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Global and GCC equities continue their recovery in June

MSCI postpones Kuwait's entry into emerging market indices

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GCC markets extend their recovery, registering gains for the third straight month in June. Undervalued Dubai equities topped gainers among the GCC while oil prices breached the USD 40/bbl. level.

We see the following issues as key developments during the month of June:

1. **Defensive sectors in GCC- A great bet in today's times –** The 2020 stock market crash due to Covid-19 has impacted different sectors of the GCC economy in different ways. This can be observed in the performance of the GCC Sector Indices. We make a comparison of their current levels with that of the 52-week high and 52-week low to check which sectors are good bets in these uncertain times.

2. **Among many, Dividends can be one of the causalities in the GCC –** GCC Companies are likely to report reduced earnings for 2020 due to Covid-19 and the Oil Price Crash. GCC Companies have historically paid high amount of dividends to shareholders. We look at the impact of dividend payments by listed GCC Companies due to the crisis.

3. **10 Million and counting: COVID-19 breaches a grim milestone -** On 28th June 2020 the Global Coronavirus cases crossed a grim milestone of 10 million cases. Most of the countries have initiated the process of re-opening their economy, as vaccines are still being developed, opening up the economies could lead to surge in new cases. We are still away from herd immunity, as about 70% of the population needs to get infected. Hence exit strategy needs to carefully planned and executed.

4. **COVID-19 brings GCC's fiscal vulnerability to the fore –** Heavy reliance on oil revenue has long been a pain point for GCC's fiscal position. While fall in oil prices due to COVID-19 has highlighted this, measures to contain the pandemic's spread have brought about additional challenges. The current times reinforce the urgency of fiscal reforms and could aid in hastening their implementation.

5. **GCC economic measures to contain COVID-19 has mostly been monetary so far –** COVID-19 led health and economic crisis has pushed many governments around the world to respond with a wide armor of fiscal and monetary actions. GCC countries also acted with alacrity in providing stimulus measures. However, the strained budgetary positions has led GCC countries' to announce comparatively much smaller fiscal stimulus measures.

GCC Market Commentary

GCC Market Trends – June 2020

Index	M. Cap (USD Bn)	Last Close	2019 %	June'20	YTD %	S&P correlation**	ADVT* (USD mn)	P/E TTM	P/B TTM	Div. Yield
S&P GCC	367.3	97	8.3	-16.1	-18.4	0.334	N.A	14.8	2.0	3.4
Saudi Arabia	2,195.1	7,224	7.2	-13.9	-15.2	0.302	4,614.7	17.6	1.8	-
Qatar	129.8	8,999	1.2	-13.7	-15.9	0.170	110.1	13.8	1.2	4.4
Abu Dhabi	131.8	4,286	3.3	-15.6	-16.7	0.265	45.8	11.6	1.1	5.8
Kuwait (All Share PR)	96.8	5,131	23.7	-18.3	-20.8	0.204	106.7	12.7	1.1	3.9
Dubai	60.3	2,065	9.3	-25.3	-26.7	0.291	80.6	5.2	0.6	4.5
Bahrain	20.8	1,278	20.4	-20.7	-18.6	0.195	1.5	9.1	0.7	0.0
Oman	11.3	3,516	-7.9	-11.7	-11.1	0.185	2.4	8.0	0.6	7.7

Source: Refinitiv, Zawya; Note: * Average Daily Value Traded ** - 3-year daily return correlation with S&P 500 index

Regionally, the S&P GCC composite index rose by 1.6% in June, with all GCC markets barring Oman registering gains. Dubai was the top gainer among GCC markets, rising 6.2% for the month, followed by Abu Dhabi, Kuwait, Qatar and Saudi Arabia, which gained 3.5%, 2.7%, 1.7%, and 0.2% respectively. The World Bank in its recent report stated that GCC economies will contract 4.1% in 2020 but will bounce back in 2021 with 2.2% growth. Saudi Arabia turned to their mining industry to supplement its economic recovery. The country's cabinet approved a new mining law that facilitates investor access to financing and supports exploration and geological survey activities. The law falls in line with Saudi Arabia aims to diversify away from hydrocarbons by increasing foreign investment in the mining sector. Among GCC Blue Chip companies outside Kuwait, Etisalat and International holding company were the top gainer for the month, increasing 5.0% and 4.9% respectively.

Monthly returns heat-map of S&P GCC Composite index

S&P GCC	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2014	3.4%	3.7%	2.7%	2.8%	3.2%	-7.4%	8.1%	6.4%	-1.4%	-6.8%	-10.9%	-4.4%	-2.6%
2015	2.8%	4.4%	-6.9%	10.1%	-2.3%	-3.5%	0.1%	-13.2%	-1.1%	-2.7%	-2.3%	-2.4%	-17.3%
2016	-10.7%	3.7%	1.9%	5.7%	-5.1%	1.1%	-0.1%	-1.2%	-3.9%	2.2%	7.9%	4.2%	4.3%
2017	1.6%	-0.8%	-1.5%	-0.4%	-1.4%	3.2%	-0.4%	0.9%	-0.6%	-2.7%	-1.5%	3.4%	-0.4%
2018	5.3%	-2.5%	3.4%	2.9%	-0.4%	1.1%	2.2%	-2.5%	0.2%	0.1%	-2.0%	0.7%	8.4%
2019	6.8%	-1.0%	2.8%	4.4%	-5.6%	2.5%	1.1%	-5.8%	-0.7%	-2.6%	1.3%	5.9%	8.3%
2020	-0.9%	-7.4%	-18.2%	8.6%	1.3%	1.6%							-16.1%

Source: Refinitiv

Kuwait markets were positive, with the Kuwait All Share index registering gains of 2.7% in June. Relaxation of curfew regulations and the rebound in oil prices contributed to the positive sentiment of investors. Morgan Stanley Capital International (MSCI) announced that they would implement the reclassification of Kuwait indices from frontier market status to emerging market in November 2020 along with the semi-annual index review. Meanwhile, Kuwait cabinet agreed to cut the government entities' budget for fiscal year 2020-2021 by at least 20% to soften the deficit caused by COVID-19 outbreak. Agility was the top gainer for the month of June among Kuwaiti Blue Chips, gaining 11.2%. During the month, Agility signed a mega agreement with the Kuwaiti Public Authority for Housing Welfare (PAHW) to develop industrial and storage zones in Sabah Al Ahmed residential city. Basic materials and Industrials were the top performing sectors in Kuwait during the month, with their indices rising 9.2% and 7.8% respectively.

Among the GCC Blue Chip companies, SABIC was the top gainer for the month, increasing by 14.6%. Meanwhile, First Abu Dhabi Bank lost 4.0% for the month. The bank had earlier announced that it has put discussions to acquire the Egyptian assets of Lebanon's Bank Audi on hold due to tough market conditions.

