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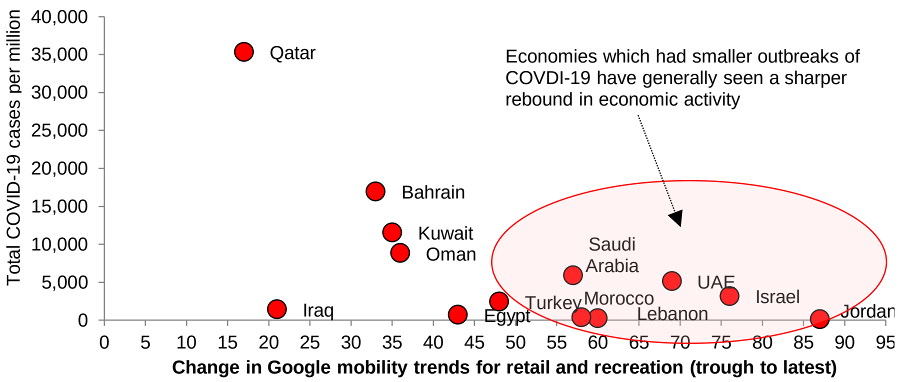
Prospects for the MENA region in the second half of 2020 – the path to the next normal

- Lockdowns and social distancing measures continue to ease across the MENA region as authorities attempt to strike the delicate balance between limiting further damage to their economy's weighed against health risks. The reopening of economies are coming at a time when the number of COVID-19 infections across the region (and globally) are still rising. The second wave of virus infections in Iran, Saudi Arabia and Israel, as well as the precipitous increase of the current first wave in Iraq and Oman, is particularly concerning. The outbreak in other parts of the region appears to be more under control while in Jordan, Lebanon and Tunisia, the number of cases has virtually ground to a halt.
- As far as our regional forecasts are concerned, our base case assumes that we continue on a path of tentative and occasionally interrupted re-opening, rather than seeing further iterative waves of the pandemic that forces a return to draconian lockdowns. However, that does not mean there will be no lingering impact on consumer behaviour from the pandemic or no permanent economic damage from the measures put in place to contain it. Far from it. Our forecasts point to a region which, by end 2021, has a level of activity that is not just well below its pre-pandemic growth trajectory but, in many cases, still below its end 2019 level. We forecast deep recessions across almost all MENA regional economies, with overall real GDP growth to contract in 2020 by -5.6% from +0.2% in 2019 (GCC region to fall -3.9% in 2020 from +0.6% in 2019).
- Despite the phased easing in lockdown restrictions, the region is by no means out of the woods, but these economies have passed the nadir in economic contraction. Looking ahead, there is much about the pandemic that we can't be sure of. Iterative virus waves certainly cannot be ruled out. Though, one actuality is clear – debt ratios will be higher – for individuals, corporates, and especially for governments as well as government related entities (GREs). In the absence of strong growth, there are only so many ways the latter can be addressed: austerity, default, inflation or taxation. Across the region, we are likely to see some mixture of all of these in some scope, magnitude and various timeframes.

TOTAL COVID-19 CASES PER MILLION VS. CHANGE IN GOOGLE'S RETAIL AND RECREATION MOBILITY TRENDS (TROUGH TO LATEST)



Source: Google, John Hopkins University, ourworldindata.org, MUFG MENA Research

Prospects for the MENA region in the second half of 2020 – the path to the next normal

Reopenings versus health risks

Lockdowns and social distancing measures continue to ease across the MENA region as authorities attempt to strike the delicate balance between limiting further damage to their economy's weighed against health risks. As far as our regional forecasts are concerned, our base case assumes that we continue on a path of tentative and occasionally interrupted re-opening, rather than seeing further iterative waves of the pandemic that forces a return to draconian lockdowns. However, that does not mean there will be no lingering impact on consumer behaviour from the pandemic or no permanent economic damage from the measures put in place to contain it. Far from it. Our forecasts point to a region which, by end 2021, has a level of activity that is not just well below its pre-pandemic growth trajectory but, in many cases, still below its end 2019 level. We forecast deep recessions across almost all MENA regional economies, with overall real GDP growth to contract in 2020 by -5.6% from +0.2% in 2019 (GCC region to fall -3.9% in 2020 from +0.6% in 2019).

