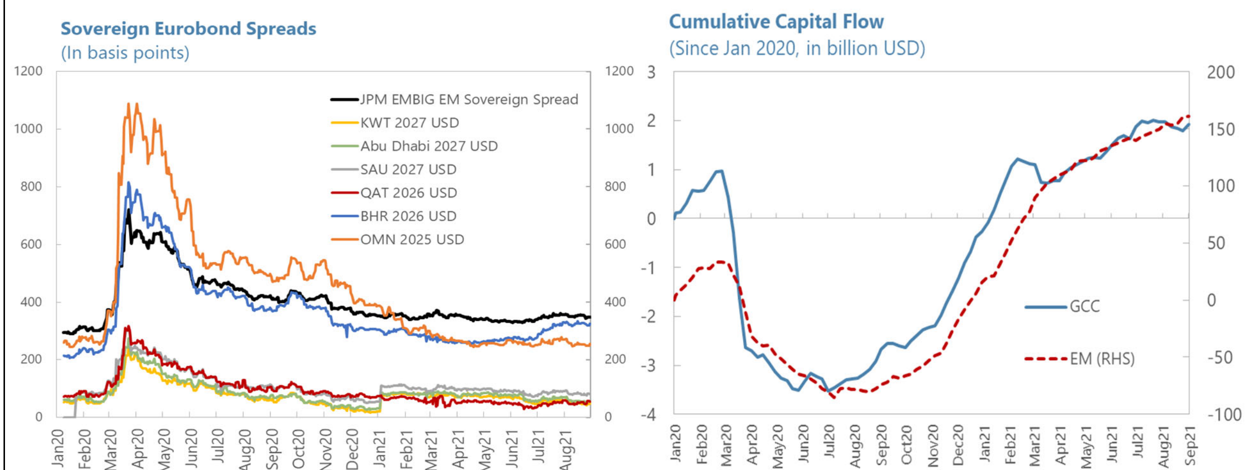
Figure 11. Current Account Balance

(Unweighted average, percent of GDP)



Sources: Country Authorities; and IMF Staff Estimates.
*Projected.

Figure 12. Spreads and Capital Flow



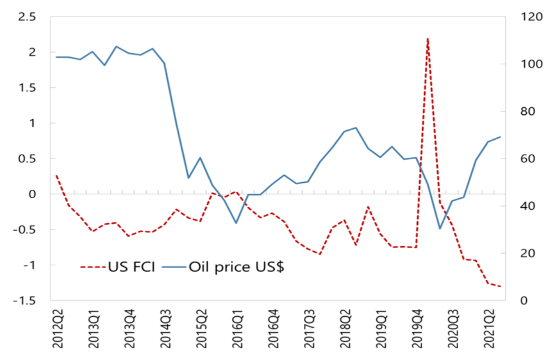
Sources: Bloomberg L.P. Haver Analytics; and IMF Staff Estimates.

9 In Saudi Arabia, the mid-2020 VAT rate increase caused a jump in inflation, which was largely reversed in 2021 as the base effect disappeared.

Risks to the Outlook

19. There are notable risks and uncertainties around the outlook. Economic recoveries remain fragile against the risk of renewed rises in COVID-19 cases. Despite rapid progress in GCC vaccination efforts, uneven global progress in vaccinations and risk of new strains of the virus underscore important downside risks to outlooks, including through negative effects on oil prices and potential travel restrictions. A tightening of global financial conditions in response to higher global growth or inflation could reverse capital flows, driving sovereign spreads higher, and squeezing public financing, especially in economies with limited fiscal buffers and reliance on external financing (Figure 13). An appreciation of the U.S. dollar would undermine competitiveness of GCC non-oil sectors. On the upside, higher oil prices would generally support GCC public balance sheets and macroeconomic outlook although they could give rise to pro-cyclical fiscal policies. Pursuing fiscal and structural reforms would also strengthen macro-stability and raise potential growth.

Figure 13. US Financial Conditions Index and Oil Prices



Sources: Country Authorities; and IMF Staff Estimates.

20. Climate change and related mitigation policies pose additional risks (Box 4). The region is directly vulnerable to climate risks posed from increased temperatures and low rainfall, while increased agricultural efforts have increased pressures on non-renewable natural water sources and desertification has increased the severity of sandstorms. Global mitigation efforts will also pose a particularly serious challenge for the demand of hydrocarbons over the medium to long term, weighing on fiscal and external sustainability. Although some countries have managed to reduce their dependence on hydrocarbon revenues during the past decade, the share of hydrocarbon receipts remains very high at about 51 percent of revenues.

Box 4. Climate Change Impacts and Responses in the GCC

Climate change is impacting the GCC region. Climate stressors have significant impact on water, environment, and health. The region has begun to take actions to mitigate and adapt to climate change. Structural and fiscal reforms have been accelerated in response to the transition risks from a global low-carbon future.

Stressors. The region exhibits significant vulnerabilities to climate change. Current climatic conditions range from semi- to hyper-aridity, with extremely low rainfall, lack of perennial rivers or permanent water sources, and high evapotranspiration. The annual average temperature has seen an increase of 1.3°C—more so than MENAP global averages—since the turn of the millennium. Low rainfall, where precipitation averaged 6.7mm annually compared to 16 mm for MENAP and 94 mm for the world over the period 1991–2020, have resulted in limited renewable resources of surface water. Agriculture (about 85 percent of total water consumption in Oman, Saudi Arabia, and UAE) and urbanization (approximately 50-60 percent of total water consumption in Bahrain and Qatar) have increased the pressure on non-renewable natural water sources. As a result, water stress is severe, with freshwater usage exceeding their available freshwater resources, placing GCC (except Oman) among the 10 most-water stressed countries. Desertification has increased the severity of sandstorms. Coastal zones are highly vulnerable to the impacts of sea level rise. Coral reefs are at risk of disappearance due to climate change (ocean acidification and seawater warming) and human activities (fishing, dredging and marine pollution).

Responses. GCC countries communicated a mix of mitigation and adaptation actions, which have co-benefits in the form of reduction of greenhouse gas (GHG) emission, through their nationally determined contribution (NDC) as part of the 2015 Paris Agreement.[1] Also, to identify adaptation needs and implement programs to address those needs, Kuwait, Oman, and UAE published a National Adaptation Plan (NAP). Some countries have also formulated climate strategies outside of the NDC and NAP process: Oman developed the National strategy for Adaptation and Mitigation 2020-2040; Saudi Arabia established the Circular Carbon Economy National Program to consolidate and accelerate the current momentum toward climate sustainability;[2] and UAE adopted the National Climate Change Plan 2017-2050. A range of actions have been undertaken to address the region's vulnerability to climate change impacts and foster resilience, including but not limited to:

- *Energy sector*: with the sector being the largest GHG emitter, countries have set targets to increase the share of cleaner energy sources: 20 percent in 2030 (Oman), 50 percent in 2030 (Saudi Arabia), 40 percent in 2040 (UAE). Also, the sector has implemented measures to reduce gas glaring, improve the energy efficiency in the upstream and downstream facilities, and reduce methane leaks.
- *Water management*. Integrated water management actions have aimed at harnessing new sources of freshwater (e.g., building additional dams in Oman and Saudi Arabia) and prudent use of water. Waste-water management actions have also promoted the reduction, recycle, and reuse of water, while reducing water desalination and thereby energy consumption.
- *Agriculture:* responding to the water-food-energy nexus, the region has adopted sustainable agriculture practices to ensure water and food security such as vertical and hydroponics agriculture. Oman prioritizes domestic production through investment in mega-projects in agriculture and fisheries.
- *Land degradation*. A range of actions have been implemented to reduce desertification and stabilize sand movements through using green belts as barriers. The Saudi Green Initiative and Middle East Green Initiative aim to plant 50 billion trees in the upcoming decades.
- *Marine protection*. Costal management measures have been undertaken to protect biodiversity of seas, reduce coastal erosion, and increase the sinks for blue carbon. GCC's actions have included planting of mangrove seedlings, restoring coral reefs, and landing artificial reefs (Bahrain and UAE).

[1] As of August 2021, Oman and UAE communicated their second NDC in 2021.

[2] G20 Leaders during their 2020 Riyadh Summit endorsed the Circular Carbon Economy (CCE) Platform.

