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Executive summary

- Saudi pre-budget signals more austerity in 2021. Saudi Arabia's pre-budget 2021 released by the Ministry of Finance (MoF) on 30 September has struck a pragmatic balance between two competing objectives – fiscal prudence in accordance to its medium-term balanced budget by its terminal date of 2023 on the one hand, and enhancing real GDP growth on the other hand. Based on an real GDP growth assumption of -3.8% in 2020 and +3.2% in 2021 – signalling a shallower recession but a modest recovery with respect to our and market expectations – the fiscal deficit is targeted to decline from an expected USD79.5bn (12.0% of GDP) this year to USD38.7bn (5.1% of GDP) in 2021. For the projections of the MoF's spending side of the fiscal equation to tally up with the arithmetic estimates of its economic growth targets, it is likely that the onus of project spending may fall on other government related entities and potentially the Public Investment Fund (PIF) to stimulate the economy. It is thus on the expenditure side that warrants closer scrutiny next year as pressures to some of the acute cost rationalisation witnessed thus far in 2020 in order to stimulate growth and job creation over the medium term are likely to be significant.
- Turkey's "new economy programme" visualises a V-shaped recovery. The Turkish Ministry of Trade and Finance (MoTF) announced on 29 September the "new economy programme" (NEP) for 2021-2023. The government has significantly lowered real GDP growth to 0.3% this year (from 5% earlier), while anticipating a V-shaped recovery starting in the third quarter of this year. The MoTF also outlined 2023 forecasts where growth and inflation will reach a long-desired 5% level, alongside a balanced current account, when simultaneous parliamentary and presidential elections will be held on the centenary of the Republic. The NEP signals that the government is increasingly concerned about the economy and willing to take to necessary measures to safeguard economic and financial stability. However, the magnitude of recent measures and the speed of the shifts are not yet considerable. We believe a broader recalibration of the policy mix away from providing accommodation for a short-lived growth boost and towards a more comprehensive framework ensuring a more balanced and sustainable economic model is necessary to place Turkey on a more sustainable footing.
- Saudi and Bahrain record sharp economic contraction in Q2 2020. After shrinking by 1.0% y/y in Q1 2020, Saudi Arabia's economy contracted by 7.0% y/y in Q2 2020. Both oil and non-oil components were down at -4.5% y/y and -8.6% y/y, respectively. In Bahrain, economic activity showed a very sharp decline in the second quarter of the year. Real GDP contracted by 8.9% y/y despite oil sector growing in the quarter and up by 3.2% y/y. As with economies across the world, Q2 2020 will mark the trough of the contraction, given the economy was shut-down for much of April and only partially reopened in May. We expect Q3 2020 to be the quarter of economic stabilisation and gradual recovery and Q4 2020 should witness the recovery pickup further with strengthening optimism surrounding COVID-19 vaccine probabilities (we believe such prospects are underpriced and underappreciated at the current juncture).

SAUDI PRE-BUDGET SIGNALS MORE AUSTERITY IN 2021

Balancing fiscal prudence with higher economic growth

Saudi Arabia's pre-budget 2021 released by the Ministry of Finance (MoF) on 30 September has struck a pragmatic balance between two competing objectives – fiscal prudence in accordance to its medium-term balanced budget by its terminal date of 2023 on the one hand, and enhancing real GDP growth on the other hand.

Fiscal deficit is expected to materially narrow in 2021

Based on an real GDP growth assumption of -3.8% in 2020 and +3.2% in 2021 – signalling a shallower recession but a modest recovery with respect to our and market expectations – the fiscal deficit is targeted to decline from an expected USD79.5bn (12.0% of GDP) this year to USD38.7bn (5.1% of GDP) in 2021. Conservative cost rationalisation (total spending down -7.3% y/y), a sharp rebound in economic activity and stronger revenues (total revenues up 9.9% y/y), are expected to be the core drivers behind this improvement. On the latter, tax collection – supported by the tripling of VAT hike to 15% from July – is expected to be the core driver behind higher revenues. Should activity recover to pre-virus levels, then the fiscal deficit could possibly narrow to levels witnessed in 2019 (4.5% of GDP).

