GRC Commentary & Analysis

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Saadia Zahidi, managing director of the World Economic Forum (WEF), recently stated that "the short-term risk landscape is dominated by energy, food, debt, and disasters." What she was in essence correctly noting is that the current economic environment is particularly littered with precarious factors and events that are spurring an increased sense of volatility. The war in Ukraine, the potential for widespread economic unrest in the Middle East, natural disasters, political instability, and food and energy insecurity are all external factors that GCC economic planners must be prepared to tackle. Food and energy demand particular attention because although they are often lumped together, they demand completely different strategies, especially in the context of the GCC countries. Whereas GCC states have a direct say in the supply of energy they play a rather passive role when it comes to food supply.

Increasing food and commodity prices have already raised the specter of inflation in the Middle East. In 2022, Turkey's annual inflation rate reached 78%, Egypt's inflation rate reached 14.7%, and Lebanon's annual inflation rate hit 208%. Inflation rates in the GCC states remain relatively modest and are expected to stabilize with Saudi Arabia at 3.7%, Kuwait at 2.6%, Bahrain at 3.0%, Qatar at 2.4% and both the UAE and Oman currently at 4.2%. According to the IMF, the GCC's GDP is projected to grow at respectable rates despite an increase in commodity prices. Current inflation is largely the result of the fiscal policy pursued during the COVID-19 pandemic and due to the war in Ukraine, GCC governments are taking precautions since the start of 2023 to treat the inflationary threat. At the World Economic Forum, Saudi Finance Minister Mohammed Al Jadaan mentioned that some of these measures include a price ceiling on fuel, which is a measure used across the GCC. Price caps on necessities like food and fuel have kept regional households relatively insulated. However, there is a variance among individual GCC states in the severity of the crisis. Bahrain, for example, launched an urgent program at the start of 2023 to extend financial support for families in need and temporarily suspended certain governmental fees.

Despite such fiscal measures, GCC countries remain almost exclusively import-dependent due to their marginal agricultural lands and are therefore incredibly vulnerable when it comes to food supply shocks. Current subsidies will continue to chip away at financial reserves if the cost-of-living crisis persists, which is a likely scenario. Agri-commodities and fertilizers remain historically costly, while grain stockpiles remain tight. Furthermore, bad weather in global agricultural hubs could have widespread implications. As it stands, there is no guarantee that the Black Sea Grain Initiative will continue to secure the safe transport of vital foodstuffs and grain through Ukrainian ports in the Black Sea, and so the global food market cannot be described as resilient to future fluctuations.

Concerns over food security also highlight the potential challenge of increased political instability in the wider Middle Eastern regions with countries like Lebanon, Egypt, and Turkey who are significantly impacted by rising living costs, and who do not have the financial means to subsidize consumer necessities like the GCC. To be sure, such issues also play a role in the ongoing protests in Iran. It is also important to note that many GCC banks like QNB, Emirates NBD, and Burgan Bank are directly exposed to the higher credit risk of Turkey and Egypt through loans or investments. Therefore, the success or decline of the Turkish or Egyptian economies has immediate implications for the aforementioned financial institutions.

Nevertheless, domestic fiscal policies will not overcome the marginal agricultural conditions of the GCC. In that regard, the region has been limited to financial restructuring, price caps, and subsidies to protect itself and its people. Despite its relative insulation, the GCC is still exposed to the same food security risk factors affecting the rest of the world both directly and indirectly through neighboring Middle Eastern countries. The GCC's current food security configuration would have been much more daunting had it also not been for India's continued supply of wheat to the GCC. Therefore, the GCC will remain dependent on agricultural partners to secure its food sources. So long as chokepoints are secure and agricultural partners are diversified and in good spirits, the GCC can enjoy a modest level of food security. This highlights that the GCC's most vulnerable sector, until agricultural technology proves otherwise, might not be in the hands of economic planners as much as it is in the hands of diplomats.

On a less dire note, a warmer than usual winter and a worrisome global economic outlook have caused both Brent and WTI to crash 9% at the start of the year. This is unpleasant news for GCC oil producers and economies in general and underlines one of the many concerns that GCC economies face as they enter 2023. At the same time, the news highlights how Saudi Minister of Energy Abdulaziz bin Salman’s rationale to cut oil production back in October 2022 was by-and-large correct. With expectations that China will soon re-enter the global economy, the need for OPEC spare production capacity to accommodate the increase in demand certainly echoes the GCC’s pleas to ensure that there is sufficient investment in the energy sector moving forward. While the impact of China’s return is subject to debate, it is nevertheless clear that an increase in energy prices would not fare well in today’s economic environment. Although a higher price is always beneficial for GCC oil producers, there is a point after which that it is so detrimental to partner economies that it harms GCC oil revenues in the long run. GCC oil producers and OPEC+ aim for a stable price to ensure that government spending both locally and internationally can be budgeted for and applied.

Considering these tumultuous times, the GCC must develop a means of continuing its developmental agenda regardless. Given the above, a key reform effort includes the goal to “de-couple” fiscal budgets from oil prices. In the past, projects have stalled or even been abandoned due to the oil dropping below the “breakeven price.” Today however, government projects are expected, excluding the scenario of extreme downward shifts, to be implemented and completed regardless of the state of oil prices. One of the virtues of taxation is the state’s ability to build financial reserves to accommodate oil price fluctuations so that fiscal budgets can be accurately maintained, ensuring the timely progress of projects and programs. Moreover, the institution of taxation of any sort increases the state’s sense of accountability to complete projects and initiatives in a timely manner. This heightened sense of responsibility also extends to funds leaving the country. Gone are the days of “no strings attached” foreign grants and deposits as noted by Finance Minister Jadaan at the World Economic Forum in Davos. Receiving countries are expected to keep true to their promised reforms. There is an increased sense that foreign investments should be financially sound, and it is simply more difficult to use tax funds as foreign aid.

The GCC finds itself nestled in between three global supply chain choke points, making the Saudi Minister of Investment Khalid Al-Falih's concerns about the global supply chains even more worthwhile. Saudi Arabia recently launched a National Initiative for Global Supply Chains which aims to enhance the flexibility of local and global supply chains, and as a result, will protect not only the GCC but also nations dependent on these choke points from dramatic disruptions. The GCC facilitates the transport of both food and energy but has less of a role to play in terms of food security as it is a net importer and will remain so for the foreseeable future. Europe has, in impressive fashion, isolated Russian energy by diversifying its energy portfolio. Although still fragile, the current energy configuration is stable enough to maintain reliable prices. However, by opting for Qatari LNG and Emirati crude oil, the Strait of Hormuz has become all the more crucial. Given the attacks on the tanker off the Gulf of Oman last November, the protection of this passage remains an ongoing endeavor of utmost priority.

Concerns over energy security, further military escalation in Ukraine, regional inflation, political instability, and food security will therefore preoccupy GCC economic planners as volatile exogenous factors. Since Russia suspended its role in the initiative back in October, it has been actively attempting to slow down the pace of Ukrainian grain exports in several ways. As a result, the number of Ukrainian outbound ships carrying grain exports has fallen for three straight months resulting in a 1.2-million-ton decrease. The cost-of-living crisis, excluding prospects of military escalation in either Ukraine or the Middle East, is arguably the most significant global challenge of 2023. Building financial reserves, having accurate assessments regarding the global economy, and maintaining more economically sound international relations are all means to mitigate the impact of price fluctuations and supply disruptions. Overall, however, it is a daunting agenda that GCC economic policymakers face as they proceed through 2023.