Box 4. Climate Change Impacts and Responses in the GCC

- *Health and early warning systems (EWS)*. The development of EWS within the region aims at: reducing vulnerability to extreme weather events such as floods and dust storms; increasing resilience of infrastructure; and raising environmental quality and thereby improving public health. A mid-day break is mandatory for outdoor workers during summer.
- *Urban planning*. Ongoing measures have included expansion of metro systems to promote the use of public mass transport systems (Saudi Arabia and UAE) and within urban areas (Dubai and Riyadh). Also, green building councils have promoted the construction of energy efficient, resource efficient, and environmentally responsible buildings.
- *Efficiency*. District cooling systems have been built to conserve energy and water (Qatar and UAE). Fuel and water tariff reforms have been implemented over the last few years to reduce subsidies and improve energy efficiency and use of water. Ongoing education and awareness programs aim to reduce energy consumption amongst both residential and commercial consumers, including through energy efficiency products (e.g., appliances and air conditioners).
- *Carbon capture, utilization, and storage.* It has been used by BAPCO (Bahrain), Aramco and SABIC (Saudi Arabia), and ADNOC (UAE) to either store carbon emissions deep underground or turn them into marketable industrial and commercial products.
- *Waste management.* Circular economy actions have been implemented. Qatar recycles and reuses construction waste. Saudi Arabia has established the National Center for Waste Management in 2019 to promote waste reduction, recycle, and convert the waste into energy. Abu Dhabi adopted the Single Use Plastic Policy in 2020.
- *Sustainable finance*. Governments and state-owned entities have stepped up green financing to boost green investment and accelerate the transition to a low-carbon economy. UAE adopted Guiding Principles in Sustainable Finance to encourage financial firms to incorporate ESG considerations in their business. Oman and UAE are developing sustainable finance frameworks to mobilize private capital for sustainable investments. Saudi Arabia is developing an ESG agenda for its financial market and plans to issue its first green bond in 2022.
- *International collaboration*. NDCs emphasized the need for technology transfer and technical assistance from advanced economies to achieve adaptation and mitigation targets.

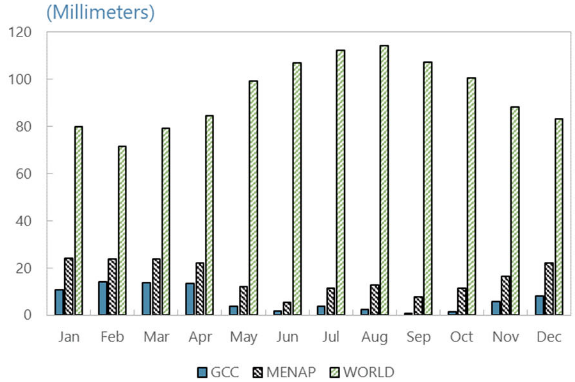
Transition. Oil and gas are the region's main sources of export and fiscal revenue. Global mitigation efforts will pose a particularly serious challenge for the demand of oil over the medium to long-term, stemming from moving to net-neutrality and thereby shifting away from fossil fuels. This would have a profound macroeconomic impact, especially on fiscal and external sustainability. To manage the transition risks, GCC countries have embarked on structural and fiscal reforms to lay the foundation for a low carbon economy by increasing the share of other productive sectors and diversifying export and fiscal revenues.

(continutued)

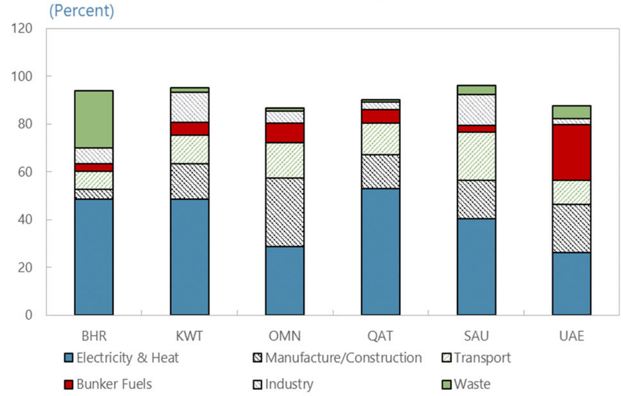
Box 4. Climate Change Impacts and Responses in the GCC (concluded)

Climate Indicators

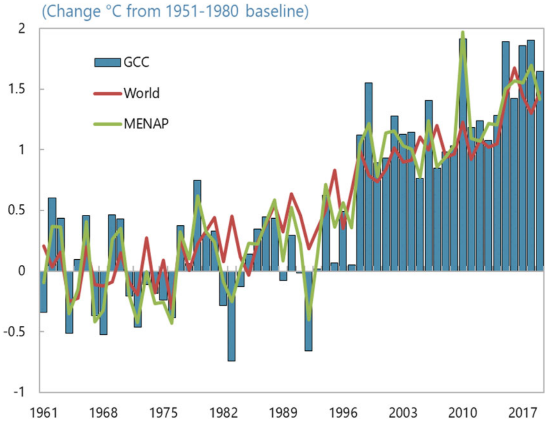
Monthly Precipitation, 1991–2020
(Millimeters)



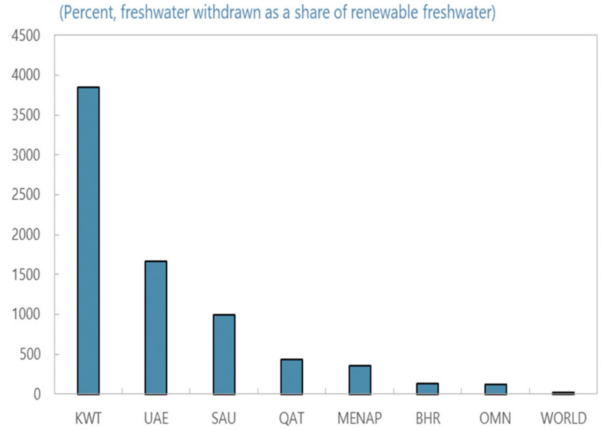
GCC: Greenhouse Gas Emissions by Sector, 2016.
(Percent)



Annual Mean Temperature Change, 1961-2019
(Change °C from 1951-1980 baseline)



Most Water-Stressed Countries, 2018
(Percent, freshwater withdrawn as a share of renewable freshwater)



Sources: FOA, World Bank, CAIT Climate Data Explorer, Our World in Data; and IMF Staff Estimates.

Note: Total greenhouse gases are the sum of all greenhouse gases, measured in tons of carbon dioxide equivalents (CO_2e) by sector. The level of water stress is defined as the ratio between total freshwater withdrawals by all economic activities and total available freshwater resources, after taking into account environmental flow requirements.

C. Policy Priorities

Policies to Ensure the Recovery is Firmly Established

The near-term priority is to fight the pandemic and secure the recovery with increasingly targeted policy support, including to the most vulnerable segments of the population and the economy.

21. **Protecting public health and supporting the most vulnerable remains the top priority.** Despite rapid progress on vaccinations, GCC countries have seen some spikes in the number of cases in 2021. Vaccination rollout for all residents should continue until vaccination targets are

achieved, while contingency health plans should be in place to respond to any reemerging virus outbreaks.

22. Macroeconomic policies should remain accommodative until the recovery is firmly established but be increasingly targeted. Future withdrawal of policy support should be carefully calibrated and coordinated.

- Fiscal support to hard-hit sectors and segments of the population has been critical to support the recovery and should be maintained as needed to avoid long-lasting crisis effects and mitigate social impacts. However, policymakers should also limit fiscal burdens, protect the credibility of policy frameworks, and implement increasingly targeted policies to ensure efficiency. Where policy space is more limited, these policy tradeoffs will be more difficult. Nevertheless, targeted support to hard hit sectors and vulnerable groups should be maintained, while still identifying fiscal savings from cutting or reallocating non-priority spending. Policy communication should be clear that the extended support is temporary by nature and will be withdrawn, in a targeted manner, as the recovery progresses.

- Macro-financial policies to ensure liquidity and spur credit growth should minimize the potential build-up of imbalances and be complemented by close monitoring of financial stability risks. Where recoveries remain weak policy measures should be extended, but increasingly targeted to viable sectors, firms, and future engines of growth, while nonviable entities should be quickly and transparently addressed. Policy withdrawal and targeting should be guided by macro-financial developments. Extension of loan moratoria should be data-dependent and complemented by continued intense monitoring of financial stability risks, including through forward-looking assessment of banks' asset quality and credit portfolios to ensure adequate bank buffers. Central banks should analyze the use of liquidity lines to gradually target and wind them down once the recovery is well under way.

- As the recovery strengthens, carefully coordinating the withdrawal of crisis-related policy support is essential to ensure the recovery, allow businesses and firms time to adjust, and protect the most vulnerable in society. Given the highly uncertain environment, policymakers should stand ready to respond to renewed stress from a reemergence of the pandemic or other potential shocks, such as oil price drops and shifts in global financial sentiment.