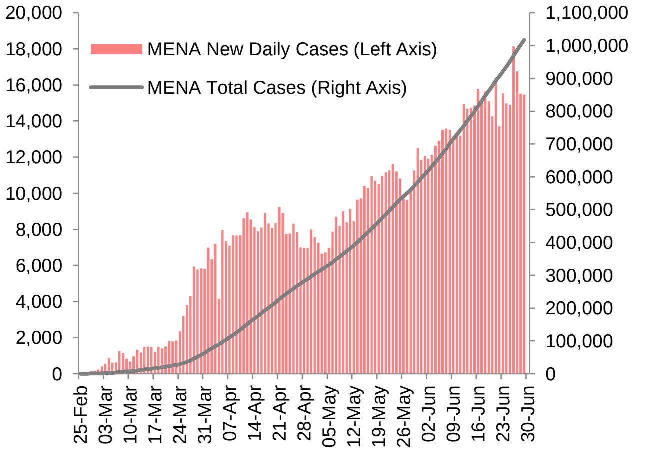
Twin shocks have been unprecedented but our confidence in MENA regional oil exporters is growing

The MENA exporters, which comprise more than 80% of regional GDP, have grappled with shocks to both the demand-side (COVID-19 induced consumption evisceration) and the supply-side (lower oil prices and oil production curbs). Facing either one of these shocks would be unprecedented. The combination of the two, signals an acute recession in 2020. However, our confidence in these economies capacity to weather the losses has strengthened recently. Part of our rationale is explained by the firming in global oil markets, with a combination of recovering demand and OPEC+'s success in its oil market management strategy in supporting oil prices to recover to witness the best quarter since 1990 in Q2 2020 (US WTI crude). Whilst we have consistently remained resolutely long oil since early May (see here and here), the price rebound has been striking and ahead of our above consensus expectations, and we believe that with supply below demand, the market deficit has carved out a cyclical bottom in prices (Brent ~USD35/b; WTI ~USD30/b).

Entered the crisis from a position of strength

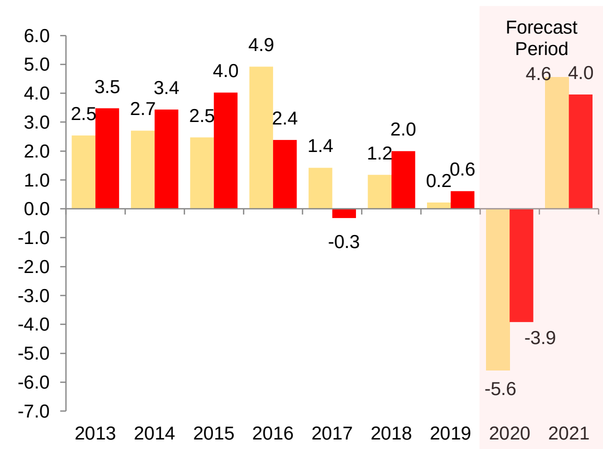
Moreover, most MENA oil exporters have proven effective in using their large accumulation of wealth in recent decades to offset the impact of lower oil receipts, drawing down savings and leveraging their balance sheet to retain access to

MENA DAILY NEW CASES AND TOTAL CASES OF COVID-19 INCIDENCES



Source: John Hopkins University, ourworldindata.org, MUFG MENA Research

MENA AND GCC REGIONAL REAL GDP GROWTH (%)



Source: MENA National Statistical Offices, IMF, MUFG Research international credit markets. Coupled with easing liquidity constraints, this has allowed these oil exporters to comfortably fund large budget shortfalls, notably in Saudi Arabia, Kuwait and the UAE, without building pressures on their currencies or on local rates. We expect this to continue, and see no meaningful threat to fiscal stability, or to the maintenance of the US dollar (USD) peg FX regime.

