

# Economic Research

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## *Economic Monitors: Gulf Cooperation Council (GCC) Brief Notes*



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**Nor Zahidi Alias**  
Chief Economist  
+ 603 2092 5398  
[zahidi@marc.com.my](mailto:zahidi@marc.com.my)

**Mohd Afzanizam Abd. Rashid**  
Economic Analyst  
+ 603 2092 5398  
[afzanizam@marc.com.my](mailto:afzanizam@marc.com.my)

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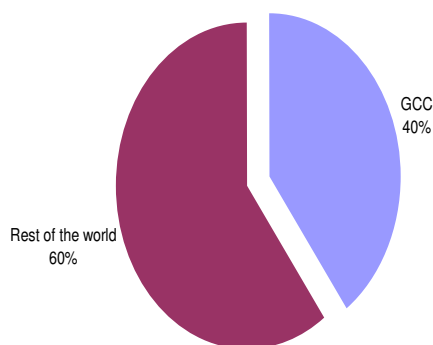
## Economic background

The Gulf Cooperation Council (GCC) was founded on May 25, 1981 with the intention to forge a close alliance among its six member states; Bahrain, Oman, Kuwait, Qatar, Saudi Arabia and United Arab Emirates (U.A.E). Following its formation, the member states signed an agreement to establish the GCC Free Trade Area in November 1981. In an effort to foster further economic integration, the member states agreed on December 31, 2001 to a revised economic agreement and to put in place a Common Market and Economic and Monetary Union by 2010.

Among the strengths of GCC is the common language, shared cultural and political history of its member countries. In addition, the region jointly account for about 40% of global oil reserves and 23% of natural gas reserves. According to the International Monetary Fund (IMF), oil and gas production in these countries contribute about one half of total gross domestic product (GDP) and three-fourths of their total exports and annual government revenues.

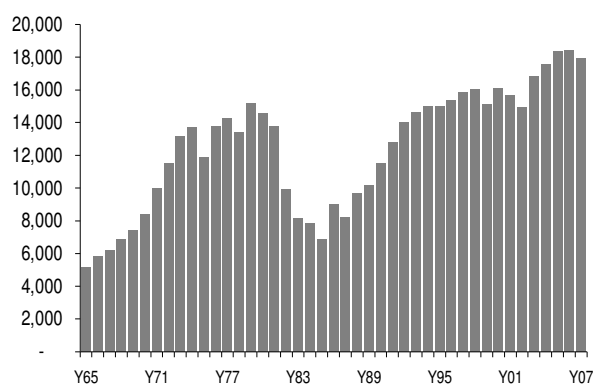
Up until mid-2008, the GCC economy benefited immensely from the sharp rise in crude oil prices which surged to nearly US\$150 per barrel. Between 2001–2007, average GDP growth for the member states climbed to 5.4% from 3.8% during 1991–2000 and 0.6% during 1981–1990. Similarly, fiscal and current accounts have recorded sizeable surpluses of 10.6% and 18.9% of GDP respectively for the period between 2001 and 2007, after registering continuous deficits in the preceding decade.

**Chart 1: Share of global oil proved reserve in 2007**



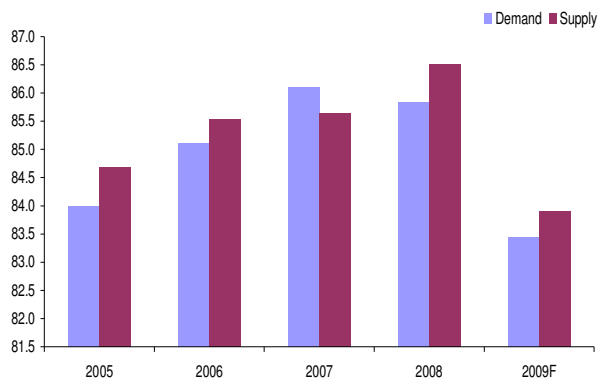
Source: BP Statistical Review 2008 & MARC Economic Research

**Chart 2: GCC oil production in thousand barrels daily**



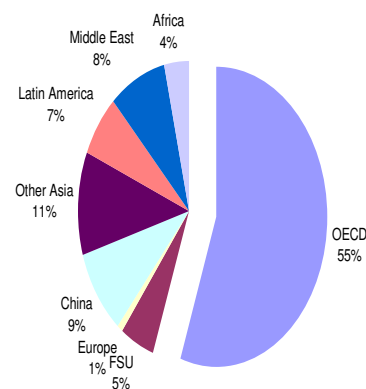
Source: BP Statistical Review 2008 & MARC Economic Research