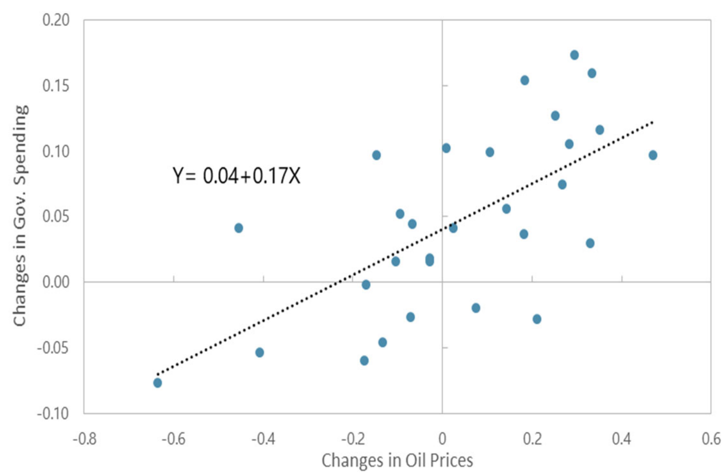
Medium- and Long-Term Policies for Potential Growth, Fiscal Sustainability, and Financial Stability

As the COVID-19 crisis abates, and economic recoveries are well-established, policies should address medium- and long-term challenges made more pressing by the pandemic: securing fiscal sustainability, ensuring sound yet dynamic financial sectors, and raising potential growth and competitiveness in a more diversified economy. Prudent and forward-looking policies would quickly strengthen credibility and put economies in a position of strength should there be a rapid change in the global environment and risk sentiment.

Policies to Ensure Fiscal Sustainability While Supporting the Economy

23. The crisis has brought forward the medium-and long-terms fiscal policy challenges to secure fiscal sustainability and meet intergenerational equity needs. While the gap between actual non-oil primary balances and those implied by the Permanent Income Hypothesis to ensure intergenerational equity has been declining in recent years it is still substantial (Box 3). This requires gradual and determined consolidation over the medium-term. Additional efforts may be needed beyond this to ensure adequate savings for future generations and to meet the increasing challenges posed by climate change and lower demand for oil from the transition away from fossil fuels (Box 4). To this end, GCC policymakers should carefully leverage higher oil prices to reduce debt burdens and avoid past patterns of procyclical policies (Figure 14). Once the pandemic is under control and the recovery firmly underway, priority should be given to achieving durable and growth friendly fiscal consolidation. Fiscal policy adjustment and reform should be geared towards economic diversification and inclusive growth, while promoting gender equality and addressing intensifying vulnerabilities from climate change.

Figure 14. Procyclicality of Government Expenditure in the GCC



Sources: National Authorities; and IMF Staff Estimates.

24. Fiscal consolidation should be underpinned by credible medium-term fiscal frameworks (MTFFs) and public outreach. Efforts in these directions would help prevent procyclical fiscal policies, strengthen fiscal policy efficiency, and enhance transparency in government operations, thereby helping to ensure sustainable access to external funding. A MTFF anchored by a clear medium-term fiscal objective and guided by a binding operational target—for example, based on either expenditure ceiling or a non-oil fiscal balance)—and supplemented by well-defined escape clauses in case of large shocks, would help achieve medium-term objectives. Further building macro-fiscal capacity in ministries of finance would help successfully implement multi-year budget frameworks, while aligning sovereign wealth funds to the fiscal frameworks through inflow and outflow rules that would ensure a consistent fiscal anchor. Strengthening contingency plans through a fiscal risk analysis framework would enable GCC governments to respond to future adverse shocks and maintain credibility of their MTFFs. Progress on such frameworks (e.g., Oman, Saudi Arabia) is welcome and should continue. Clearly communicating the aims and scope of fiscal consolidation, medium-term frameworks and underlying reform measures would strengthen their credibility.

25. The consolidation efforts should be supported through a combination of revenue and expenditure reforms, including to further greening the economy. Priority reforms include:

- ***Mobilizing non-oil revenue*** through introducing or expanding VAT rates, phasing out tax exemptions, increasing the efficiency of tax collection, including by harnessing digital solutions, and considering the introduction of corporate and income taxes. Recent progress in these directions has been made. For example, Saudi Arabia increased the VAT rate in July 2020, while Oman introduced the VAT in April 2021.

- **Containing the wage bill** by proceeding with necessary public wage and employment reforms. Public sector wage bills are generally large compared to other countries and could be rationalized, including by gradually reducing the size of the civil service for non-essential services and by increasing efficiency through expenditure reform. Public sector employment is furthermore often very attractive compared to private sector employment for nationals and large gaps between public and private sector compensation should be reduced.[10]

- **Phasing out poorly targeted subsidies**, particularly water and energy subsidies which would help reduce energy consumption and carbon emissions. Savings from these reforms would be partly used to strengthen safety nets and boost investment in infrastructure for diversification, and climate adaptation (resilience) and mitigation (e.g., alternative energy resources).

26. Further progress in fiscal transparency is needed. Fiscal coverage should be expanded beyond the operations of central government and reflect a more comprehensive picture of public sector sustainability. To further strengthen fiscal transparency and the credibility of budget frameworks GCC countries should also improve the disclosure and management of fiscal risks. Enhancing the disclosure of fiscal data, such as revenue, expenditure, and financing, would further support these efforts.

Policies for Financial Risk Mitigation and Robust Financial Sectors

27. Ensuring financial stability and a dynamic financial sector is key for a smooth recovery and sustained strong economic growth.[11] Overall, financial sectors appear sound and able to support the recovery and structural transformation, but current stresses, legacy risks and emerging vulnerabilities need to be managed. As policy support measures are withdrawn, underlying financial vulnerabilities among banks and their clients will likely surface. Sectoral winners and losers should become clearer and continued weak profitability paired with increased leverage in corporations and SMEs (Figure 15), could be a source of financial instability, weigh on banking systems and have long-lasting negative effects on economies, in particular in contact-intensive sectors. Prudent

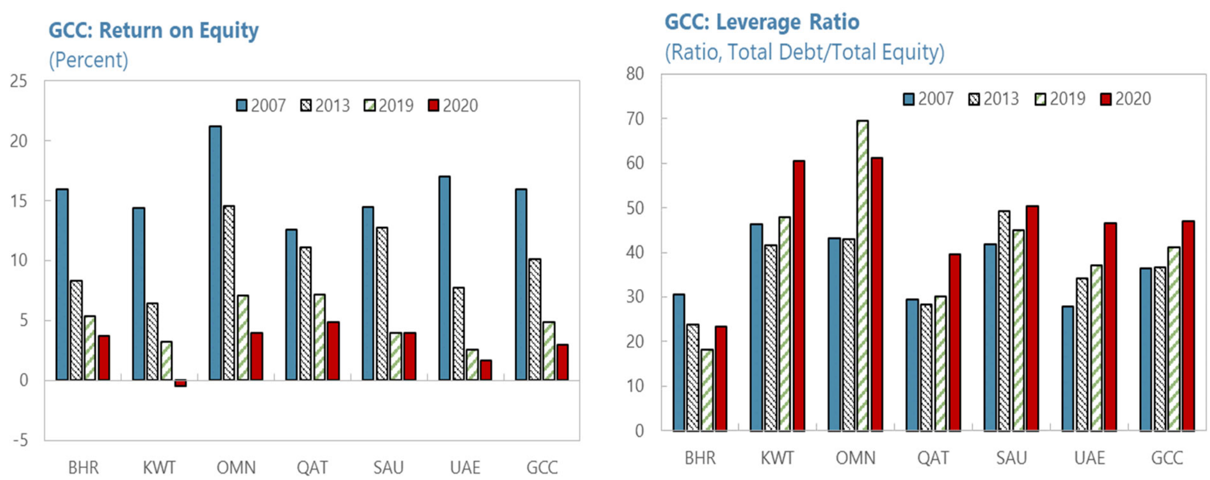
---

[10] See GCC Economic Prospects and Policy Challenges prepared for the GCC Annual Meeting of Ministers of Finance and Central Bank Governors, October 25, 2020.

[11] See forthcoming IMF Departmental Paper "GCC: Assessing banking sector vulnerabilities in the wake of COVID-19," by AlHassan *et.al.*

management of corporate deleveraging pressures in the post-crisis period could foster a speedier recovery.

Figure 15. Corporate Indicators



Sources: National Authorities; and IMF Staff Estimates.