Global Market Trends – June 2020

Equity	Last close	June change (%)	2020 change (%)
S&P GCC	97	1.6	-16.1
MSCI World	2,202	2.5	-6.6
S&P 500	3,100	1.8	-4.0
MSCI EM	995	7.0	-10.7
MSCI FM	814	1.4	-17.8
FTSE -U.K	6,170	1.5	-18.2
Commodities			
IPE Brent($)	41	16.5	-37.7
Gold($)	1,781	3.1	17.4

Source: Refinitiv

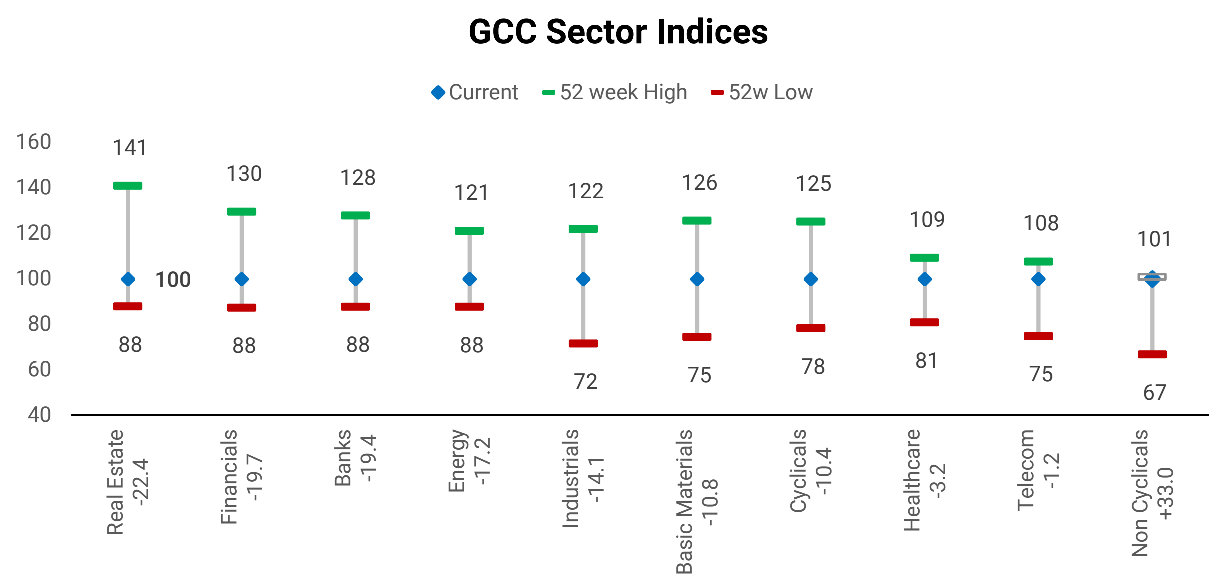
The performance of Global equity markets was positive for the third consecutive month, with the MSCI World Index gaining 2.5% in June. U.S. equities (S&P 500) gained 1.8% despite the second wave of cases starting to spike in several states. The Federal Reserve decided to keep interest rates unchanged during its June meeting and indicated that they would maintain rates at near zero levels until the economy recovers. The U.S. Fed expects the U.S. GDP to decline by 6.5% in 2020 before bouncing back in 2021 by 5%. In addition, the apex bank affirmed its commitment to keep buying bonds, targeting USD 80 billion a month in Treasury securities and USD 40 billion in mortgage-backed securities. The UK (FTSE 100 index) markets stayed positive, gaining 1.5% for the month. The Bank of England (BoE) during its June announcement said that it would expand its bond-buying program by USD 123 billion and keep its key interest rate at a record low of 0.1%. Emerging markets were buoyant for the month, with the MSCI EM increasing by 7.0%.

Oil prices closed at USD 41 per barrel at the end of June 2020, up by 16.5% as OPEC members and allies tightened output while the outlook for energy demand rose due to easing of restrictions on lockdowns. Gold prices continued to rise steadily, increasing 3.1% in June as fears over a second wave increased the demand for the safe haven asset.

1. Defensive sectors in GCC- A great bet in today's times

The 2020 stock market crash due to Covid-19 has been fast and short, if the markets do not fall to the lows of March 2020 again. The Oil price crash and social distancing measures to prevent the spread of Covid-19 has impacted sectors in the GCC in different ways. This can be observed in the current level of GCC Sector Indices. We make a comparison of the current levels of GCC sector indices with that of 52-week high and 52-week low to check which sectors are good bets in these uncertain times.

GCC Sector Indices along with their 52 week High and 52 week low



Source: Refinitiv; Data as of June 17, 2020.
Note: Current values rebased to 100. 52 week high and low are shown relative to current price
Year-to-date price performance shown along with X-axis labels

Real estate, Banks & Financials and Energy indices have seen huge falls

As a region with a primarily oil-based economy, GCC equity markets have been affected by the Oil price crash. This has resulted in a huge fall for the GCC Energy index which has fallen 17.2% for the year till date (YTD). However, the lockdowns, interest payment deferrals and travel restrictions instituted by the GCC nations to contain the spread of COVID-19 have affected the Real estate (down 22.4% YTD) and Financials (down 19.7% YTD) indices by even greater levels. Since these sectors constitute a significant percentage of the S&P GCC Composite, the whole index has been affected.

Are Defensive Sectors a great bet during these times?

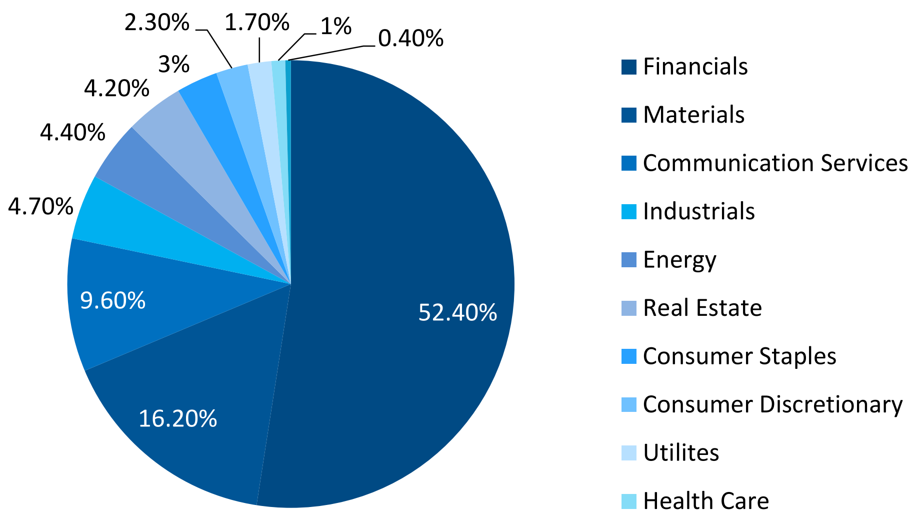
The downturn has increased the need for fund managers and investors to look at defensive stocks. Defensive stocks are those which perform well even during periods of crisis. Defensive stocks generally provide stable earnings inspite of the underlying economic conditions. Their businesses also tend to provide products or services that are in demand even during recessions. Examples of such sectors are consumer staples, consumer discretionary and Utilities. We can observe that the GCC Non-Cyclicals index trades at very close to the 52 week high and has also gained 33% YTD as against the S&P GCC composite index which has fallen 15.2% YTD. This indicates that defensives are a great investment bet in uncertain times.
Other sectors which can be considered to be defensives like telecom have also outperformed the S&P GCC composite index with the GCC telecom index only being down 1.2% for the year and trading very close to the 52 week high. With increased internet data usage due to people being confined to their homes during the lockdown, telecom companies are expected to benefit from the crisis. In the long run also, with e-

learning and work from home expected to increase, telecom sector is also expected to outperform the market.

Another index to significantly outperform the S&P GCC Composite is the GCC Healthcare index which has fallen by 3.2% YTD. The Covid-19 pandemic has seen an increased focus on the healthcare sector in the near term. The long term prospects for the sector also look good as GCC Governments are likely to increase healthcare spending even after the pandemic ends.