**Chart 3: Global oil demand and supply in million barrels per day**



Source: International Energy Agency (IEA)

**Chart 4: Share of global oil demand in 2008**



Source: International Energy Agency (IEA)

## Key issues

**Persistently low oil prices** – Oil exports accounted for 75.7% of total exports in 2007, up from 59.9% in 1998, and at the same time made up 79% of government's revenue in 2007 (1998: 54.1%). Since the decline of oil prices have declined from as high as US\$147 per barrel in mid-2008 to as low as US\$31 per barrel in December 2008, economic growth prospects for the region has dimmed as countries struggle to complete some of their massive infrastructure and property projects launched during the boom. As a result, many private forecasters have revised down GDP growth forecasts for the region. While recent views of a possible economic turnaround to take place in the near term amid signs of stabilization in the US and emerging economies, oil prices are likely to remain well below their 2-year average of circa US\$86 per barrel.

**Plunging property prices** – In the wake of global economic turmoil that resulted in widespread credit crunch, property prices have declined dramatically in the region. The first symptom of trouble in the property sector emerged in the 4Q2008 when property values in highly sought after areas in Dubai fell by 8% according to a property consultant, Colliers International. By 1Q2009, deterioration occurred as further house prices in Dubai plummeted by 41%. It was also reported that a massive 39% drop in average office sales took place between 3Q2008 and 1Q2009 while residential rental rates declined by 20%-40%. Similarly in Abu Dhabi, the capital value of residential property launched in 2Q2008 dropped by an average 20% while office rentals slipped by 24% between 3Q2008 and 1Q2009. It is believed that primary reasons for the decline in property prices in the region are the lack of mortgage availability, job losses among expatriate workers, delayed projects and poor investor sentiment.

**Declining budget and current account surpluses** – Weakening economic conditions have prompted policy makers to embark on expansionary fiscal policies through higher infrastructure spending, increase in wages and salaries and higher subsidies. However, the relatively low level of oil price is expected to lead to a budget deficit of between 4% and 6% of GDP in 2009 for the region, according to a consensus survey. Similarly, current account surpluses, which had surged to 25.8% of GDP in 2007 from an average of 9.4% of GDP in 2001, are likely to decline sharply in 2009. However, this is expected to improve when oil prices move back to above its long-term trend line of a 1 standard deviation (between US\$60 – US\$75 per barrel).

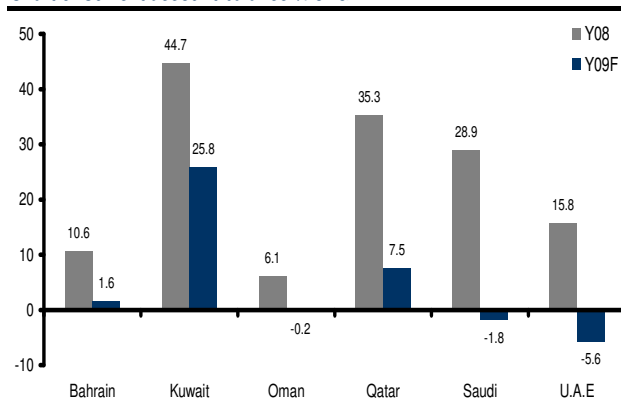
**Establishment of Monetary Union** – With 2010 looming as the date for the formation of GCC Monetary Union, the critical decision to be made will be the setting of an appropriate exchange rate regime for a single currency. Except for Kuwait – which has pegged its currency to an undisclosed basket of currencies – other GCC members currently peg their currencies against the USD, and have agreed to maintain the peg until the establishment of GCC Monetary Union. As was the case in the Euro region in 1999, macro stability may be slightly affected during the initial phase of the establishing the GCC Monetary Union.

Chart 5: West Texas Intermediate (USD per barrel)



Source: Bloomberg & MARC Economic Research

Chart 6: Current account balance % of GDP



Source: IMF World Economic Outlook, April 2009

## Mitigating factors

**Fiscal expansionary policies** - Fiscal policy response has been forthcoming in the region and is considered to be the main stabilization tool for the economy. Accumulated surpluses in government budgets in the past years have been used for various fiscal measures to support domestic economic activities. In Bahrain, apart from the planned infrastructure projects, the government will be financing new housing projects as part of the measures to boost the economy. In the UAE, the federal and Dubai governments have announced fairly sizeable increases in planned expenditures for 2009 (+24% and +9% respectively).