28. Expediting the strengthening of insolvency and resolution frameworks should be a priority. This would help banks deal with crisis legacy loans, which should be swiftly addressed, and provide the necessary credit provisions, while limiting any long-lasting effects on growth prospects stemming from weak corporations. Policies to ensure swift recognition of impairment and resolution of bankrupt borrowers (while targeting distressed but viable borrowers) and ensuring adequate bank buffers remain in place could help reduce the length and severity of any negative credit cycle. As some firms may not be viable after the crisis, strengthening insolvency resolution frameworks to speed up loan resolutions and increase their recoveries will help banks to deal with crisis legacy loans and support their economies by providing the necessary credit provisions.

29. In parallel, ensuring bank soundness is paramount to contain systemic risk. Close monitoring of credit standards among SMEs and corporations needs to be paired with intense supervision of banks and other financial institutions. This requires detailed on and off-site inspections, including to ensure adequacy of credit risk assessments and provisioning, asset quality reviews, and stress-testing. Banks should also be encouraged to address declining profitability through increased efficiency and lower costs, including by continuing to harness the benefits of digital solutions and fintech to further expand financial inclusion, especially of women, youth, and SMEs. Authorities have generally stepped up their supervisory efforts as the crisis has evolved and this should continue.

30. Some prudential measures may need tightening. Supervisors should gradually reinstate prudential measures that were relaxed in 2020 and work with affected banks on restoring their buffers. This includes restoring pre-pandemic asset classifications, where it was relaxed, to recognize the underlying quality of banking assets. Constraints on dividend distribution should also be considered, if needed, to ensure that banks' buffers are adequate to withstand any future materialization of credit risks. Pre-existing vulnerabilities also need to be addressed, including reducing loan-to-deposit ratios—where they remain above the regulatory norms—and significant FX mismatches.

31. Continued reforms are needed to further develop financial markets and the non-bank sector and increase financial inclusion. Priority reforms include developing a yield curve and increasing market liquidity through secondary markets trading. There is also a need to focus stock market reforms on enhancing corporate governance and investor protection, removing restrictions on foreign ownership, and encouraging financial market competition.[12]

32. Systemic risks from deeper links between public, financial, and real sector balance sheets must be addressed. The efforts discussed above to secure financial stability are important in this regard, but a comprehensive reduction of systemic risks must also come through credible fiscal adjustment to reduce government debt and reform efforts to ensure economic diversification. In addition, continued progress in building statistical capacity and closing data gaps are necessary, particularly for balance sheet data for the broader public sector, non-bank financial institutions, and the private sector.

Revive economic diversification and lift medium-term growth and competitiveness to ensure a smooth adjustment to a more sustainable future

33. Sustained economic growth, competitiveness, and diversification will be as central as ever. Economies are vulnerable at this juncture, making it a near-term issue to support the economy and bolster policy credibility while there are risks of substantial lasting negative effects on productive capacity from the COVID-19 crisis unless economies are fully revived and allowed to develop. Preserving and continuously enhancing competitiveness remains critical for diversification and investment, especially in the context of a global transition to lower carbon-intensive economies. Over the longer-term a move toward environmentally sustainable growth is essential with lower expected global demand for hydrocarbons including due to worldwide policies to confront mounting concerns about climate change making the transformation even more urgent.

34. Reforms to address long-standing structural issues, promote competitiveness and boost non-oil growth continued during the pandemic. Although the business environment has continued to improve, the region entered the pandemic with a number of structural weaknesses, including over-sized public sectors, low female labor force participation, insufficient training and upskilling of the labor force (in particular, in innovative sectors), and limited private sector activity crowded out by dominant SOEs. There have been encouraging examples of reforms just prior to and during the COVID-19 crisis that helped economies adapt to the shock. For example, GCC countries acted swiftly to accelerate digitalization during the pandemic. Recent labor market reforms to the Kafala sponsorship system in Oman, Qatar and Saudi Arabia will enhance expatriate labor's job mobility. Saudi Arabia implemented reforms to raise female labor market participation, and the UAE

[12] IMF Policy Paper "Gulf Cooperation Council: How Developed and Inclusive are Financial Systems in the GCC?"

is boosting private sector employment among nationals and attracting highly skilled expatriate professionals through a number of reform efforts.

35. Nevertheless, further structural reform efforts are needed to foster higher productivity growth, promote diversification, and lift inclusive medium-term potential growth, including:

- Facilitating resource reallocation within and across sectors, including from non-viable firms to viable ones by further improving and utilizing bankruptcy frameworks. For GCC countries, it would be particularly important to reduce distortions that favor public sector in the labor market and the financial market.

- Encouraging labor force participation of nationals, in particular among females. This is critical for enhancing labor productivity and competitiveness, and requires leveling the playing field by removing explicit and implicit barriers for women to enter certain sectors or jobs and by providing more maternity and childcare support.

- Adopting and implementing more flexible policies for expatriates who are an important part of the labor force and source of talent in the GCC to avoid abrupt declines in labor supply. More flexibility will also reduce the wage gap between nationals and expats, which will also encourage firms to hire more nationals.

- Improving the quality of education and training to transform the labor force for the future. The education sector in the GCC should be reformed to reduce structural mismatches in labor markets and deliver world-class quality.

- Enhancing regulations and governance to further mobilize private sector and foreign direct investment in the non-oil sector and raise productivity. This includes reducing restrictions on foreign ownership, aligning tax treatments of local and foreign firms, reducing preferential treatments for government related entities, improving transparency and accountability in the public sector, and further strengthening AML/CLT frameworks.

- Promoting digitalization to prepare for the future of work and to protect macro-financial stability. The digital transformation accelerated by the pandemic will benefit countries, sectors and firms that invested in digital technology before and during the COVID-19 crisis. Developments in fintech, central bank digital currency and the sweeping move of activities from brick-and-mortar shops to online create both opportunities and competitions. GCC countries have been leaders in digital transformation in the MENA region. For instance, regulatory sandboxes in Bahrain and Saudi Arabia are providing infrastructure and regulatory support to fintech. Recent adoption of the UAE Data Law will support the move to higher digitalization as it aims to protect privacy of individuals and institutions and limit entities' use of personal data for profit. Oman has recently established the National Digital Economy Program that aims to help in creating national industries based on the digital economy, speed up the digital transformation in the public sector and upgrade the level of electronic services. Efforts in these directions will need to continue to reap the benefits from digitalization for productivity and broad economic and financial development.

36. Pegged exchange rate regimes remain appropriate for GCC economies. More flexible exchange rates over time could support the development of non-oil tradable sectors. However, moving away from the peg would remove a credible monetary anchor—delivering low and stable inflation—with limited competitiveness gains in the near-term. Fiscal consolidation and competitiveness-enhancing structural reforms would foster private-sector-led growth, ensure external sustainability and support the peg, while measures to further strengthen liquidity management and forecasting frameworks and deepen domestic money and capital markets would help support more active monetary policy frameworks in the future.

37. Continued GCC integration will support economic and financial development. The Al-Ula Declaration from January this year is very welcome and should boost intra-regional trade, tourism, and financial flows. If integration progresses further, the longer-term growth gains could be substantial with significant room to enhance intra-GCC trade. Closer integration paired with further improvements in the business environment could also attract additional FDI inflows to the region.

38. Climate change policies are critical given the region's dependence on hydrocarbons. A range of actions have been undertaken to address the region's vulnerability to climate impacts and foster resilience. These include reforms of the energy sector to increase the share of cleaner energy sources, energy efficiency, water management actions to develop new sources of freshwater, policies to fight land degradation, coastal marine management, and investment in carbon capture, utilization, and storage (see Box 4). Further broad-based policy efforts and cooperation are essential for adapting to climate change and mitigating emissions, including (i) managing transition risks by rebuilding financial buffers and diversifying economies and sources of fiscal revenues; and (ii) protecting impacted vulnerable households and businesses through cash transfers, social safety nets, and retraining workers. The recent Saudi Green Initiative is in this context very welcome.

D. Concluding Remarks

39. Policy priorities vary across GCC countries and depend on the stage of the pandemic and available policy space. Nevertheless, the top priority remains securing the health of the population and mitigating the immediate economic and social effects of the crisis. Macroeconomic policies should remain accommodative until recoveries are firmly established. Where policy space is more limited, targeted support should be maintained, while identifying fiscal savings from cutting or reallocating non-priority spending. As the pandemic subsides and the economy regains strength, including from a more favorable global environment, policies will need to ensure the recovery while managing a gradual withdrawal of support and remaining flexible to respond to potential recurrent virus outbreaks through health contingency plans.