Our estimates put the 2021 budgeted oil price assumption at a conservative USD51-54/b

Whilst the MoF did not provide details on the breakdown of revenues and expenditures, as well as what oil prices the pre-budget is centered on (as has historically been the case). Our calculations suggests that the 2021 estimates assumes a rational average Brent price within a range of USD51-54/b. This is slightly higher than the price implied by Brent forwards but lower than our Brent price projections of USD57/b next year (see here). From this, we take comfort from the MoF's estimates of the revenue side and see negligible risks at the current juncture.

Spending side of the fiscal equation warrants closer examination

For the projections of the MoF's spending side of the fiscal equation to tally up with the arithmetic estimates of its economic growth targets, it is likely that the onus of project spending may fall on other government related entities and potentially the Public Investment Fund (PIF) to stimulate the economy. It is thus on the expenditure side that warrants closer scrutiny next year as pressures to restore some of the acute cost rationalisation witnessed thus far in 2020 in order to stimulate growth and job creation over the near and medium term are likely to be significant.

Debt issuance will continue being a central lever of financing

The statement projects that debt issuance will total USD20.3bn in 2021, taking the total debt stock to USD250.9bn (32.9% of GDP) – MoF's self-imposed ceiling is 50% of GDP. Whilst the MoF did not provide the compositional breakdown of financing by source, it did declare that, whilst it wants to deepen the local market and widen the local investor base, international markets will remain a core source of financing.

SAUDI MOF IS ATTEMPTING TO STRIKE THE BALANCE BETWEEN FISCAL PRUDENCE AND HIGHER GROWTH …

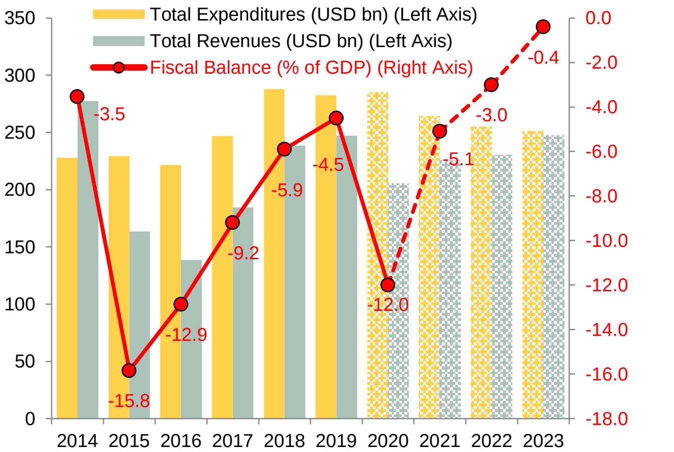
FISCAL BUDGET AND REAL GDP GROWTH PROJECTIONS (2019-2023)

USD bn	2019	2020	2021	2022	2023
Revenues	247.2	205.3	225.6	230.4	247.5
% y/y		*-16.9%*	*9.9%*	*2.1%*	*7.4%*
Expenditures	282.4	284.8	264.0	254.7	250.9
% y/y		*0.8%*	*-7.3%*	*-3.5%*	*-1.5%*
Budget Deficit	-35.5	-79.5	-38.7	-24.3	-3.5
% of GDP	*-4.5%*	*-12.0%*	*-5.1%*	*-3.0%*	*-0.4%*
Debt	180.8	227.7	250.9	2700.9	274.4
% of GDP	*22.8%*	*34.4%*	*32.9%*	*33.4%*	*31.8%*
Real GDP, %	0.3%	-3.8%	3.2%	3.4%	3.5%