**Strong trade linkage with emerging Asia** - GCC's economy is increasingly integrated with Asia and is now less dependent on advanced economies such as the US and European Union. As such, the GCC economy is set to benefit from Asia's expected recovery in 2010. Exports to Asia accounted for 58% of total trade in 2006, up from 37% in 1981, while exports to Europe and the US have declined to 10% and 9% respectively in 2006 (1981: 35% and 11% respectively). Recent development suggests that China's economy, while remaining below its potential rate, has shown signs of a recovery as the impact of huge stimulus package have started to kick in. China's fixed asset investment leapt by 30.5% in the four months to April compared to a year ago, offsetting its exports which declined by 22% in April. As a result, Asian exports to China will likely improve in the coming months and as the latter is anticipated to recover earlier than developed nations, further collapse in demand from Asia is unlikely. This provides a much needed buffer for the GCC countries.

**Table 1: Direction of trade, selected years (Share in percent)**

|                                     | 1981       | 2001       | 2006       |
|-------------------------------------|------------|------------|------------|
| <b>Exports to World</b>             | <b>100</b> | <b>100</b> | <b>100</b> |
| of which:                           |            |            |            |
| Exports to United States            | 10.5       | 11.2       | 8.8        |
| Exports to European Union           | 35.4       | 10.2       | 10.1       |
| Exports to Asia (including Japan)   | 37.3       | 56.4       | 57.8       |
| Exports to GCC                      | 1.3        | 1.9        | 4.8        |
| <b>Imports from World</b>           | <b>100</b> | <b>100</b> | <b>100</b> |
| of which:                           |            |            |            |
| Imports from United States          | 17.8       | 12.5       | 11.4       |
| Imports from European Union         | 35.2       | 32.5       | 31.9       |
| Imports from Asia (including Japan) | 29.1       | 29.9       | 34.8       |
| Imports from GCC                    | 7.8        | 8.9        | 7.9        |

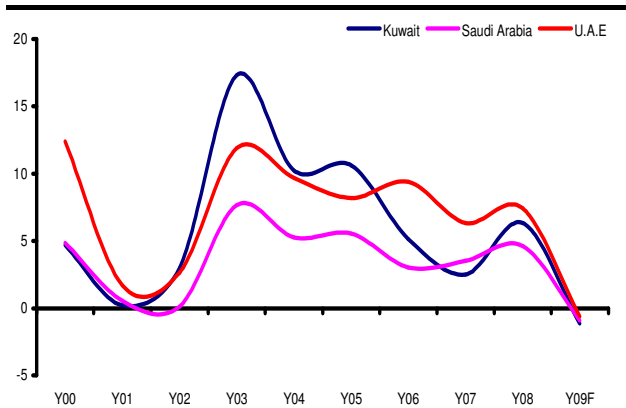
Source: IMF

## Economic prospects in 2009 and 2010

**Heightening risk of recession** - GCC's economy is set to post a marginal growth or may register a slight contraction in 2009, largely on account of a reduction in oil production following an agreement among OPEC members in November last year to reduce production and the impact from ongoing recession in the global economy. However, expansionary fiscal policy, coupled with accommodative monetary stance will buffer the economy from experiencing a deep contraction in 2009. The prospects for recovery hinge critically on global economic conditions, which at this juncture appears to have stabilized. In its latest forecast, the IMF foresees the global economy to contract deeper by 1.3%, compared to January's forecast of a 0.5% expansion, signaling that growth prospect remains bleak for this year. The institution anticipates the economies of Saudi Arabia, U.A.E and Kuwait to contract between 0.6% and 1.1% in 2009. On contrary, Qatar's economy is expected to maintain a strong growth of 18.0% owing to its production of natural gas which is expected to double this year. Meanwhile, Oman and Bahrain are set to post slower growth rates of 3.0% and 2.6% in 2009 after growing by an average 5.4% and 6.3% respectively since 2000. Going forward, however, the prospects for GCC economies would be less subdued as global de-leveraging process subsides and domestic economy responds to fiscal and monetary measures. By 2010, the GCC is expected to register a positive growth in 2010.