40. Once recoveries are firmly established, medium-term policy priorities should focus on securing strong inclusive and green growth, sustainable fiscal positions, and macro-financial stability. Fiscal policy should be geared toward achieving growth friendly consolidation with the aim to ensure long-term fiscal and external sustainability. Priority should be given to strengthening fiscal frameworks, further mobilizing non-oil revenues, and increasing spending efficiency. With higher oil prices, procyclical spending should be avoided, and the windfall used to rebuild policy space. Overall, financial sectors appear sound and able to support the recovery and structural transformation, but current stress, legacy risks and emerging vulnerabilities need to be managed. GCC economies are vulnerable to risks of scarring from the COVID-19 crisis like other countries, and over the longer-term declining global oil demand as the world confronts climate change. Ongoing reforms to drive productivity and diversification should be accelerated to meet these challenges.

Table 1. GCC: Financial Soundness Indicators

	Capital Adequacy (Tier 1)				NPLs to Total Loans				Loans to Deposits					Return on Assets			
	2019	2020	2021Q1	2021Q2	2019	2020	2021Q1	2021Q2	2019	2020	2021Q1	2021Q2		2019	2020	2021Q1	2021Q2
BHR[1]	20.4	20.0	19.8	20.7	6.3	5.1	4.9	4.6	54.2	61.6	62.7	60.8		1.5	0.8	0.3	0.6
KWT	17.5	19.0	N/A	N/A	1.8	2.0	N/A	N/A	88.1	87.9	90.4	N/A	*	1.2	0.6	N/A	N/A
OMN	18.5	18.9	18.5	18.9	3.4	4.2	4.2	4.2	109.2	110.4	109.5	N/A	*	1.4	0.9	1.2	N/A
QAT	18.6	19.0	18.9	18.8	1.8	2.0	2.2	2.1	122.4	124.6	124.3	125.4		1.6	1.4	1.5	1.4
SAU	19.3	20.3	20.2	N/A	1.9	2.2	2.2	N/A	86.4	91.7	90.5	91.7		1.9	1.2	1.4	N/A
UAE[2]	17.7	18.1	17.9	17.5	6.5	8.2	8.3	N/A	94.0	94.0	93.3	92.7	*	1.6	0.7	0.9	1.0

Sources: National Authorities

[1] Data is for retail banks'

[2] National banks only.

* Indicates that these ratios reflect 2021 Q1 data.

Table 2. GCC: Selected Economic Indicators

GCC: Selected Economic Indicators[1]

	2017	2018	2019	2020	Proj. 2021	2022
Real GDP Growth	**-0.2**	**2.0**	**1.0**	**-4.8**	**2.5**	**4.2**
(Annual change; percent)						
Bahrain	4.3	1.7	2.6	-5.1	2.4	3.1
Kuwait	-4.7	2.4	-0.6	-8.9	0.9	4.3
Oman	0.3	0.9	-0.8	-2.8	2.5	2.9
Qatar	-1.5	1.2	0.8	-3.6	1.9	4.0
Saudi Arabia	-0.7	2.4	0.3	-4.1	2.8	4.8
United Arab Emirates	2.4	1.2	3.4	-6.1	2.2	3.0
Real Non-oil GDP Growth	**2.1**	**1.7**	**2.7**	**-3.9**	**3.8**	**3.4**
(Annual change; percent)						
Bahrain	5.5	2.4	2.0	-5.5	3.0	3.7
Kuwait	1.8	2.9	-1.1	-7.5	3.0	3.5
Oman	2.4	-1.6	-2.8	-3.9	1.5	2.3
Qatar	-1.0	2.2	2.4	-4.5	2.0	4.7
Saudi Arabia	1.3	2.2	3.3	-2.3	4.7	3.6
United Arab Emirates	4.8	0.7	3.8	-6.2	3.2	2.8
Consumer Price Inflation	**0.2**	**2.2**	**-1.5**	**1.2**	**2.8**	**2.4**
(Annual average; percent)						
Bahrain	1.4	2.1	1.0	-2.3	1.0	2.7
Kuwait	1.5	0.6	1.1	2.1	3.2	3.0
Oman	1.6	0.9	0.1	-0.9	3.0	2.7
Qatar	0.4	0.3	-0.7	-2.7	2.5	3.2
Saudi Arabia	-0.8	2.5	-2.1	3.4	3.2	2.2
United Arab Emirates	2.0	3.1	-1.9	-2.1	0.6	2.2
General Gov. Overall Fiscal Balance	**-5.5**	**-1.5**	**-1.5**	**-8.8**	**-1.8**	**-0.4**
(Percent of GDP)						
Bahrain[2]	-14.0	-11.8	-9.0	-17.9	-8.0	-8.0
Kuwait[2]	6.3	9.2	5.0	-8.3	-1.5	1.0
Oman[3]	-12.0	-7.7	-5.6	-18.7	-2.6	1.1
Qatar[3]	-2.5	5.9	4.9	1.3	2.8	5.7
Saudi Arabia[2]	-9.2	-5.9	-4.5	-11.3	-3.1	-1.8
United Arab Emirates[4]	-1.7	1.9	0.6	-5.6	-0.5	-0.2
Current Account Balance	**2.8**	**8.6**	**5.8**	**-0.4**	**6.0**	**6.3**
(Percent of GDP)						
Bahrain	-4.1	-6.5	-2.1	-9.3	-2.9	-2.9
Kuwait	8.0	14.4	16.3	16.7	15.5	13.3
Oman	-15.6	-5.4	-5.5	-13.7	-5.8	-0.9
Qatar	4.0	9.1	2.4	-2.4	8.2	11.6
Saudi Arabia	1.5	9.2	4.8	-2.8	3.9	3.8
United Arab Emirates	7.1	9.6	8.5	3.1	9.7	9.4

Sources: National authorities; and IMF staff estimates and projections.

[1] GCC aggregates in the form of growth rates or shares of GDP are weighted by GDP valued at purchasing power parities

[2] Central government.

[3] Central government and estimated net income of sovereign wealth funds.

[4] Federal government and emirates.

Appendix I. Policy Measures to Mitigate the Pandemic Effect

A. GCC Monetary and Financial Measures to Mitigate the Pandemic Effect

Country	Reduced policy rates	Liquidity support offered	Loan payments deferral	Concessional financing	Loan guarantees	Regulatory and prudential
Bahrain	yes	BD 3.7 billion zero interest repo	For private sector until December 2021	Redirected Tamkeen (Labor Fund) programs to provide financing to SMEs affected by the pandemic.	Doubled the SMEs liquidity fund to BD 200 million.	Reduced cash reserve ratio, LCR and NSFR; relaxed LTV for new residential mortgages; reduced the risk weight of loans to SMEs; allowed the booking of loan deferral-related losses directly to equity and not to P&L; amended IFRS9 classification for Stage 2 and Stage 3 assets.
Kuwait	yes		For citizens' loans until September 2021		For clients whose businesses are affected by the coronavirus pandemic	Reduced capital requirements, LCR, and NFSR, relaxed LTV for existing homes and home construction; reduced the risk weight of loans to SMEs
Oman	yes	Repo facility (OMR 1.7 billion) in, FX swap (OMR 1 billion)	For individuals and corporates (OMR 1.7 billion), and postponed loan servicing for borrowers (SMEs) of Oman Development Bank and Al Raffd Fund. Deferrals have been extended to end-2022 for Omani citizens that have been laid off or had their wages reduced, and to end-2021 for Riyada-cardholding SMEs.	Interest-free emergency loans (OMR 19.3 million)		Reduced capital conservation buffer (OMR 4.2 billion) Increased lending ratio from 87.5 percent to 92.5 percent (OMR 1.5 billion) Allowed banks to defer the risk classification of loans related to government project (OMR 1.3 billion) Allowed tolerance up to 25 percentage points in LCR and NSFR. Relaxed LTV for first time buyers.
Qatar	yes	QR 50 billion zero-interest repo window	For private sector until June 2021	Capped rates for loans to private sector companies for wages and rental payments until September 2021	QR 5 billion guarantees for loans to private sector companies for wages and rental payments until September 2021	
Saudi Arabia	yes	SAR 50 billion deposits with banks	For affected SMEs until December 2021	To SMEs, until March 2022; National Development Fund financing to the private sector	SAR 66 billion	
UAE	yes	AED 50 billion zero-interest rate collateralized loans to banks	No blanket deferral; deferral is on individual bank basis			Reduced reserve requirements, NSFR, relaxed LTV ratio for first-time buyers and real estate lending cap; reduced risk weight of loans to SMEs, allowed the use of banks' excess capital buffers

Sources: National authorities, and IMF staff calculations

B. GCC Fiscal Measures to Mitigate the Pandemic Effect

Measure	Total estimated support		Allocated to 2020	Allocated to 2021
	in % of 2020 GDP	in LC billions	in LC billions	in LC billions
Bahrain	6.7	0.9	0.8	0.05
Kuwait	4.9	1.6	0.5	1.1
Oman	0.6	170.2	23.8	146.4
Saudi Arabia	5.5	143.9	126.6	17.4
Qatar	1.0	5.1	5.1	NA
UAE	2.8	32	31.7	0.3

Sources: National authorities, and IMF staff calculations

Appendix II. Post-COVID-19 Growth Challenges

1. The COVID-19 crisis is expected to cause persistent damage to potential output in many countries over the medium term. Chapter 2 of the April 2021 World Economic Outlook (WEO) finds that, historically, deep recessions often lead to long-lasting scars, particularly to productivity. The latest WEO forecasts suggest that expected medium-term output losses from the pandemic are substantial, with output for the world in 2024 expected to be about 4 percent lower than anticipated pre-pandemic. Output in advanced economies is projected to return to pre-pandemic trends by 2023 and rise slightly above it thereafter, mainly because of the extraordinary policy support in these countries. Other countries, including the GCC, are expected to remain below their pre-pandemic paths throughout the forecast horizon. Moreover, negative output gaps in the GCC are expected to close only gradually over the medium term.