Defensive sectors constitute a relatively small portion of the S&P GCC composite index

Sectoral Breakdown of S&P GCC Composite index



Source: S&P Indices

However, the weightage for Defensive sectors is low at 17.6% in the S&P GCC Composite with Communication Services (9.6%), Consumer Staples (3%), Consumer Discretionary (2.3%), Utilities (1.7%) and Healthcare (1%). The Covid-19 crisis and outperformance of these sectors could result in these sectors getting a higher weightage which can further result in further out-performance in the future. This could also encourage un-listed companies in these sectors to consider IPOs as they observe their listed peers outperform the market. The market too needs an adequate number of defensive stocks as they can offer support during downturns and prevent investors, particularly institutional investors from leaving the markets entirely.

2. Among many, dividends can be one of the causalities in the GCC

Dividend payments have been an important tool to get investors to buy shares of companies as dividends provide a return on investment even during periods when the markets are down. GCC Companies listed on stock exchanges have provided consistent dividends in recent years. Due to Covid-19, many GCC Companies may be forced to cut dividend payouts due to fall in earnings and need to preserve cash. We examine the impact on dividends due to the pandemic and its ramifications for the stock market.

Dividend Payouts have been high for GCC stock markets.

Dividend payout ratios and yields of GCC Stock market indices

Index	Dividend Payout Ratio (in%)	Dividend Yield (in %)
S&P GCC	50.2	3.4
Kuwait	50.2	4.1
Saudi Arabia	72.3	4.1
Qatar	61.2	4.4
Dubai	23.6	5.1
Bahrain	48.2	5.3
Abu Dhabi	67.9	5.7
Oman	62.1	7.6

Source: Refinitiv; Note: Dividend Payout Ratio is the ratio of dividends paid and net income

As seen from the exhibit above, companies listed on GCC stock indices tend to have high dividend payout ratios at more than 50% for many GCC indices. One of the reasons is that GCC governments hold a significant stake in these companies and dividend payments contribute to government revenues. High dividend payouts have been crucial to get GCC and foreign investors to invest in the GCC stock markets. Therefore, any news of dividend cuts could lead to a selloff in the markets.

Speculation of dividend cuts triggered a selloff in Kuwaiti Banks

Kuwaiti Banks listed on the Boursa Kuwait fell between 5-10% on June 10 following news reports that implied that the Kuwaiti Banking Association (KBA) had asked their members not to pay cash dividends for FY2020. The Central Bank of Kuwait had previously announced Covid-19 combatting measures as part of its Regulatory Stimulus Package, including reduction of the Capital Adequacy Ratio floor by 2.5% and more relaxed liquidity requirements. If a bank makes use of these concessions, according to Basel III rules it will have to forego paying cash dividends. Speculation on whether Kuwaiti banks would opt for the concessions and the need to forgo paying dividends led to a selloff. The banks later clarified that a final decision regarding the 2020 dividend will be made at the year-end, based on financial performance, the extent to whether the bank has made use of the above central bank concessions, the recommendation of the Board of Directors and the wishes of the shareholders. The Capital Markets Authority then cancelled the trades made on June 10 since the KBA was not authorized to issue the communication. Still, the incident shows the importance of dividends to investors.

Earnings impact is likely to constraint dividend paying capability

The IMF has estimated that all GCC Countries would see contraction in GDP for 2020. Measures to contain the spread of coronavirus and the ensuing lockdown and curfew measures is bound to impact the earnings of companies. Based on our analysis, a 20 to 30 percent fall in income levels, would severely impact the dividend paying capability of firms in Saudi Arabia, Abu Dhabi, Qatar and Oman. While those in Kuwait and Bahrain would be impacted as well. Companies in Dubai due to their low pay out ratios could weather the fall in earnings and could maintain the dividends.

Estimated Dividend Payout Ratio (DPR) under different scenarios

Index	Earnings fall of 10% DPR (in %)	Earnings fall of 20% DPR (in %)	Earnings fall of 30% DPR (in %)
Saudi Arabia	80.3	90.3	103.2
Qatar	68.0	76.5	87.4
Abu Dhabi	75.5	84.9	97.1
Kuwait	55.8	62.8	71.7
Dubai	26.2	29.5	33.7
Bahrain	53.5	60.2	68.8
Oman	69.0	77.6	88.7

Source: Marmore Research

GCC Sectors most likely to cut dividends

Banks and Financial stocks constitute a significant portion of GCC Indices with financials comprising 52% of S&P GCC Composite index. Due to Covid-19 and the need to conserve liquidity, many central banks have already placed restrictions on 2019 dividend distributions. And the IMF has also called for banks to not pay cash dividends to preserve capital in the banking system and also prevent weaker institutions from being stigmatised. In light of this, dividend cuts are to be expected for GCC banks though a final decision will be probably be taken on a bank-to-bank basis based on the extent of increase in bad loans leading to reduction in capital ratios. The possibility of dividend cuts also explains why even the strongest Banks and Financial institutions have seen big falls in share prices.

Sector wise Dividend payout ratios and Yields for Kuwait

Sectors	Dividend Payout Ratio (in%)	Dividend Yield (in %)
Healthcare	38.4	1.0
Consumer Goods	71.2	2.2
Real Estate	29.1	2.4
Industrials	36.2	3.0
Banks	53.1	3.7
Financial Services	39.5	4.6
Insurance	47.3	5.8
Oil & Gas	61.0	6.0
Telecom	66.2	6.0
Basic Materials	111.3	7.4

Source: Refinitiv;

Kuwaiti Companies in Basic Materials sector have a dividend payout ratio above 100% indicating that they have been paying dividends using cash from their reserves in addition to the cash from profits. Other sectors like Oil & Gas, Basic materials & Industrials together constitute 25% of S&P GCC Composite. Covid-19 and the oil price crash will result in significant earnings fall for these sectors and certain cuts in dividends. This leaves defensive stocks as the most likely to keep their dividend payout rates. The crisis might even result in these sectors reporting more profits and increase in dividends. However, since they comprise a small part of GCC stock markets, the impact is likely to be minimal.

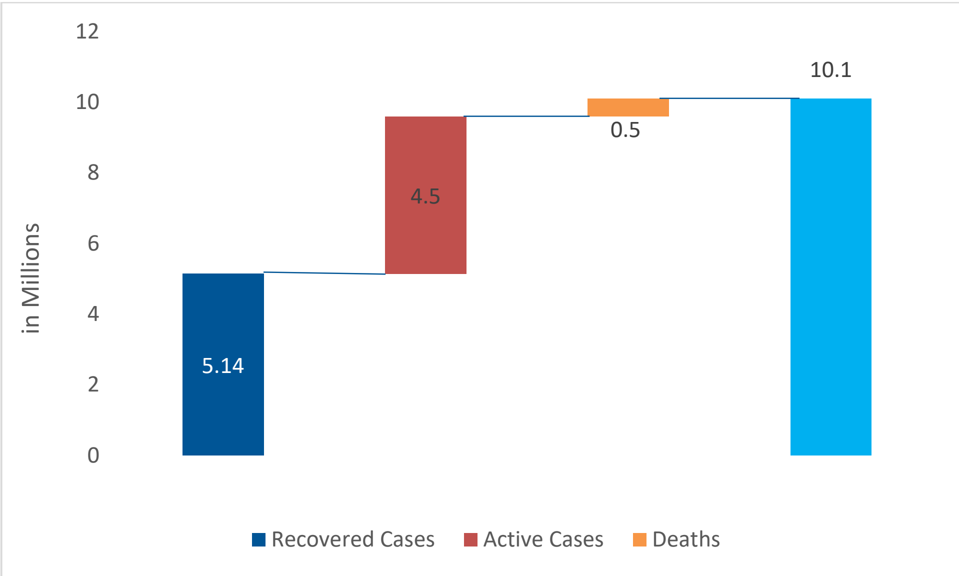
Conclusion

As the second quarter ends and GCC companies start reporting their results, a clearer picture on dividends is likely to emerge. As seen from the example of Basic materials sector in Kuwait, dividend policy was not necessarily dependant on profits and more on satisfying shareholders. However, due to the liquidity crunch caused by Covid-19, companies with adequate cash balances and banks with healthier capital ratios are likely to maintain dividends, which will give them an advantage compared to the market as a whole.