Data has rebounded – albeit from record lows recorded during April's nadir – though recovery remains uneven and heterogeneous

As lockdowns in many parts of the region have been easing, it's no surprise that much of the data has picked up off their record lows. PMIs for May and June continue to demonstrate that the rebound in corporate conditions is ongoing and high frequency data in terms of mobility as well as spending have recovered somewhat. However, the recovery remains uneven and heterogeneous. Google's mobility data shows that while the amount of time spent at retail and recreational venues has increased in all of the regional economies, the pace of recovery has in fact varied.

Spending patterns are showing through but uncertainty abound

This weakness could simply be a delayed reaction in some countries, signalling there could be an improvement in the next week(s) of data but a revival in this area of spending is apparent. Though, it is not just a function of whether restaurants re-open, but whether individuals feel comfortable returning to them. Bahrain was one of the first developed economies to relax its own lockdown restrictions and over the course of the following weeks diners returned to restaurants as they re-opened. However, in Kuwait for example, where the lockdowns have been most stringent, there has not been the same snapback in restaurant sales.

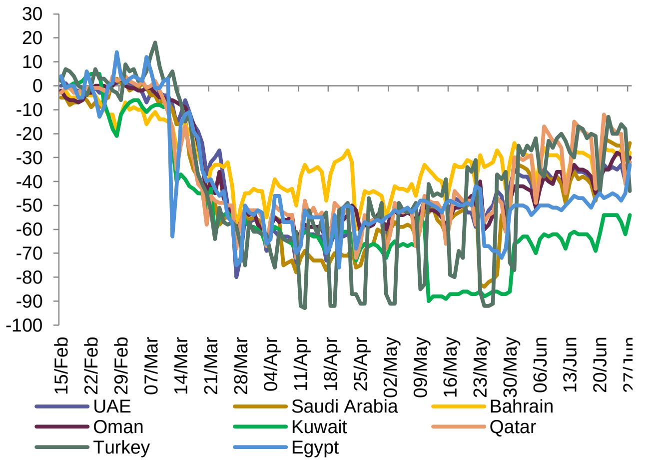
Fear and caution felt but some consumers

Restaurant spending is not the only consumer-facing area where it is not so much the pace of re-opening that will determine the rate of recovery but the extent to which the "fear" or caution felt by consumers completely subsides. Indeed, our examination suggests that it is the places with the lower case load that have seen the mobility data snap back more quickly, signalling that a smaller outbreak may mean that consumers have less fear about returning to crowded places. Thus, we have seen a sharp bounce in activity in the likes of the UAE, Jordan and Israel. Of course, some of regional economies are still in the midst of their outbreaks, and it may take longer for a recovery in sectors where large gatherings of individuals are part of them.

Central Banks financial system liquidity and corporate support schemes is showing up in credit growth data

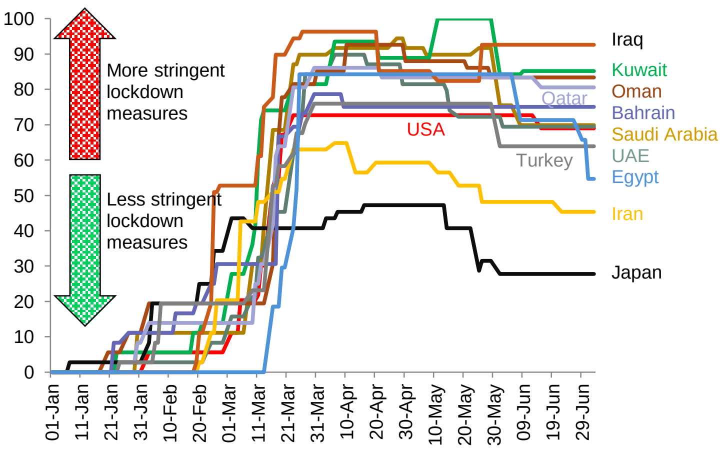
Beyond the PMI readings and Google's mobility data highlighting consumer spending, regional Central Banks financial system liquidity and corporate support schemes is showing up in credit growth data. The initial policy response across the