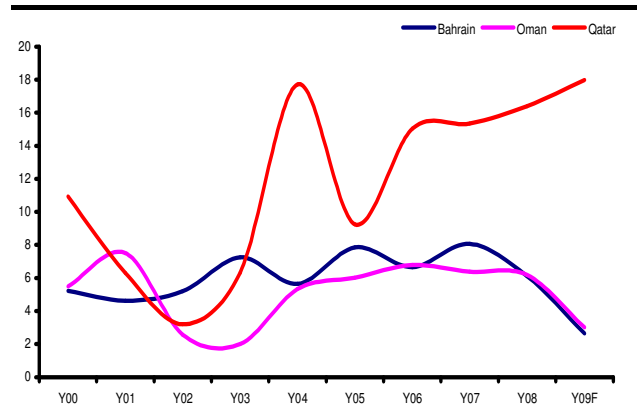
**A critical factor for the region is the development of oil price in the near and immediate term** - By May 2009, oil prices surged to the highest level in six-months following signs that the pace of global economic deterioration has moderated. Consequently, benchmark crude prices hit US\$58 – US\$60 per barrel. Similarly, oil futures climbed higher in tandem with a recovery in global financial markets. Notwithstanding, oil fundamentals remain weak according to the IEA which trimmed its forecast for global demand by 0.2 million barrels per day (mb/d) to 83.2 mb/day in May. This suggests a 2.6 mb/d or 3% less than the level in 2008 and represents the sharpest drop since the second oil shock in the early 1980s. Forecast for global oil supply on the other hand has been raised to 83.6 mb/day, up 230 kb/d following higher supply from non-OPEC countries. In the medium term, however, oil prices are likely to respond to better economic conditions in 2010. As such, we believe that the current oil price is well below its long-term trend and will eventually normalize within its long-term price band of US\$60 and US\$75 per barrel by 2010.

Chart 7: IMF forecast



Source: IMF World Economic Outlook, April 2009

Chart 8: IMF forecast



Source: IMF World Economic Outlook, April 2009

## Appendix

## GCC Countries: Selected Economic Indicators, Selected Years

|   | 1998   | 2001   | 2004   | 2007   |
|---|--------|--------|--------|--------|
| <b>Per capita GDP</b> (In US dollars)                             |        |        |        |        |
| Bahrain   | 9,660  | 11,720 | 15,601 | 22,271 |
| Kuwait  | 11,425 | 15,114 | 21,567 | 33,687 |
| Oman  | 6,467  | 8,221  | 9,994  | 15,714 |
| Qatar   | 18,306 | 27,030 | 41,949 | 78,754 |
| Saudi Arabia  | 7,484  | 8,736  | 11,127 | 15,724 |
| U.A.E.  | 17,119 | 21,685 | 27,595 | 42,501 |
| GCC Average   | 8,967  | 11,000 | 14,595 | 22,426 |
| <b>External current account</b> (In percent of GDP)               |        |        |        |        |
| Bahrain   | -12.6  | 2.8    | 4.2    | 16.7   |
| Kuwait  | 8.5    | 23.9   | 30.6   | 43.1   |
| Oman  | -22.3  | 9.8    | 2.4    | 8.0    |
| Qatar   | -18.7  | 27.3   | 22.4   | 29.2   |
| Saudi Arabia  | -9.0   | 5.1    | 20.7   | 25.1   |
| U.A.E.  | 1.8    | 9.5    | 10.0   | 20.5   |
| GCC Average   | -6.3   | 9.4    | 18.4   | 25.8   |
| <b>Hydrocarbons exports/Total exports</b> (In percent)            |        |        |        |        |
| Bahrain   | 44.2   | 56.4   | 54.2   | 63.4   |
| Kuwait  | 74.4   | 83.6   | 82.1   | 81.9   |
| Oman  | 63.1   | 76.0   | 77.2   | 73.0   |
| Qatar   | 80.0   | 81.2   | 78.7   | 83.4   |
| Saudi Arabia  | 74.6   | 81.7   | 83.7   | 85.0   |
| U.A.E.  | 35.4   | 46.2   | 40.8   | 44.7   |
| GCC Average   | 59.9   | 70.1   | 69.0   | 75.7   |
| <b>Hydrocarbons exports/Total government revenue</b> (In percent) |        |        |        |        |
| Bahrain   | 50.2   | 71.3   | 73.8   | 80.0   |
| Kuwait  | 58.7   | 68.7   | 77.1   | 76.7   |
| Oman  | 70.4   | 83.2   | 84.0   | 79.8   |
| Qatar   | 49.9   | 68.4   | 66.0   | 60.7   |
| Saudi Arabia  | 56.6   | 80.6   | 83.3   | 87.5   |
| U.A.E.  | 49.0   | 71.7   | 73.8   | 74.9   |
| GCC Average   | 54.1   | 77.3   | 79.5   | 79.0   |

Source: IMF

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