3. 10 Million and counting -COVID-19 breaches a grim milestone

As 2020 began with new hopes, little did the world know about an emerging threat coming out of the most populous country on Earth, a **virus** which spread like a wildfire in no time. The contagious nature of the virus made it more so difficult to contain it. The World Health Organization (WHO) declared the outbreak a **Public Health Emergency of International Concern** on 30 January 2020, and a pandemic on 11 March. On 28th June 2020, the global confirmed cases breached a grim milestone of 10 million confirmed cases, out of which about 5.14 million people have recovered and 0.5 million deaths have been reported.

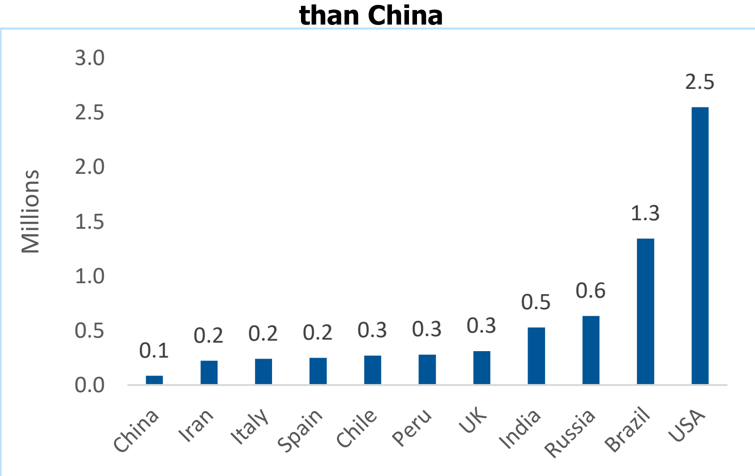
Breakdown of Global Coronavirus statistics



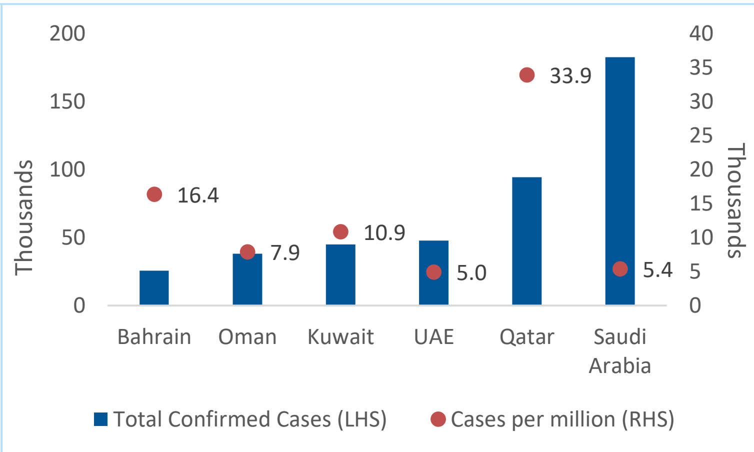
Source: Johns Hopkins University, Marmore
Note: Data as of 29th June 2020

Although China was the first country to report coronavirus cases, it also successfully curbed the spread and re-opened its economy assuming the data is correct. The USA on the contrary, was late in its response to COVID-19 and as a result it leads the world in terms of maximum reported cases. This is also a result of widespread testing across the United States, which may not be as prevalent in other countries. The number of cases reported by each country is a function of testing and contact tracing.

10 Countries have reported confirmed cases greater than China



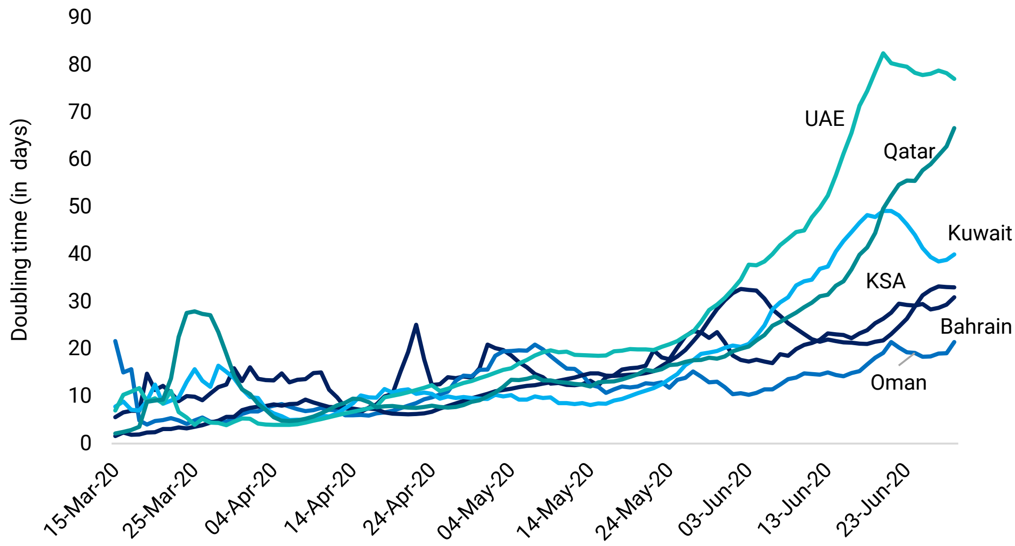
Saudi Arabia leads in GCC



Source: Johns Hopkins University, Marmore

In the GCC region, Dubai was the first to report COVID-19 case in late January, the progression was very slow initially, but from the month of May onwards the number of cases surged. Saudi Arabia leads in terms of total COVID-19 confirmed cases, however on cases per million basis Qatar has reported the maximum number of cases. A closer look into the trend of 'number of days taken to double for GCC' reveals that UAE and Qatar have managed to extend the days to double, which implies their response to COVID has been successful in curbing the pace of spread.