GOOGLE MOBILITY DATA: RETAIL AND RECREATIONAL VENUES*



*Source: Google, MUFG MENA Research; * Google mobility's retail and recreation data estimates the frequency of trips to shops and leisure locations compared to a baseline from before social distancing measures were introduced*

STRINGENCY INDEX (0-100; 0 = LEAST STRINGENT; 100 = MOST STRINGENT), GCC REGION, US AND JAPAN



Source: Oxford University, MUFG MENA Research

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region was led by Central Banks, focusing on financial system liquidity as well as direct corporate support to minimise the economic fallout. The UAE's USD70bn Targeted Economic Support Scheme (TESS) alongside the USD26bn stimulus provided by SAMA to the banking sector to facilitate financing both demonstrate that such actions have channelled through into a sharp rise in lending growth. Whilst the precise composition and magnitude of new lending provided under these packages is unclear, the surge in lending suggests that the authorities' efforts to offset the economic fallout of the oil-virus shocks are bearing fruit.

Rebound will be slow

Broadly speaking, MENA regional governments are tentatively re-opening their economies, even some of those where the COVID-19 infection rates are still elevated or even accelerating. Until the pandemic is contained globally though, there are certain parts of the region that will be very slow to recover. Even countries that have already brought the virus under control will not see travel and tourism normalise while in those countries where infection rates are still high, many consumers will be reluctant to return to pre-pandemic spending on consumer-facing services.

Activity will not return to pre-COVID-19 levels in some parts of the region even before 2021

Our forecasts point to a region which, by end 2021, has a level of activity that is not just well below its pre-pandemic growth trajectory but, in many cases, still below its end 2019 level of activity, and where unemployment and debt will be materially higher. As we have recently catalogued (see here and here), the conversation is beginning about what the next normal could entail and how sharply its contours will diverge from those that previously shaped the region, but there currently remains more questions than answers. While the region is weathering the storm, the near-term economic outlook remains challenged. Most immediately, the lockdown imposed in response to the pandemic has been far reaching and long. As the domestic economy normalises, growth should recover, bolstered by a pick-up in oil output as OPEC+ production restrictions ease. At ~4.5%, however, the recovery will leave overall output 0.8ppt smaller at the end of 2021 than at the start of 2020.

Policymakers will have to do more

Policymakers are well aware they will have to do more. Fiscal stimulus will have to do the heavy lifting from here, even if backstopped by Central Banks, which will keep interest rates on the floor – in line with the US Federal Reserve (Fed) for pegged exchange rates. On the labour market side, fiscal policy will need to become more flexible and targeted, towards lower-income households which have borne the brunt of the job losses but also towards reskilling workers who will have to seek new jobs to replace the ones that will disappear. However, setting policy optimally will be a major challenge – there are risks from forcing the labour market to adjust too slowly, which could hit future productivity, or too quickly which could jeopardise any nascent recovery. Higher infrastructure spending will likely form a major part of the fiscal support in the medium-term.

Risks abound but going forward, there is hope, tempered with caution

Looking ahead, there is much about the pandemic that we can't be sure of. Iterative virus waves certainly cannot be ruled out. Though one actuality is clear – debt ratios will be higher – for individuals, corporates and especially for governments. In the absence of strong growth, there are only so many ways the latter can be addressed: austerity, default, inflation or taxation. Across the MENA region, we are likely to see some mixture of all of these in some scope, magnitude and in various timeframes. Bottom line – despite the phased easing in restrictions, the MENA region is by no means out of the woods. The past three months have been strenuous and destabilising. The region is steadily looking to life post-COVID-19 towards a path of a new normal, but there currently remains more questions than answers. However, there's room for hope, tempered with caution.