Source: Bloomberg, CEIC, Saudi MoF, MUFG MENA Research

… WITH UNCERTAINTIES REGARDING THE VIRUS AND SPENDING THE MAIN RISKS TO THESE TARGETS

FISCAL BALANCE (% OF GDP), REVENUES AND EXPENDITURES (USD BN)



Source: Bloomberg, CEIC, Saudi MoF, MUFG MENA Research

TURKEY'S "NEW ECONOMY PROGRAMME" VISUALISES A V-SHAPED RECOVERY

An ambitious NEP

The Turkish Ministry of Trade and Finance (MoTF) announced on 29 September the "new economy programme" (NEP) for 2021-2023. The government has significantly lowered real GDP growth to 0.3% this year (from 5% earlier), while anticipating a V-shaped recovery starting in the third quarter of this year. The MoTF also outlined 2023 forecasts where growth and inflation will reach a long-desired 5% level, alongside a balanced current account, when simultaneous parliamentary and presidential elections will be held on the centenary of the Republic.

Fiscal deficit expected to narrow

On the fiscal side, the NEP projects the central government deficit at 4.9% of GDP in 2020, and thereafter the deficit narrowing moderately to 3.5% of GDP by the 2023. Currently, the budget deficit in IMF programme terms is running at 6.4% of GDP on a year-to-date basis, only 0.3ppts wider than it was in the same period last year. Though, risks around the broader public sector balance sheet have increased during COVID-19 with the robust increase in lending by state-led banks and falling reserves.

Inflationary pressures to ease but will require higher rates

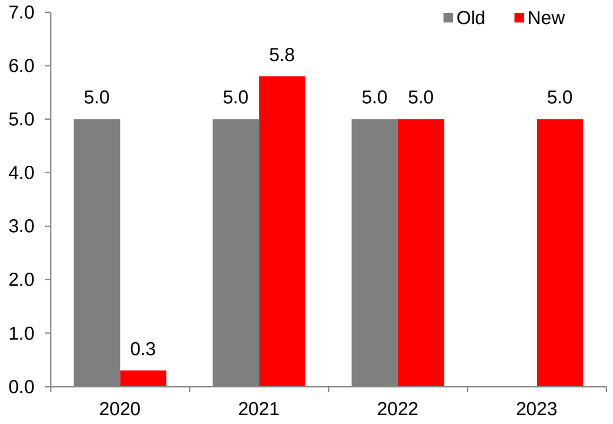
On inflation, the NEP forecasts consumer prices at 10.5% in 2020 with a downward trajectory towards 5% by end 2023. On net, it would appear the inflation trajectory is somewhat optimistic, given the marked deterioration in the inflation trajectory in recent years. We view that the NEP's disinflation trajectory would likely require additional monetary policy, which is entirely warranted and likely in our view (see here and here).

The authorities intent is undoubtedly serious but a broader recalibration of the policy mix is necessary

On the whole, it would appear that the authorities are serious about the normalisation in economic policy and the targets set out in the NEP are praiseworthy. In recent weeks, the central bank hiked three key interest rates in a surprise move by 200bps and continued tightening its average cost of funding, regulators have eased Turkish banks' FX swap limits with foreign entities, and the lenders' "active ratio" has been updated to slow credit growth. Moreover, following these moves, the NEP signals that the government is increasingly concerned about the economy and willing to take to necessary measures to safeguard economic and financial stability. However, the magnitude of recent measures and the speed of the shifts are not yet considerable. We believe a broader recalibration of the policy mix away from providing accommodation for a short-lived growth boost and towards a more comprehensive framework ensuring a more balanced and sustainable economic model is necessary to place Turkey on a more sustainable footing.