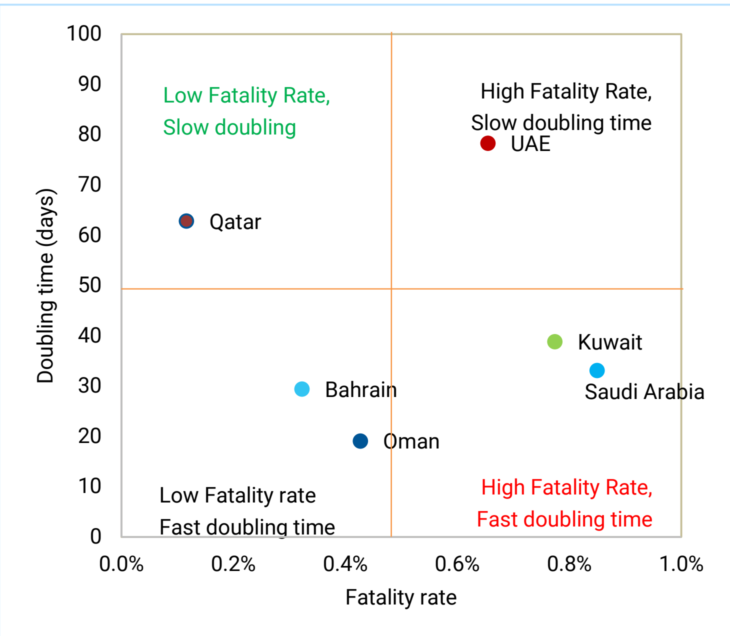
Number of days taken for cases to double for GCC



Source: Johns Hopkins, Marmore Calculations

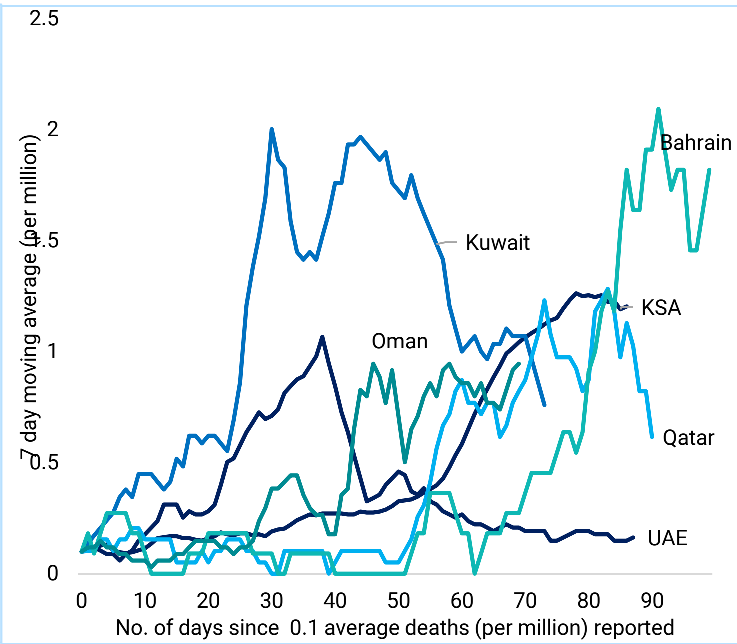
Qatar also fares well in containing the fatality rate, which has been relatively higher for UAE, but the 7 day moving average of daily deaths per million population indicates that Deaths in UAE has already peaked and is steadily declining. On the other hand, Kuwait and Saudi Arabia suffer with reasonably lower number of days to double and high fatality rate.

GCC Doubling time and Fatality rate



Source: Johns Hopkins University, as of June 28th

7 day moving average of daily deaths per million population



Source: Respective GCC health ministries, World Bank (population)

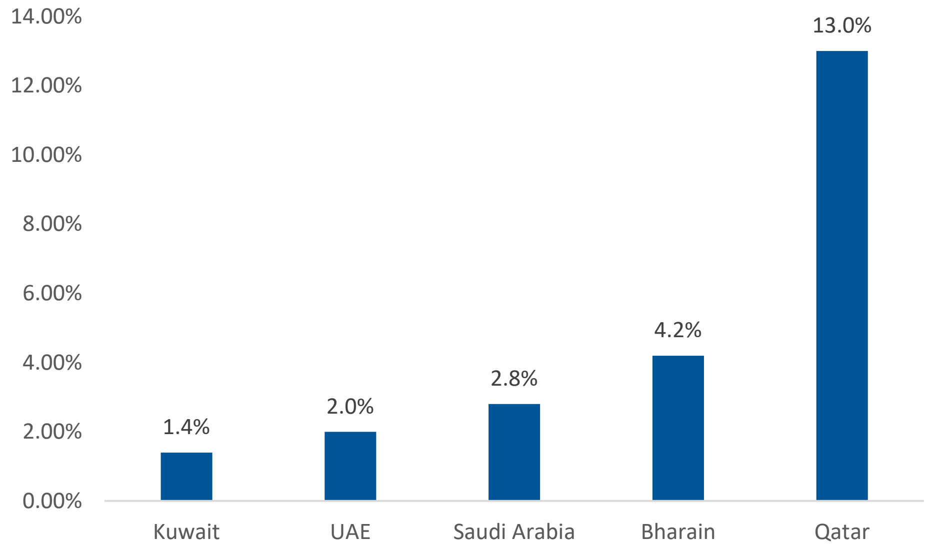
Policy responses to COVID-19[1]

The pandemic led to social and economic disruption across the globe. Many countries took measures like lockdown and curfews which led to panic buying, supply shortages and postponement or cancellation of sporting, religious, political, and cultural events. Even schools, universities, and colleges were closed. Businesses suffered due to non-operation and lack of revenues. Economies across the globe were virtually put on a standstill. These measures led to job losses and bankruptcies. The USA not happy with the WHO's role in handling the pandemic halted funding.

GCC had to deal with dual challenge of COVID-19 and Oil price crash. Suspension of inbound commercial flights, closing schools and universities, banning public celebrations and gathering, suspension of nonessential work in governmental entities were common across the region.

Post lockdown and curfews, the economic conditions deteriorated across nations, with people struggling to meet ends for living. This prompted re-opening of the economies with certain restrictions. But the damage was already done and to make up for the losses, Governments were forced to introduce economic measures. In terms of policy response, stimulus packages were announced across the board. The US lowered its Federal Fund rates by 150 basis points to 0 - 0.25bp and announced stimulus package of USD3.6 trillion, out which about half of the stimulus are loans to businesses and governments. In the Euro area, the European Central Bank (ECB) has announced robust monetary policy and supervisory measures. Across European Union, in order to contain the fallout of economic activity, the Governments implemented various fiscal measures.[2]

Fiscal Stimulus as % of GDP announced by GCC Countries



Source: IMF

How soon to Re-open or return to normal?

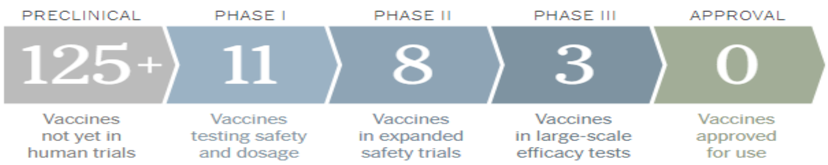
Many nations are still grappling with the pandemic, while few have set examples for others to follow. Countries like China, New Zealand, Singapore and South Korea, were quite effective in controlling the spread and are currently re-opening their economies. Vietnam also stands out for not reporting a single COVID casualty to date. In GCC UAE is leading from the front, as the number of confirmed cases reported is on a fast declining trajectory, and re-opening measures are being adopted commensurately. Kuwait has also entered into its second phase of return to normal life, wherein public and private sectors are allowed to resume work with less than 30% workforce, work in shopping malls, financial sector, construction sector,

[1] IMF
[2] BRUEGEL

retail shops, parks, and pick-ups from restaurants and cafes are allowed from 30th June 2020. Saudi Arabia moved with caution towards its final stages of de-escalation as all economic and commercial activities have restarted and about 75% of public employees have resumed office.

There has been instances of re-occurrence in countries like South Korea, New Zealand, China, and Singapore. This reminds that the COVID-19 is here to stay for some more time. To expedite the return to normalcy the world is working on a record pace to come up with a vaccine. According to the data compiled by The New York Times, there are more than 125 preclinical trials underway and 3 trials have reached the phase 3. However, an approval is yet pending for mass immunisation to begin.