Economic Weekly Round-up

- **Key data and events in the past week**:
- The IMF expects **GCC regional** growth to shrink by 7.6% this year (from its April 2020 assessment of -2.7%) – large deviation stemmed from the IMF's incorporation of sharp OPEC+ production cuts and the broader impact of COVID-19 on non-oil GDP – whilst the IMF does not provide a comprehensive country-by-country assessment in July, it did publicly state that it expect **Saudi Arabia's** growth to contract by -6.8% (from -2.3%), which SAMA's Governor stated to be "more pessimistic" than its own assessment.
- Certain stimulus measures in **Bahrain** are be extended with the government will pay 50% of salaries for insured citizens employed in the private sector (in firms most affected by COVID019) – in addition to bearing citizens' domestic electricity costs for their primary residences. The cost is estimated at USD185m and between USD32-40m, respectively for the two measures
- **Egypt's** currency (EGP) appreciated vis-à-vis the US dollar (USD), supported by positive news like support from the IMF (USD5.2bn), rise in foreign investments in Egyptian T-bills and the resumption of international tourism (albeit at select pockets within the country).
- To comply with the OPEC+ cuts, **Iraq** will reduce crude oil exports from its southern terminals (mainly Basra Light flows) in July – planned exports will be 1.53m b/d, from 3.1m b/d planned in June.
- **Jordan** issued a double-tranche Eurobond last week at competitive rates – USD500m at 4.95% over 5 year maturity and USD1.25bn at 5.85% over 10Y maturity – and it was oversubscribed by more than 6.25x, attracting bids worth over USD6.25bn.
- **Lebanon's** PMI rose to 43.2 in June (37.2 in May), though plagued by slumps in output and new orders amid signs of demand weakness. The rate of workforce contraction reported its quickest pace since Mar while new export orders declined for the fourth consecutive month.
- Talks with the IMF are on hold, disclosed **Lebanon's** Finance Minister, while a "unified approach" is being discussed to define and calculate losses in all sectors.
- Saudi Arabia's economy shrank by 1.0% y/y in Q1 2020 from -0.3% in Q4 2019, largely due to the decline in the oil sector (-4.6%) while the non-oil sector grew by 1.6%.
- The 15% VAT (5% previously) came into effect in **Saudi Arabia** from 1 July.
- The **UAE** merged some ministries and departments on 5 July, in a bid to make the government "flexible, fast and able to keep up with changes". Some of the changes included a phasing out of government services within two years (becoming digital portals instead), merging 50% of federal authorities or adding them to Ministries, and merging ministries among other changes. A strong emphasis has been placed on "agile government", digital policies and food security, with a self-imposed time limit of one year to meet the new priorities.
- **Dubai's** real GDP declined by 3.5% y/y in Q1 2020, against +2.2% growth in full year 2019, as COVID-19 affected businesses in the trade, transport and tourism sectors.
- Dubai World repaid the final USD8.2bn of the debts, two years ahead of the agreed schedule. This is a sound, pre-emptive move by Dubai given economic and financial market uncertain prospects.

- **Key focus in the week ahead**:

1. **Qatar** real GDP for Q1 2020 and **Saudi's** Q1 2020 unemployment rate.
2. In **oil markets**, the IEA's monthly report.