TURKISH ECONOMIC GROWTH PROJECTIONS SHARPLY REVISED DOWN FOR 2020 AND UP FOR 2021 …

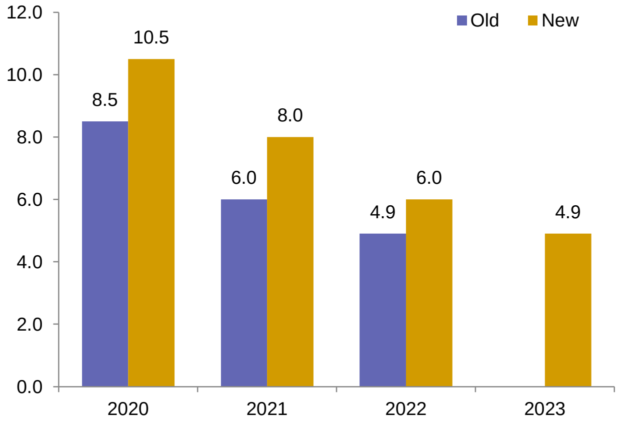
REAL GDP GROWTH PROJECTIONS (5%) UNDER NEP



Source: Bloomberg, CEIC, Turkey MoTF, MUFG Research

… WHILST THE MEDIUM-TERM INFLATION TRAJECTORY IS EXPECTED TO PRINT AT HIGHER LEVELS

USD/TRY AND TURKEY INFLATION (% Y/Y)



Source: Bloomberg, CEIC, Turkey MoTF, MUFG Research

SAUDI AND BAHRAIN RECORD SHARP ECONOMIC CONTRACTION IN Q2 2020

Saudi registers an economic growth of -7.0% y/y in Q2 2020

After shrinking by 1.0% y/y in Q1 2020, Saudi Arabia's economy contracted by 7.0% y/y in Q2 2020. Both oil and non-oil components were down at -4.5% y/y and -8.6% y/y, respectively. This was primarily on the back of virus containment measures and a challenging oil market which witnessed both prices precipitously decline and production sharply scaled back in line with the historic OPEC+ agreement.

Saudi still remains adequately buffered

Critically, whilst Saudi Arabia is nursing large fiscal shortfall this year, the authorities have proven to markets that they can put their large accumulated wealth buffers to adequate use to offset the oil-virus shocks, effectively drawing down reserves and leveraging the robust balance sheet to retain access to international capital markets. Coupled with easing liquidity constraints, this has allowed the Kingdom to comfortably fund its budget shortfalls without building pressure on the currency or on local rates. We expect this to continue, and see no threat to fiscal stability, or to the maintenance of the USD peg.

Saudi's near-term prospects remain challenging but a better 2021 is in store

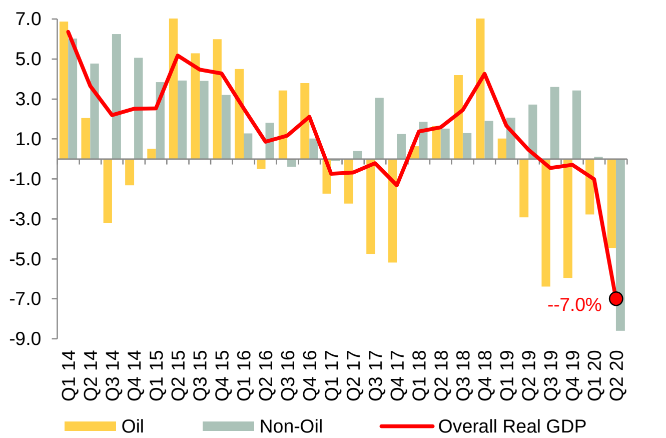
As with economies across the world, Q2 2020 will mark the trough of the contraction, given the economy was shut-down for much of April and only partially reopened in May. Looking ahead, the Saudi economy is facing headwinds from the twin nature of the oil and virus shocks. Near-term prospects are weak – we forecast Saudi real GDP to contract by -4.8% in 2020. Having said that, given our bullish oil price thesis (see here), we project a V-shaped recovery in the Saudi economy in 2021, with the authorities likely to loosen fiscal policy, supporting a rebound in domestic demand and growth (we forecast real GDP growth at 3.4% next year)