Coronavirus Vaccine Tracker



Source: The New York Times

The concept of herd immunity is still a distance away, as it either requires about 70% of the population to get infected and develop immunity towards the virus or most of the population needs to be vaccinated. By not following social distancing and taking corrective actions to curb the spread in order to achieve herd immunity, may lead to overwhelming hospitals and cause more deaths[3]. Going forward as economies attempt to re-open occurrence of COVID spikes is inevitable, applying caution and taking necessary actions to curb the spread would be the key.

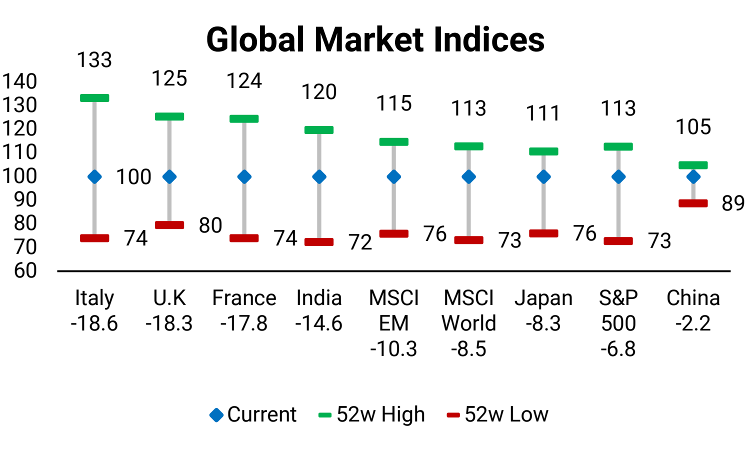
Does recent stock market recovery point to a disconnect between economic realities?

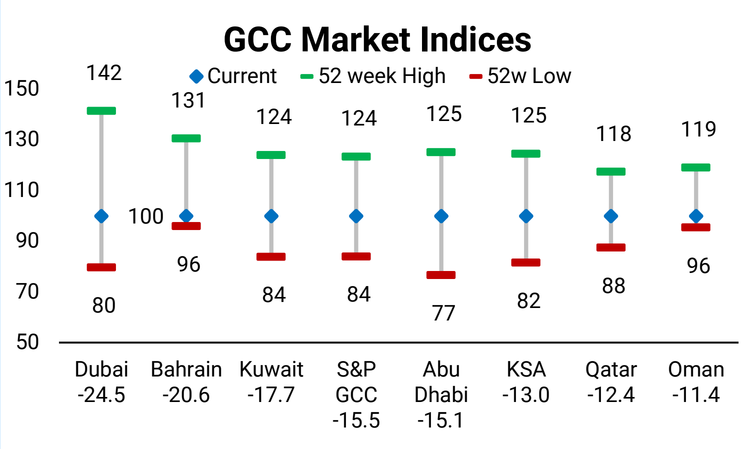
COVID-19 led the global stock markets plunge from all-time high to report the worst losses in over a decade. Developed countries except USA, are still trading at ~15% lower from their levels last seen in January 2020. The USA stock markets has recouped almost all its losses as it had multiple rounds of rally following Fed's intervention, hope of vaccine development, economic stimulus and economy re-opening. A large section believed that the worst is behind us and that the COVID-19 has already peaked, opening the path for resumption of normal life.

GCC markets on the other hand had to deal with twin crisis of COVID-19 and oil price crash. COVID-19 led fall in demand for oil and price war between Saudi Arabia and Russia resulted in the price of West Texas Intermediate (WTI) crude to trade at negative $37 per barrel on 20th April 2020. With an agreement reached at a later stage between Russia and Saudi Arabia for production cuts, the oil has bounced back to certain

[3] Johns Hopkins University

extent. Recovery in oil prices and re-opening of economies in a phased manner led to recovery in the GCC stock markets, however Dubai, Bahrain and Kuwait are still lagging with YTD returns of worse than -15%.





Source: Refinitiv; Note: Current value has been rebased to 100; 52-week high and 52-week low have been exhibited relative to that; YTD performance exhibited on X-axis labels

Given the impact that the lockdown measures had on businesses, many sectors are expected to report declining profitability and have announced culling of dividends. In this scenario, the disconnect looks to widen with every bounce of recovery in the stock markets. Overall, although the situation looks to be improving, caution needs to be practised, as experts warn against the second wave of coronavirus, which could spill more troubles for the economies and markets in the near future.

Conclusion

Economies reeling under the COVID crisis needs to take cues from Internationally, acclaimed success stories in terms of lockdown exit options. Among them are countries like South Korea and Taiwan. Some of the common themes emerging from these models include –

- Ramping up testing and deploying technology to better understand local spread or epidemiology, meticulous contact tracing and testing, and collating data to provide tailored insights to communities.
- Greater use of location-specific or cluster-oriented measures instead of blanket lockdowns.
- Methodically following legacy measures such as social distancing, restrictions on mass gatherings, etc., while enforcing sanitation (e.g., use of facemasks in public spaces).

With respect to the GCC, a phased opening may be suitable. A preparatory phase can commence with lockdown de-escalation with minor easing of people movement restrictions, including permitting personal daily walks and physical exercises with prescribed time slots for residents to leave their homes. Then, some businesses can be allowed to reopen, but with appointments only, with people aged over 65 as part of 'vulnerability shielding'.

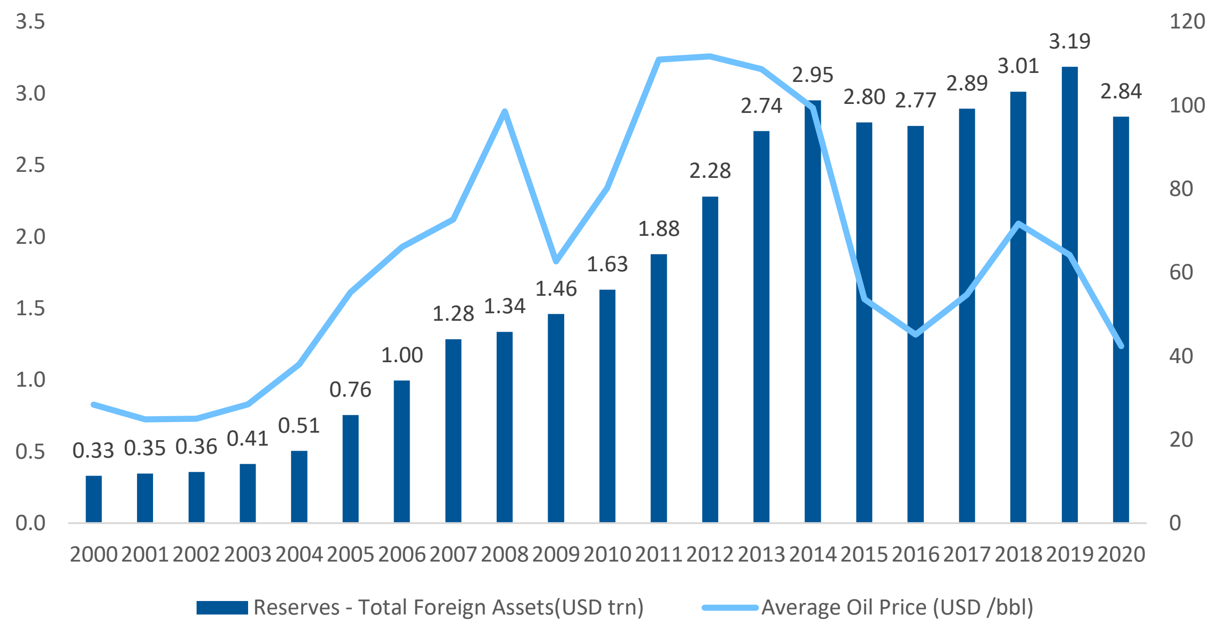
4. COVID-19 brings to the fore GCC's Fiscal Vulnerability

Revenue from oil forms significant portion of overall revenue for GCC countries, with 20-year[4] average at 74%. This dependence on oil as revenue source has long been a pain point for GCC's fiscal position, surfacing during periods of low oil prices and receding during periods of high oil price. In the backdrop of fall in oil prices due to COVID-19, building a sustainable fiscal policy in GCC has resumed higher importance.