2. For GCC countries, the path of potential output is likely to depend on the following channels, with impacts likely to differ across countries:

- *Oil market.* The structure of GCC economies suggests that the oil market will be a key channel through which future growth could be affected. If global oil demand is permanently reduced, oil output will be lower, and lower oil revenues will constrain the ability of the public sector to invest to support diversification and may reduce the region's attractiveness for private investment, including FDI. This could even force countries to lower oil production.

- *Contact-intensive sectors.* Activities in contact-intensive sectors (tourism, hospitality etc.) are likely to remain weak in the aftermath of the crisis. Tourism and hospitality sectors are a central piece of Dubai and Bahrain's economies and Saudi Arabia's diversification plan. Developments in these sectors will likely be sluggish so long as the COVID-19 risks persist.

- *Labor market.* Sectoral shifts following the crisis could lead to higher unemployment and declining labor force participation for years. If uncertainty about economic recovery, health, and travel prospects remain elevated in the post-COVID-19 environment, it may be harder to attract expatriate labor, particularly skilled workers. In some countries such as Saudi Arabia, rising female participation and nationalization may increase labor supply. Similar efforts in the UAE, including to increase the role of nationals in private sector employment, should help adjust labor markets.

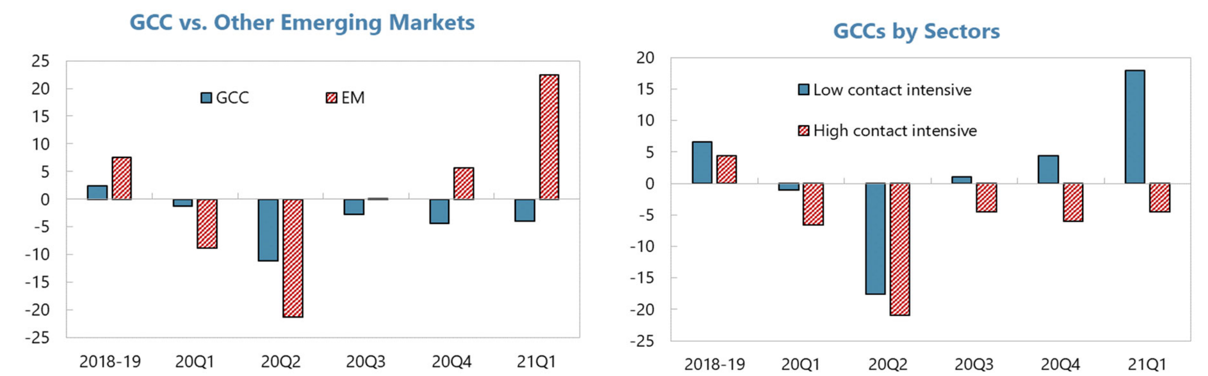
- *Human capital accumulation.* School closures interrupt learning opportunities and reduce human capital accumulation (see Chapter 1 of the April 2021 World Economic Outlook). Studies of past school closures emphasize increased dropouts, decreased learning quality because of inefficient remote teaching methods, and worsening mental health issues related to social isolation. Education losses should be mitigated by GCC countries' well-established infrastructure.

- *Corporate investment.* Impaired corporate balance sheets and elevated uncertainty could hinder investment, which will reduce capital accumulation. Non-financial corporations in the GCC region entered the pandemic with weaker fundamentals than prior to previous crises and relative to firms in emerging market economies (October 2020 ME&CA Regional Economic Outlook). The pandemic saw an unprecedented decline in corporate revenue and profitability (Figure 1). Although government policies such as tax holidays and loan deferrals have supported companies in particular SMEs during the crisis, contact intensive sectors still took a large hit to revenues and have not yet seen a firm recovery. The real test for many SMEs will come when crisis-related policy support starts to be withdrawn.

- *Total factor productivity.* Productivity could also be permanently affected by the loss of firm specific know-how due to bankruptcies and their spillovers (Bernstein and others 2019), the effects of a decline in research and development and innovation during the recession, and an increase in resource misallocation. On the other hand, reforms in labor market regulations and business environment could boost TFP growth. Productivity of firms, banks, public entities and other activities that had invested in digital capabilities before the onset of the crisis could benefit from the digital transformation accelerated by the pandemic (REO chapter 3, Box 1). COVID-19-induced sectoral reallocation of labor may also affect aggregate productivity in a different way compared to previous crises—a relatively large share of expatriates who left the labor market is of lower education and skill level.

Figure 1. Corporate Sector Revenues

(Percent, y-o-y)

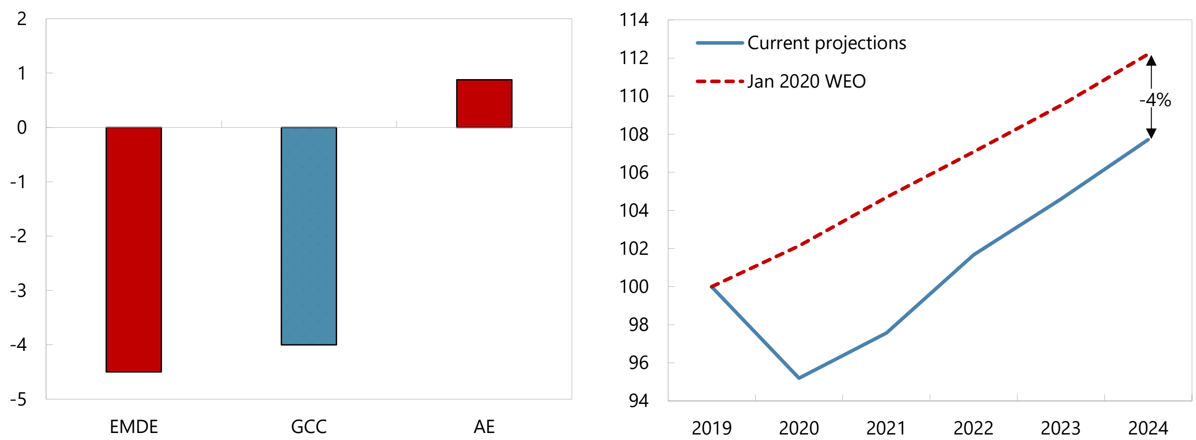


Sources: Compustat; S&P Global Market Intelligence; and IMF Staff calculations.

3. **IMF forecasts project persistent output losses over the medium term in the GCC region** (Figure 2)**.** The persistent output losses reflect both the negative output gaps that will be closed only gradually by 2026 and an expected decline in potential output relative to the pre-pandemic trend. Risks vary across GCC countries as vulnerabilities to the potential channels of persistent output loss differ. While some countries (Oman, Qatar and Saudi Arabia) are projected to fare better than many emerging markets, others (Bahrain, Kuwait and UAE) are projected to experience somewhat larger output losses. As a region, total GCC output in 2024 is projected to be 4 percent lower than its pre-pandemic projected level in that year.