Economic Calendar and Forecasts

Upcoming Events and Data Releases								
Date		**Country**	**Event**	**Period**	**Consensus**	**MUFG* Forecasts**	**Actual**	**Previous**
06/07/2020		Qatar	PMI Composite	June 2020	---	---		36.6
07/07/2020		Saudi Arabia	Unemployment Rate, %	Q1 2020	---	---		12.0%
07/07/2020		Qatar	Real GDP	Q1 2020	---	---		-0.6%
09/07/2020		UAE	Dubai PMI Composite	Jun 2020	---	---		46.0
10/07/2020		Turkey	Unemployment Rate, %	April 2020	---	---		13.2%
10/06/2020		Egypt	Real GDP	Q1 2020	---	---		4.2%

** MUFG MENA Research*
Source: Bloomberg, Refinitiv, MUFG MENA Research

MENA Market Indicators – Tables

Benchmark Bond Yields (%, Local Currencies)

	Maturity	26-Jun	03-Jul	Change in Yield (bps) Week	MTD*	YTD*
Advanced Countries						
US	10 yrs	0.64	0.67	2.8	1.3	-124.8
Germany	10 yrs	- 0.48	- 0.43	5.0	2.2	-24.7
Italy	10 yrs	1.29	1.26	-3.7	-0.3	-15.7
Japan	10 yrs	0.01	0.03	1.6	0.0	3.9
MENA Countries						
Bahrain***	3 yrs	3.91	3.83	-7.7	-13.5	84.5
Egypt	4 yrs	13.57	13.55	-1.0	-0.8	-0.1
Qatar***	10 yrs	2.34	2.14	-19.6	-10.2	-51.1
Saudi Arabia**	10 yrs	2.09	2.11	2.2	1.0	-92.9
Abu Dhabi***	7 yrs	1.78	1.58	-19.2	-21.6	-82.8
Dubai***	9 yrs	3.11	3.10	-1.4	-3.3	-6.5

Heat Map Legend: Rising Yields – Falling Yields

Note: * Month to Date and Year to Date; ** 10-year swap rate; *** USD denominated

Exchange Rates vs USD

	26-Jun	03-Jul	Change (%) Week	MTD	YTD
Advanced Countries					
US Dollar Index	97.433	97.172	-0.3	-0.2	0.8
Euro Area*	1.122	1.125	0.3	0.1	0.3
Japan	107.220	107.510	-0.3	0.4	1.0
MENA Countries					
Egypt	16.100	16.142	-0.3	0.0	-0.5
Kuwait	0.308	0.308	0.0	0.1	-1.5
UAE 12M Forward	3.681	3.680	0.0	0.0	0.0
Bahrain 12M Forward	0.378	0.378	-0.1	0.0	-0.1
Oman 12M Forward	0.391	0.391	0.1	0.2	-0.7
Qatar 12M Forward	3.667	3.649	0.5	0.4	-0.2
Saudi Arabia 12M Forward	3.763	3.762	0.0	0.0	-0.3
UAE Spot	3.673	3.673	PEGGED		
Bahrain Spot	0.377	0.377			
Oman Spot	0.385	0.385			
Qatar Spot	3.641	3.641			
Saudi Arabia Spot	3.751	3.751			

Heat Map Legend: Stronger Currency vs USD – Weaker Currency vs USD

Note: * Exchange rate quoted as amount of USD per currency in line with market convention, other exchange rates are amount per USD

Equity Indices

	26-Jun	03-Jul	Change (%) Week	MTD	YTD
Advanced Countries					
US (S&P 500)	3,009	3,130	4.0	1.0	-3.1
Europe (STOXX 50)	3,204	3,294	2.8	1.9	-12.0
Japan (Nikkei 225)	22,512	22,306	-0.9	0.1	-5.7
MENA Countries					
Bahrain (BB)	1,280	1,278	-0.2	0.0	-20.7
Egypt (EGX 30)	10,765	10,959	1.8	1.8	-21.5
KSA (Tadawul)	7,265	7,388	1.7	2.3	-11.9
Kuwait (KSE)	5,121	5,142	0.4	0.2	-18.1
Oman (Muscat 30)	3,525	3,508	-0.5	-0.2	-11.9
Qatar (Doha 20)	9,261	9,187	-0.8	2.1	-11.9
UAE (Abu Dhabi)	4,330	4,304	-0.6	0.4	-15.2
UAE (Dubai)	2,099	2,062	-1.8	-0.2	-25.4