Bahrain's economy shrinks materially in Q2 but we remain constructive on the story

In Bahrain, economic activity showed a very sharp decline in the second quarter of the year. Real GDP contracted by 8.9% y/y despite oil sector growing in the quarter and up by 3.2% y/y. The management of COVID-19 and the strict regulations in place to combat the spread of the virus pushed the hospitality sector down by 61.2% y/y. Notwithstanding Bahrain remaining one of the weakest spots in the region, with a fiscal breakeven oil price of close to USD100/b, we remain cautiously constructive on the Bahraini story. Our positive thesis is centred on the basis that the fiscal balance programme (FBP) remains credible, the policy framework is relatively robust and that demonstrable headway is being made by the government in its implementation. There are, of course, downside risks, including the possibility of fiscal slippage and delays in funding by donors through the FBP, which we remain mindful of.

SAUDI REAL GDP SHRINKS SHARPLY IN Q2 2020 MARKING THE NADIR IN ECONOMIC CONTRACTION …

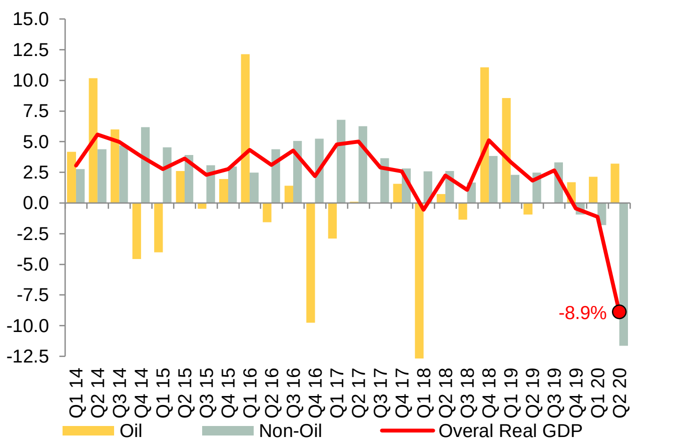
SAUDI REAL GDP (% Y/Y)



Source: Bloomberg, CEIC, Saudi GASTAT, MUFG MENA Research

… WHILST BAHRAIN'S REAL GDP ALSO CONTRACTED OF A SIMILAR MAGNITUDE IN Q2 2020

BAHRAIN REAL GDP (% Y/Y)



Source: Bloomberg, CEIC, Bahrain Central Informatics Organisation, MUFG MENA Research

Economic Weekly Round-up

- **Key data and events in the past week**:
- **Bahrain's** government will continue to pay 50% of wages of citizens in private sector firms affected by the pandemic during October to December.
- **Egypt** plans to borrow EGP640bn (USD40.6bn) from the domestic market this quarter via the issuance of T-bills and bonds, to finance the fiscal deficit.
- The **Lebanese pound (LBP)** has been falling versus the US dollar (USD) on the parallel market, as the country's troubles linger on, with warnings by the central bank that it is running of reserves to subsidise essential commodity imports, and discussions with the IMF on hold until a new cabinet is formed.
- **Qatar Airways** received a cash injection of QAR7.3bn (USD2.0bn) from the government as support to navigate the oil-virus shocks
- In an effort to support citizens that want to own homes, **Saudi Arabia** will exempt real estate deals from the 15% VAT and instead imposed a new 5% tax on transactions.

- **Key focus in the week ahead**:
    1. **Regional PMI** data for September.
    2. **Inflation** in **Egypt** and **Turkey** for September
    3. In **oil markets**, the EIA's short-term energy outlook and OPEC's annual world oil outlook.