Figure 2. Loss of Potential Output Relative to Pre-Pandemic Trend

(Percent)

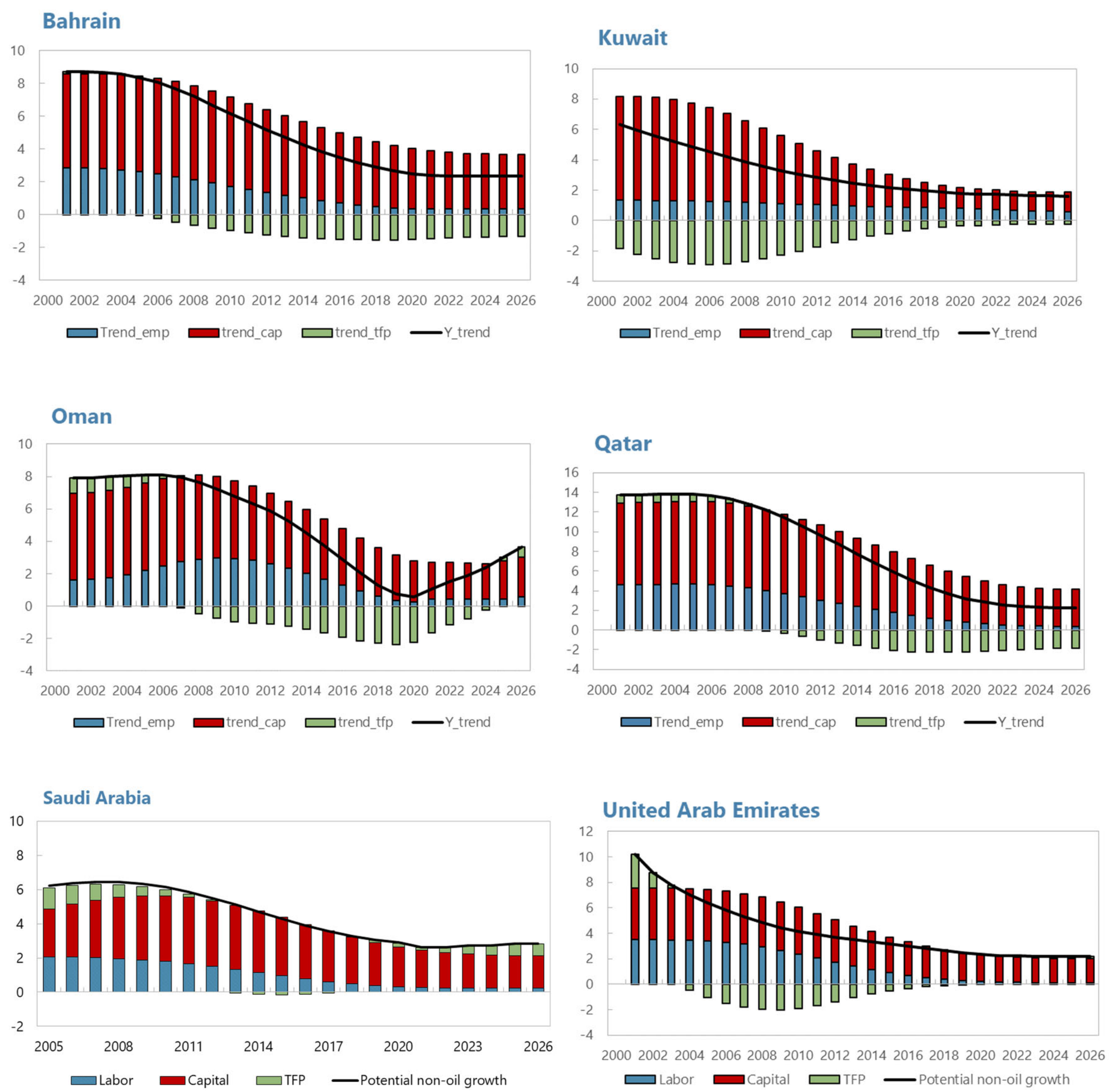


Source: Country authorities; and IMF staff estimates.

Note: Output in panel 1 is measured in terms of real GDP. Losses in panel 2 are calculated as the difference between current forecasts and those made in the January 2020 WEO for variable levels in 2024. AE=Advanced economics; EMDE=Emerging Markets and Developing Economies.

4. **Capital and labor markets are expected to be the main channels of persistent damage post pandemic, whereas the trends of TFP are projected to improve as reforms start to bear fruit** (Figure 3)**.** Capital accumulation is expected to slow across the GCC as needed fiscal consolidations begins after the crisis. Employment growth is projected to be weaker than pre-pandemic trend because of both weaker supply of expatriate workers and lower demand in the contact-intensive sectors. TFP growth is expected to pick up over the medium term with the implementation of reforms on business environment, labor market reforms and accelerated digitalization.

Figure 3. Contributions to Potential Non-oil Growth (Percentage point)



Source: Country authorities; and IMF staff estimates.

Note: non-oil capital is estimated as the difference between total GCF and fixed assets from national oil companies' balance sheets if a country does not report non-oil GCF. For Bahrain, total GCF is used as data does not allow estimation of non-oil capital stock and its oil sector is relatively small.

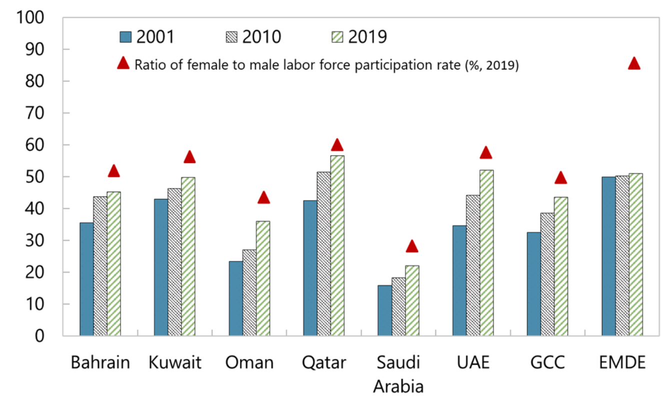
Appendix III. Gender Reform in the GCC

Gender gaps in the GCC region have been declining during the last decade, thanks to a range of reforms implemented to enhance female economic and political participation, facilitate women access to finance, upgrade the legal framework to strengthen women's rights, increase women educational attainment and equal access to quality healthcare. This improvement is encouraging, but gaps remain and further policy actions should be undertaken.

1. **Female labor participation in the GCC has increased in recent year.** Female participation in the GCC labor market increased by 5 percentage points during the last decade to reach 44 percent on average in 2019, in line with average female participation rate in EMDEs. This was driven by improved participation in Oman, the UAE and Qatar by 9 percent, 8 percent and 5 percent, respectively (Figure 1). This progress reflects a range of reforms that GCC countries have implemented to incentivize women to participate in the labor market. Qatar amended the labor law in 2004 to impose gender equality in working rights, including pay, training opportunities, and job advancement. In the last three years, Saudi Arabia and UAE have passed legislation that prohibits gender-based discrimination in employment, including by imposing equal remuneration, allowing women to work in jobs deemed men-specific (e.g., the mining sector, jobs with night shifts), prohibiting dismissal of women during pregnancy and maternity leave and equalizing the retirement age. Bahrain and the UAE have recently adopted legislations that inflict criminal penalties for sexual harassment in the workplace. In addition, the UAE has introduced in 2020 a paid parental leave for the first time for employees in the private sector. These reforms were reflected in a significant improvement in the Women, Business and Law Index (Figure 2).

Figure 1. Female Labor Participation

(In percent)



Sources: : National authorities, ILO; and IMF staff calculations.

2. **Despite these improvements, female labor participation remains less than half of male participation, and even less in managerial positions.** This stands in contrast to Emerging Market and Developing Economies (EMDE), where female labor participation exceeds 80 percent. Women in managerial positions in GCC countries also remains limited. The share of women in managerial positions and decision-making bodies is around 16 percent, on average, with the highest rate in Kuwait (26 percent) and the lowest in Saudi Arabia (10 percent) (Figure 3).