Heat Map Legend: Higher Index – Lower Equity Index

5 Year USD CDS Spreads

	26-Jun	03-Jul	Change in Yield (bps) Week	MTD*	YTD*
MENA Countries					
Bahrain	348.92	343.38	-5.5	-5.0	167.4
Kuwait	72.78	71.78	-1.0	-2.0	35.1
Qatar	76.77	63.48	-13.3	-9.8	26.8
Saudi Arabia	103.31	88.63	-14.7	-18.6	31.7
UAE (Abu Dhabi)	76.98	64.74	-12.2	-9.6	28.7
UAE (Dubai)	185.84	189.52	3.7	-3.7	98.5

Heat Map: Rising Yields – Falling Yields

Commodity Prices*

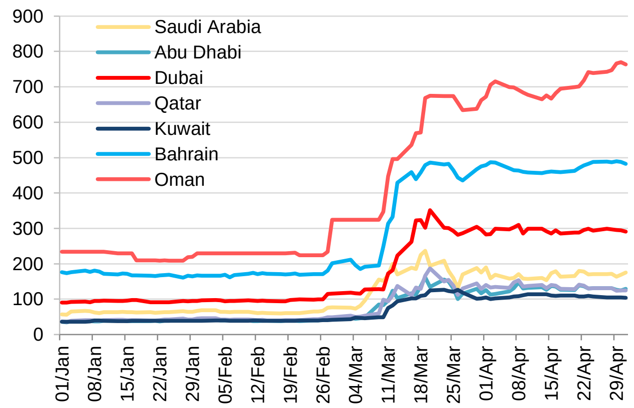
	26-Jun	03-Jul	Change (%) Week	MTD	YTD
Energy					
Brent	41.0	42.8	4.3	4.0	-35.2
WTI	38.5	40.3	4.8	2.7	-34.0
LNG	1,496.4	1,518.0	1.4	1.0	41.6
Precious Metals					
Gold	1,771	1,772	0.0	-0.5	16.8
Silver	17.8	18.0	1.2	-1.1	0.9
Industrial					
Copper	5,957	6,017	1.0	0.0	-2.5
Steel	492	487	-1.0	-0.2	-17.2
Aluminum	1,602	1,614	0.8	-0.3	-10.8
Wheat	474	490	3.4	0.0	-12.3

Heat Map Legend: Higher Commodity Prices – Lower Commodity Prices

Note: * Spot prices or nearest expiring future

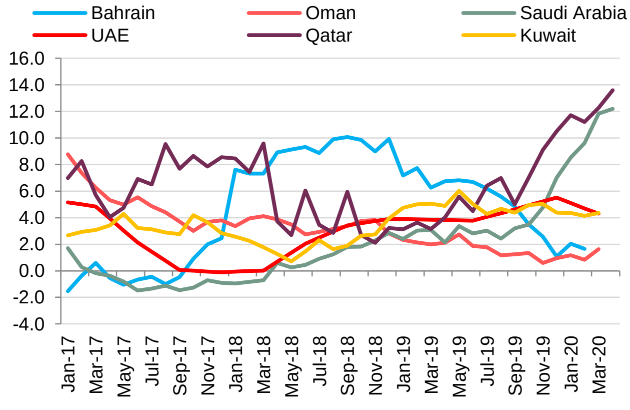
MENA Market Indicators – Charts

CHART 1. GCC 5 YEAR CDS SPREADS (BASIS POINTS)