Economic Calendar and Forecasts

Upcoming Events and Data Releases

Date		Country	Event	Period	Consensus	MUFG* Forecasts	Actual	Previous
05/10/2020		Saudi Arabia	PMI	Sep 2020	---	---		48.8
05/10/2020		UAE	PMI	Sep 2020	---	---		49.4
05/10/2020		Qatar	PMI	Sep 2020	---	---		57.3
05/10/2020		Egypt	PMI	Sep 2020	---	---		49.4
05/10/2020		Turkey	CPI, % y/y	Sep 2020	12.1%	---		11.8%
05/10/2020		Egypt	Real GDP, % y/y	Q2 2020	---	---		-9.4%
08/10/2020		Egypt	CPI, % y/y	Sep 2020	---	---		3.4%
08/10/2020		Qatar	Real GDP, % y/y	Q2 2020	---	---		0.9%
09/10/2020		UAE	Dubai, % y/y	Sep 2020	---	---		-3.7%

Source: Bloomberg, Refinitiv, MUFG MENA Research

MENA Market Indicators – Tables

Benchmark Bond Yields (%, Local Currencies)

	Maturity	25-Sep	02-Oct	Change in Yield (bps) Week	MTD*	YTD*
Advanced Countries						
US	10 yrs	0.65	0.70	4.6	1.7	-121.7
Germany	10 yrs	-0.53	-0.54	-0.7	-1.4	-35.1
Italy	10 yrs	0.89	0.78	-10.2	-8.2	-62.8
Japan	10 yrs	0.01	0.02	1.1	0.6	3.3
MENA Countries						
Bahrain***	10 yrs	3.73	3.69	-3.6	-10.0	70.0
Egypt	4 yrs	14.31	14.23	-7.9	-2.2	-2.6
Qatar***	10 yrs	2.02	1.92	-9.5	-4.8	-72.9
Saudi Arabia**	10 yrs	2.48	2.47	-0.5	0.0	-56.9
Abu Dhabi***	7 yrs	1.42	1.42	0.0	0.2	-99.1
Dubai***	9 yrs	2.84	2.80	-3.6	-4.6	-36.3

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

	25-Sep	02-Oct	Change (%) Week	MTD	YTD
Advanced Countries					
US Dollar Index	94.642	93.844	-0.8	0.0	-2.6
Euro Area*	1.163	1.172	0.7	0.0	4.5
Japan	105.580	105.290	0.3	0.2	3.2
MENA Countries					
Egypt	15.741	15.755	-0.1	0.0	2.0
Kuwait	0.306	0.306	0.0	0.0	-1.0
UAE 12M Forward	3.677	3.676	0.0	0.0	0.1
Bahrain 12M Forward	0.378	0.379	0.0	0.0	-0.2
Oman 12M Forward	0.391	0.391	-0.1	0.1	0.1
Qatar 12M Forward	3.677	3.677	0.0	0.0	-0.9
Saudi Arabia 12M Forward	3.758	3.758	0.0	0.0	-0.2
UAE Spot	3.673	3.673	PEGGED		
Bahrain Spot	0.377	0.377			
Oman Spot	0.385	0.385			
Qatar Spot	3.641	3.642			
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

	25-Sep	02-Oct	Change (%) Week	MTD	YTD
Advanced Countries					
US (S&P 500)	3,298	3,348	1.5	-0.4	3.6
Europe (STOXX 50)	3,137	3,191	1.7	-0.1	-14.8
Japan (Nikkei 225)	23,205	23,030	-0.8	-0.7	-2.6
MENA Countries					
Bahrain (BB)	1,451	1,436	-1.0	0.1	-10.8
Egypt (EGX 30)	10,963	11,082	1.1	0.8	-20.6
KSA (Tadawul)	8,245	8,238	-0.1	-0.7	-1.8
Kuwait (KSE)	5,578	5,594	0.3	2.7	-11.0
Oman (Muscat 30)	3,621	3,595	-0.7	-0.5	-9.7
Qatar (Doha 20)	9,787	9,954	1.7	-0.4	-4.5
UAE (Abu Dhabi)	4,490	4,493	0.1	-0.6	-11.5
UAE (Dubai)	2,285	2,245	-1.8	-1.3	-18.8