Figure 2. Women, Business and the Law Index
(Index)

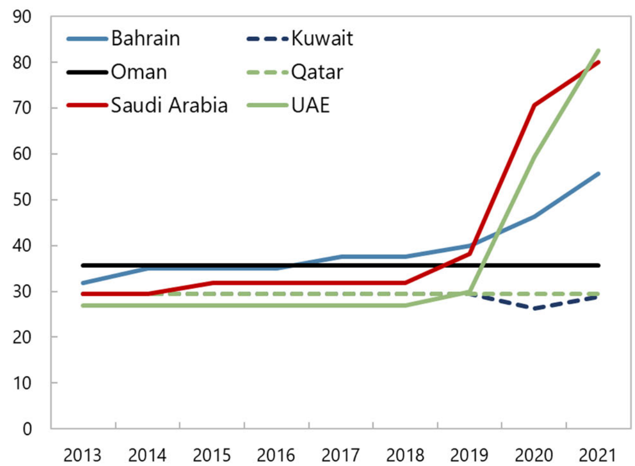
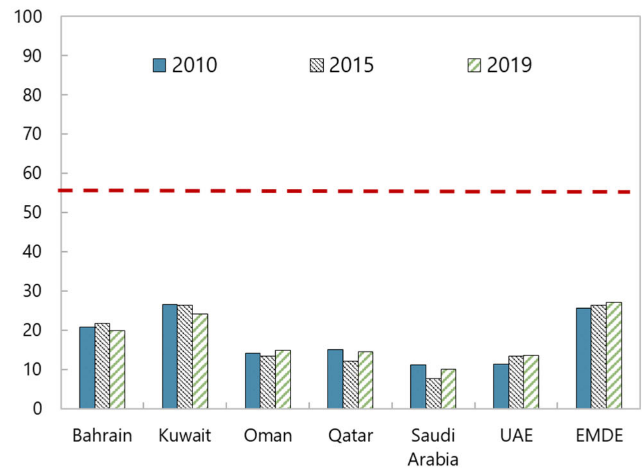


Figure 3. Estimated Share of Women in Managerial Positions
(In percent)

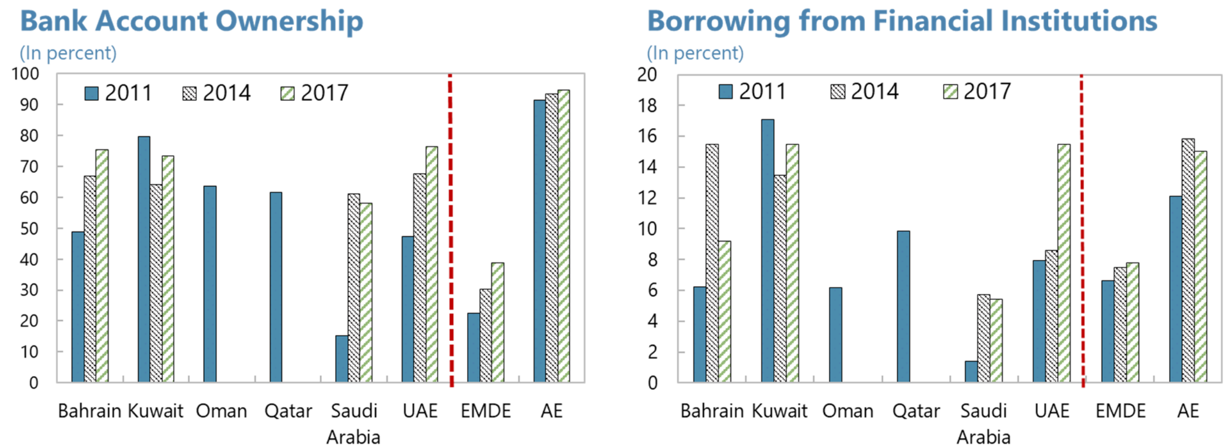


Sources: ILO, World Bank; and IMF staff calculations.

Note: Women, Business and the Law Index is a composite indicator produced annually by the World Bank to capture progress in gender-related reforms. It is composed of 8 timeseries measuring gender discrimination across 187 economies that are structured around women's interactions with the law as they begin, progress through and end their careers: Going Places, Starting a Job, Getting Paid, Getting Married, Having Children, Running a Business, Managing Assets and Getting a Pension. The WBL survey questionnaire comprises 35 questions which are scored across the 8 indicators of 4 or 5 binary questions. Indicator-level scores are obtained by calculating the unweighted average of the questions within that indicator and scaling the result to 100. Overall scores are then calculated by taking the average of each indicator, with 100 representing the highest possible score.

3. **Female access to finance has improved, though progress varies across countries.** On average, about 71 percent of female adults in the GCC had an account at a financial institution in 2017, up from 65 percent in 2014—almost double the average of EMDE rates (Figure 4). Although this rate remains lower than for male adults (86 percent in 2017), the gender gap has been narrowing in Bahrain, Kuwait and the UAE since 2014. The share of female adults who are borrowing from financial institutions was around 11 percent in 2017 on average, with 15 percent in Kuwait and UAE—slightly higher than rates recorded in Advanced Economies (AE). Bahrain, Saudi Arabia and the UAE have all introduced legislation to prohibit gender-based discrimination in access to credit. In Saudi Arabia, as part of the Housing Program, the Real Estate Development Fund (REDF) has provided subsidized mortgage loans to 73,000 women in 2020, to boost female home ownership and women usage of loans and mortgages. The percent of credit card holders in GCC among female adults increased to 21 percent in 2017 on average against 17 percent in 2014, with the gender gap declining from 14 percent to 11 percent.

Figure 4. Women's Financial Inclusion



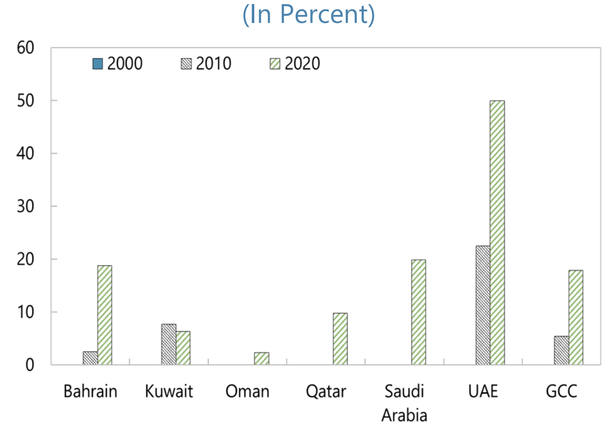
Sources: National authorities; World Bank Findex 2017; and IMF staff calculations.

Note: The Findex database is based on a worldwide survey covering 1,000 randomly selected individuals in each of over 140 countries associated with the GALLUP world poll, containing comparable information on access to a broad range of financial services and the intensity of their use. The Findex survey questionnaire comprises 44 questions relating to financial inclusion covering in particular access to different types of financial services and use of financial services, through saving and borrowing, formally and informally, in addition to questions on individual circumstances. These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints, and information availability. They may also not reflect more recent important structural transformations.

4. **GCC countries have undertaken reforms to strengthen civil and social rights and political participation.** Saudi Arabia announced in 2019 several measures to expand women's role in society, including increasing their mobility through giving them the right to obtain passports on their own and travel without seeking male guardian permission, enabling them to be heads of households in the same way as men, and allowing them to choose a place of residency, with the removal of the obedience provision. The UAE announced new reforms in 2019-2020 to enhance women's social status and ensure their empowerment, including by guaranteeing equality for passports application; removing the obedience provision and guaranteeing freedom to travel abroad, within the marriage and with respect to parenthood, and their ability to manage assets. Both Kuwait and the UAE have recently enacted legislations criminalizing domestic violence and protecting women. The political participation of women has also improved in recent years: the shares of seats held by women in national parliaments and women in ministerial level positions increased from 5 percent and 7 percent in 2010 to 17 percent and 10 percent in 2020 on average, respectively. Women hold around 20 percent of the seats in the Shoura Council in Saudi Arabia, and 10 percent

Figure 5. Share of Seats Held by Women in National Parliaments

(In Percent)



Sources: National Authorities; and IMF Staff Calculations.

in Qatar (Figure 5). This share reached 2 percent in Oman, 19 percent of the National Assembly in Bahrain and 50 percent in UAE in 2020.

5. The gender gap continues to decline in healthcare and education. Mortality of female adults in the GCC has declined in the last two decades from 82 per 1000 female adults in 2000 to 51 on average in 2019, lower than the mortality of men which hovers around 73 per male adults in 2019. The women survival rate to age 65 reached 89 percent in 2019, on average, higher than 86 percent for men. This is due mainly to the broad and significant improvement in the health services in the GCC and equal access to free-of-charge quality healthcare. Educational attainment has significantly improved in the last decade (Figure 6). The share of women in the GCC who completed at least primary education increased from 54 percent in 2001 to 84 percent in 2018 on average, while the share of those who completed at least undergraduate studies increased from 15 percent in 2001 to 28 percent. This will help women access employment and higher positions in their society.

Figure 6. Women's Health and Education

Sources: National authorities; and IMF staff calculations.

1/ the closest year of available data.

6. Despite the important advances for women in the GCC, there is scope for further reforms. Better access to finance and closer vocational guidance for women would help develop their entrepreneurial skills and enter the job market as employers. Increasing women participation in political decision-making would help enhance the design of gender-related policies. More initiatives to reduce the stigma of health issues, particularly with mental health, and increase the number of female medical professionals are crucial for improving women's health in the GCC. Full rights in terms of working hours, maternity leave and independence in asset management should be ensured across the GCC.