Ascend to Prosperity

Referred to as black gold, oil has propelled GCC economies to prosperity. Oil prices have been on the rise from 2000 to 2008 supported by rise in globalization and high growth in countries like India and China. After a blip in prices due to global financial crisis in the 2009, economic recovery on the demand side and geopolitical tensions stressing the supply side sustained high oil prices until 2014. This period has been quite favourable for the GCC countries in terms of building up assets and flourishing as welfare states.

Growth in total foreign assets of GCC countries



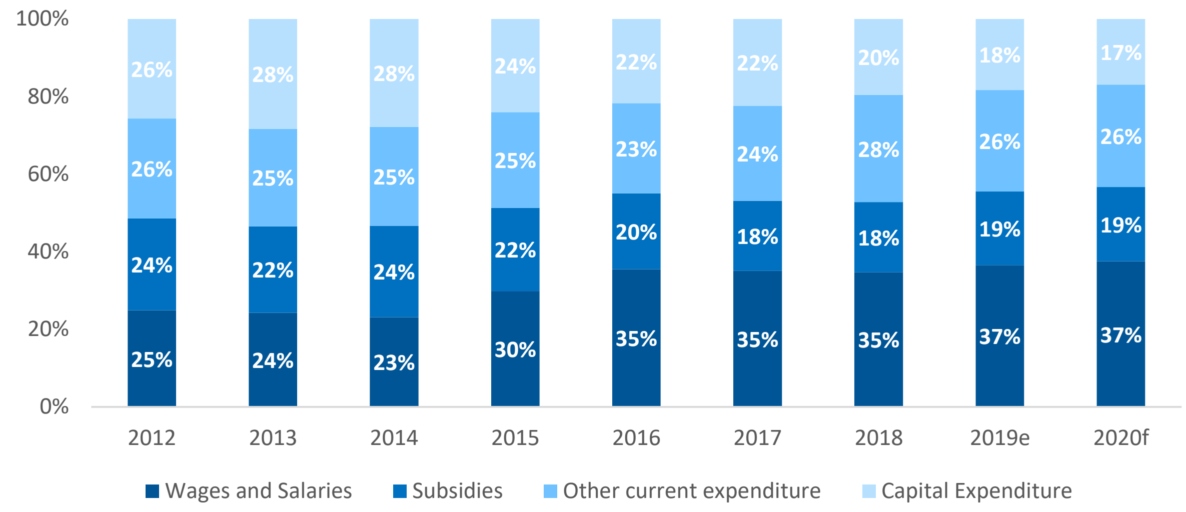
Source: IIF

Fiscal Vulnerability

While the reserves of GCC countries continued to increase in line with revenues, so did the government's expenditure bills. Over the period 2000-2013, while total revenue for all of GCC increased at CAGR of 12.9%, total expenditure increased at a CAGR of 13.1%. The expenditure as percentage of GDP in GCC is higher than the EMs and other oil importers.[5] GCC's fiscal policy was also skewed towards current expenditure, particularly wages and subsidies. This pattern of expenditure made the GCC economies vulnerable in two ways – first, the expenses were based on oil prices, an unstable revenue source; second, less focus on capital expenditure implied minimal economic diversification and continued reliance on oil.

[4] 2000-2019
[5] IMF -2017

Expenditure break up of GCC countries(2010-2020f)



Source: IIF;

On the back of increase in shale oil supply and slowdown in economies like China, oil prices started to fall in 2014 and reached their trough in 2016. With fall in revenues and elevated expenditure levels, all GCC countries, except Kuwait, posted fiscal deficit from 2015-2017. Kuwait had managed to return to surplus in 2016, from fiscal deficit in 2015, by reducing current expenditure. There was considerable increase in government debt for the GCC countries by 2016. While some countries across the world do run on deficit budgets, vulnerability of GCCs' fiscal position arises from its lack of stable revenue base and singular dependence on oil revenues.

Fiscal Balance, Reserves and Government Debt (as % of Nominal GDP)

	Fiscal Balance				Total Foreign Assets (Reserves)				Government Debt			
	2000	**2013**	**2016**	**2019e**	**2000**	**2013**	**2016**	**2019e**	**2000**	**2013**	**2016**	**2019e**
Oman	9.5	3.4	-21.1	-9.3	30.6	59.9	66.7	54.7	20.5	4.9	30.2	61.4
Bahrain	7.6	-3.4	-13.5	-6.5	34.4	55.2	46.4	44.2	N.A	43.2	82.4	97.9
KSA	3.2	5.6	-17.2	-4.5	38.9	139.1	125.9	113.7	86.7	2.1	13.6	22.8
UAE	10.4	8.4	-2.0	1.0	149.4	192.1	248.4	268.3	N.A	15.8	19.3	23.0
Qatar	4.8	19.3	-9.2	1.3	99.5	169.0	266.3	237.3	55.5	33.1	46.7	40.7
Kuwait	46.8	35.6	0.9	4.8	193.2	314.1	559.5	530.0	21.8	3.2	11.2	12.7
GCC	**9.9**	**10.8**	**-11.0**	**-4.0**	**87.3**	**168.8**	**203.8**	**195.7**	**N.A**	**10.2**	**21.0**	**27.5**

Source: IIF

Periods of rising oil prices from 2000-13, did provide an opportunity to diversify into a non-oil economy and increase job opportunities. Though efforts had been made to improve non-oil economy such as national development plans enabling diversification through infrastructure development and improving ease of doing business to promote private sector growth, much more had been required to have fully capitalised on the period of high revenue.

After the 2016 crash, though prices recovered, they did not touch pre-crash levels. But government expenditure continued to remain high. For example, in Kuwait, it is difficult to rein in expenses on wages and subsidies that form a major portion of total expenditure. This has left the economies much weaker to face COVID-19 and resultant fall in prices, than they were before the 2014-16 crash.

Challenges due to COVID-19

COVID-19 has highlighted the vulnerabilities in the fiscal position of GCC countries.

1. COVID-19 has brought out a dual crisis. On the one hand, there is increased expenditure on measures to contain spread of the virus and on fiscal stimulus to provide support to livelihoods and businesses affected by the lockdown. On the other, revenues have been affected by the fall in oil prices on the back of lockdown measures to contain spread of COVID-19.
2. Uncertainty over duration of COVID-19 also contributes to uncertainty over the fiscal health of the GCC countries and makes their fiscal planning difficult.
3. Moving away from oil would require significant investments in the non-oil sector. As revenues fall due to low oil prices, the inclination and the ability in making such investments is curtailed. For example, in 2014-16, significant cuts were made in capital expenditure.
4. Additionally, in the face of COVID-19, non-oil sectors have also slumped and might take time to recover despite investments. For example, tourism was one of the thrust areas amongst non-oil sectors. But with travel restrictions, the sector has been severely impacted.
5. With the current period of low oil prices coinciding with a global recession, fiscal consolidation has to be balanced against growth and employment considerations. With livelihoods of people already affected by COVID-19, implementing cuts to wages and subsidies might not be viewed favourably.