Heat Map Legend: Higher Equity Index / Lower Equity Index

5 Year USD CDS Spreads

	25-Sep	02-Oct	Change in Yield (bps) Week	MTD*	YTD*
MENA Countries					
Bahrain	351.87	345.86	-6.0	-1.0	169.9
Kuwait	57.72	60.73	3.0	0.0	24.0
Qatar	55.12	50.29	-4.8	-1.8	13.6
Saudi Arabia	99.17	88.96	-10.2	-2.7	32.0
UAE (Abu Dhabi)	55.31	50.76	-4.6	-2.6	14.7
UAE (Dubai)	157.74	153.51	-4.2	-7.3	62.5

Heat Map Legend: Rising Yields / Falling Yields

Commodity Prices*

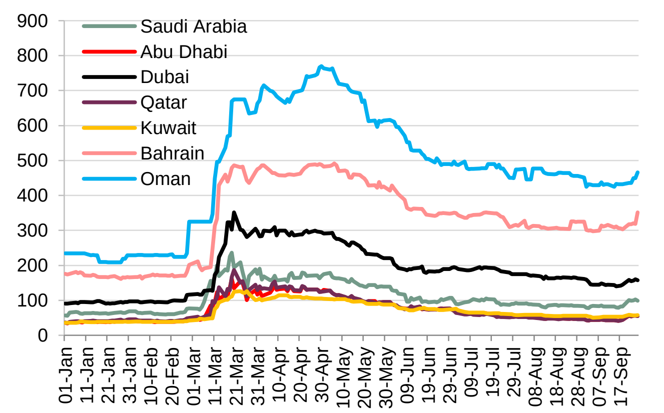
	25-Sep	02-Oct	Change (%) Week	MTD	YTD
Energy					
Brent	41.9	39.3	-6.3	-4.1	-40.5
WTI	40.3	37.1	-8.0	-7.9	-39.3
LNG	1,532.8	1,555.0	1.4	0.2	41.6
Precious Metals					
Gold	1,862	1,900	2.1	0.7	25.2
Silver	22.9	23.7	3.7	2.2	33.0
Industrial					
Copper	6,545	6,553	0.1	-1.8	6.1
Steel	548	626	14.2	1.8	6.5
Aluminum	1,749	1,768	1.1	0.2	-2.3
Wheat	550	573	4.3	-0.8	2.6