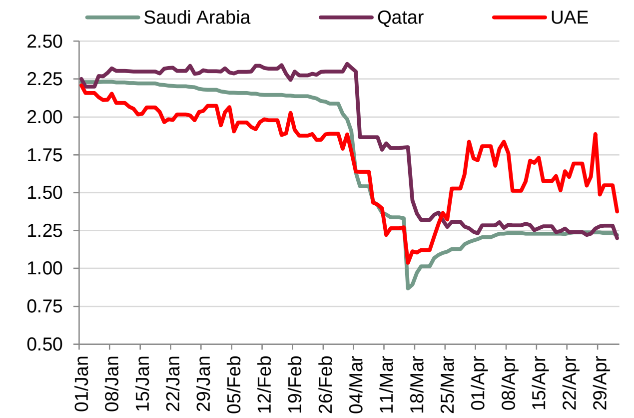
Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 2. GCC PRIVATE SECTOR CREDIT GROWTH (% Y/Y)



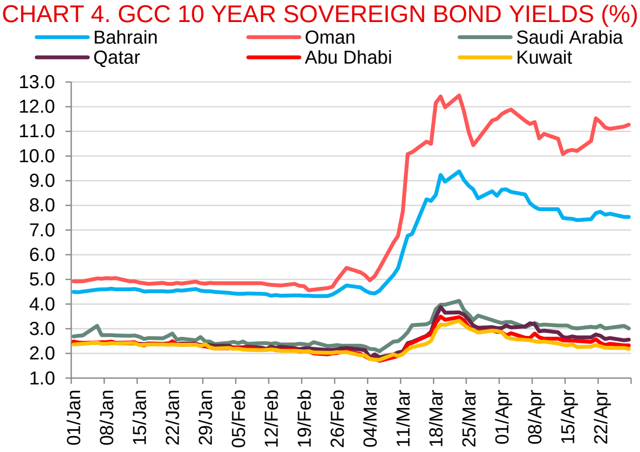
Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 3. CORE GCC 3 MONTH INTERBANK RATES (%)



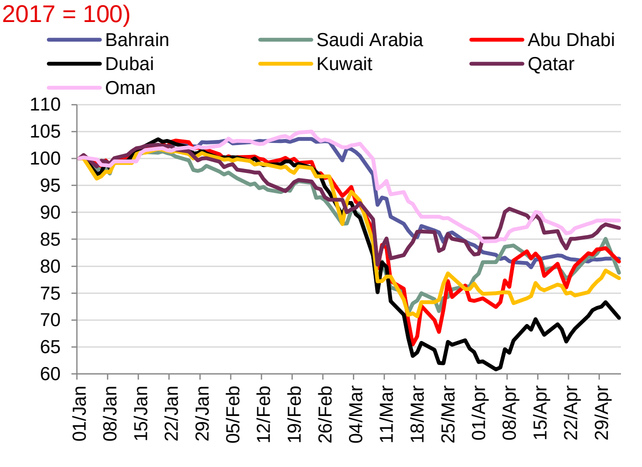
Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 4. GCC 10 YEAR SOVEREIGN BOND YIELDS (%)



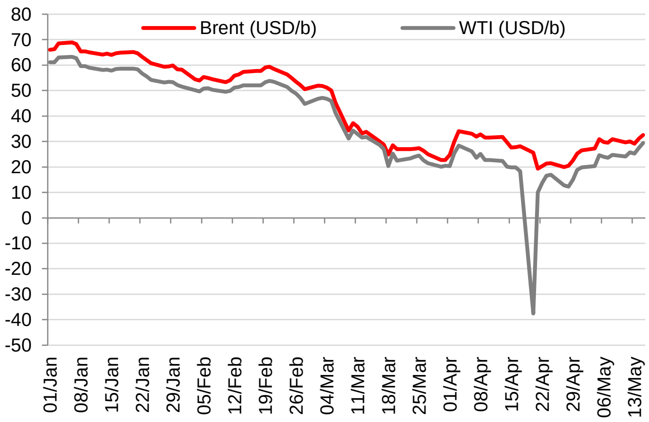
Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 5. GCC EQUITY MARKETS (REBASED JANUARY 2017 = 100)



Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 6. BRENT AND WTI CRUDE PRICES (USD/B)



Source: Bloomberg, CEIC Database, MUFG MENA Research

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