The way forward

The future of oil has become more uncertain in the face of COVID-19. Changes brought about by COVID-19 in terms of reduced globalisation as supply chains are being localised, less travelling due work from home and video-conferencing and shift towards cleaner energy sources might impact demand for oil. There are also forecasts of high, though unsustainable, oil prices. This is based on the cyclical nature of the industry, wherein oil production cuts during period of low prices cause deficit, thereby pushing up prices of the commodity.

However, there is wide consensus that global oil demand is set to decline in the long term, re-iterating need for fiscal reforms. Expenditure cuts by Kuwait, Oman etc. and tripling of value added tax by Saudi Arabia are some of the recent measures undertaken by the countries to shore up finances. Other measures that could be implemented are,

1. Reducing current Expenditure
    a. Targeted subsidy programs to the truly needy, while being effective would also reduce burden on state finances. The subsidies and transfers could also be anchored to oil revenue until a more stable revenue system like taxation is implemented.
    b. Reforms to reduce burden of the wages bills on budget by reducing premium on public sector wages, restructuring of public sector, encouraging and facilitating private sector employment etc.
2. Sustained implementation of consolidation measures is important. While the countries had implemented expenditure cuts during oil price crash of 2014-16, the reduction was sustained only by Qatar. This is observed particularly in Saudi Arabia and Bahrain, where the current expenditure in 2019 is estimated to be up by 23.5% and 6.6% from their 2014 levels.
3. Diversifying into non-oil economy driven by private sector
    a. Capital expenditure has seen significant decline since 2014, except in Kuwait and Qatar. This reduction in capital spending has more pronounced negative impact on growth.[6] Hence, investments could be channelled into revenue-generating non-oil sectors.

[6] IMF

b. A drawdown from GCC countries’ considerable reserves to prop up the economy could be considered.
c. Public Private Partnerships and Foreign Direct Investments could aid in private sector growth.

While periods of high oil prices provide less incentive to diversify, periods of low oil prices provide less room to do so. Exiting this vicious cycle would ensure sustainable growth to prosperity in GCC. The current times reinforce the urgency of reforms and could aid in hastening their implementation.

5. GCC economic measures to contain COVID-19 has mostly been monetary so far

The COVID-19 led health and economic crisis has pushed many governments around the world to respond with a wide armour of fiscal and monetary actions that far exceed the measures taken in the past when the Global Financial Crisis happened in 2009. The measures were announced in a quick and concerted manner across the developed countries, emerging countries, and less developed countries. GCC countries also acted with alacrity in providing stimulus measures:

- to meet the COVID-19 Impact that hit them with lower global Oil prices,
- economic output fall in various sectors of the non-oil economy consequent to lockdowns imposed on citizen movements and production and service facilities to limit the spread of the virus; and
- lower trade resulting from COVID-19 impact on the economies of their trade partners.

Types of stimulus measures provided by economies world over

The economic stimulus measures across the globe comprised of monetary policy measures like interest rate cuts, Central Bank liquidity support, Central Bank swap lines, and Central Bank asset purchase programs of both Government securities as well as corporate bond purchases by the United States. Financial policy stimulus measures were easing banks' capital buffers, capital adequacy ratios, liquidity requirements, risk weights for some asset categories and provisioning requirements. Stimulus actions also included direct cash transfers to citizens in lower income categories and financial reliefs for borrowers in the form of postponement/ moratorium for instalments and interest, restructuring of loans and credit guarantees support. Lastly, the measures included administrative/ regulatory measures like extending deadlines for compliances and submissions of tax and other government payments, waiver of various types of government and bank fees etc.

Size of COVID-19 stimulus measures across the World

The total global monetary and fiscal measures to fight COVID-19 Impact are estimated at USD 20.4 trillion comprising Central Bank liquidity injection of USD 10.4 trillion and government fiscal stimulus of USD 10.0 trillion. These stimulus measures provided by major countries are as shown in the table below:

Stimulus measures to tackle COVID-19 crisis

Country/Region	Fiscal Stimulus (% of GDP)	Monetary Stimulus (% of GDP)
United States	13.9%	3.3%
Japan	42.2%	6.3%
China	4.1%	6.8%
GCC Countries		
Saudi Arabia	3.2%	4.0%
Qatar	13.0%	5.7%
United Arab Emirates	2.0%	17.4%
Kuwait	1.4%	11.7%
Oman	n.a	27.3%
Bahrain	5.5%	28.7%

Source: IMF; Ceyhun Elgin (Columbia Economic Professor); Note: Policy measures as of June 25, 2020

GCC countries mainly provided monetary stimulus restrained by budgetary deficits

The GCC countries are impacted internally by economic lockdown to counter COVID-19 as well as by the external impact from COVID-19 influence global economies that led to sharp fall in oil Prices. Consequently, the GCC economies are expected to face large budgetary deficits in 2020. However, this may not be new to GCC countries, which faced a similar crisis though of somewhat lesser proportion in 2009 and 2016 when oil prices plummeted. To stave off a hit to their non-oil sectors to the extent manageable they announced a string of measures in the form of fiscal stimulus, monetary stimulus, cash supports, and regulatory measures targeted at the non-oil sectors.

Bulk of GCC countries stimulus is through monetary measures

The GCC countries have provided large monetary stimulus packages in the form of Central Bank interest rate cuts by almost all the countries and liquidity support to its banks in the form of reduction in liquidity ratios, capital adequacy ratios and risk weights for some category of assets like MSMEs and higher lending ratios to their important non-oil sectors like real estate.

Saudi Arabian Monetary agency (SAMA) provided USD 13.3 billion support to banks for funding the private sector particularly SMEs. In addition, SAMA is supporting banks to defer loan instalments by three months. Central Bank of UAE has provided monetary stimulus of USD 70 billion (17.4 % of GDP) to the banks and credit guarantees and allowed deferral of loan instalments until end 2020. Qatar Central Bank is providing support for extending loan instalment deferral to borrowers for six months. Central Bank of Kuwait has provided Monetary stimulus in the form of lower Liquidity ratio and lower Capital Adequacy Ratio to release funds (estimated at around USD 16 billion) to fund deferral of loan instalments for individuals and for affected borrowers for six months, subsidized funding for SMEs and extend additional loans to borrowers. Central Bank of Oman has extended Liquidity support of USD 20.3 billion (27.3% of GDP) to the banks which will fund the deferral of loan instalments for borrowers for six months and extend additional lending to borrowers. Central Bank of Bahrain has extended Liquidity measures of USD 9.8 billion (28.7% of GDP) to meet funding for deferral of loan instalments for borrowers for six months and provide new loans.

Other stimulus measures provided by GCC countries

Saudi Arabia provided other measures like wage benefits to companies, utility subsidies, and suspension of some government taxes and fees. UAE also announced electrical and water subsidies, among others. Kuwait set up a USD 31 million fund to combat COVID-19. Qatar is providing exemption of rent payments and utility payments and salaries to quarantined migrant labor. Oman has waived port and airfreight charges and rent payments in industrial zones. Bahrain waived electricity and water bills for Bahraini individuals and companies, social benefits to low income Bahraini families and payments to unemployed Bahrainis in the private sector.

Overall, their strained budgetary position may explain GCC countries' comparatively much smaller size of COVID-19 fiscal stimulus measures.

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