Heat Map Legend: Higher Commodity Prices / Lower Commodity Prices

Note: * Spot prices or nearest expiring future

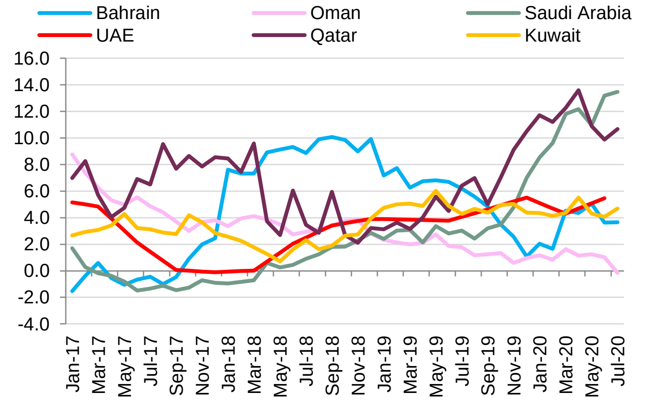
MENA Market Indicators – Charts

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



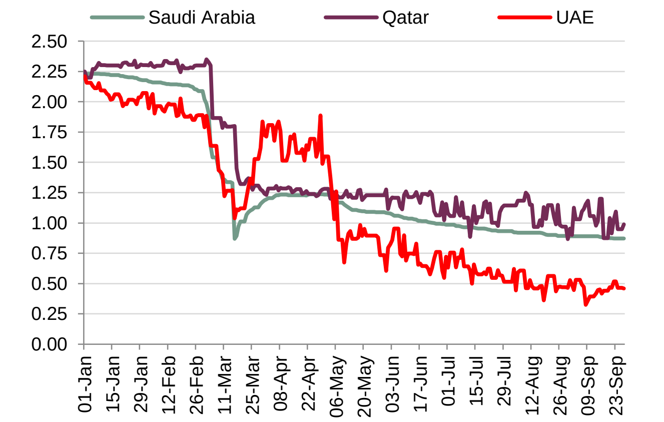
Source: Bloomberg, CEIC Database, MUFG MENA Research

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



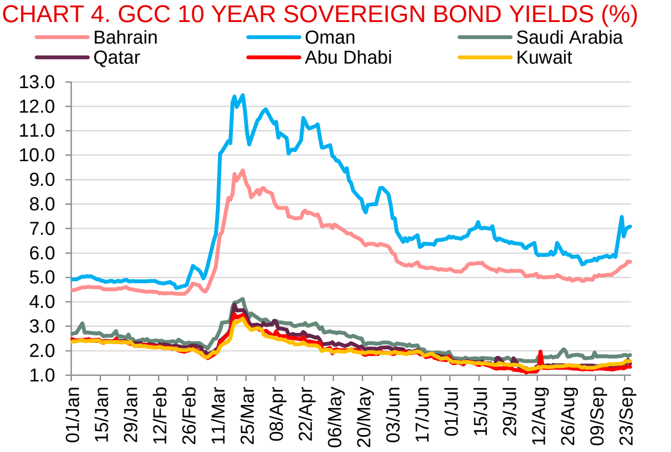
Source: Bloomberg, CEIC Database, MUFG MENA Research

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



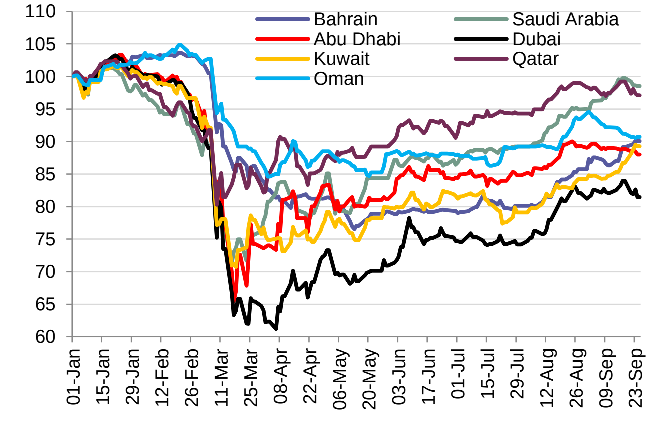
Source: Bloomberg, CEIC Database, MUFG MENA Research

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



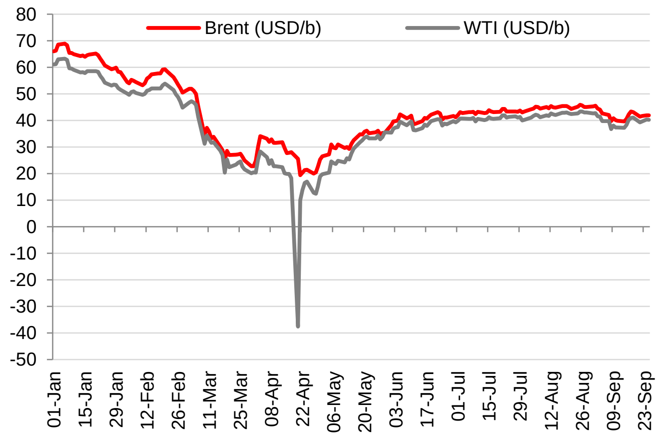
Source: Bloomberg, CEIC Database, MUFG MENA Research

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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