The Arab World's Perfect COVID-19 Storm, Project Syndicate Article, Mar 2020

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In the face of the COVID-19 pandemic, policymakers in the Gulf Cooperation Council states are rolling out stimulus measures to support businesses and the economy. But the camel in the room remains oil, especially the immediate impact on demand of the Chinese and global economic slowdown.

Middle Eastern and Gulf Cooperation Council (GCC) economies are heading toward a recession in 2020 as a result of the COVID-19 pandemic, collapsing oil prices, and the unfolding global financial crisis.

The fast-spreading global pandemic – with Europe its new epicenter – is generating both supply and demand shocks. The supply shock results from output cuts, factory closures, disruptions to supply chains, trade, and transport, and higher prices for material supplies, along with a tightening of credit. And the aggregate-demand shock stems from lower consumer spending – owing to quarantines, "social distancing," and the reduction in incomes caused by workplace disruptions and closures – and delayed investment spending.

The two largest Arab economies, Saudi Arabia and the United Arab Emirates, are proactively fighting the spread of COVID-19, for example by closing schools and universities and postponing large events such as the Art Dubai fair and the

Dubai World Cup horse race. Likewise, Bahrain has postponed its Formula One Grand Prix.Saudi Arabia has even announced a temporary ban on non-compulsory *umrah* pilgrimages to Mecca, and has closed mosques. Because religious tourism is one of the Kingdom's main sources of non-oil revenue, the *umrah* ban and likely severe restrictions on the obligatory (for all Muslims) *hajj* pilgrimage will have a large negative impact on economic growth.

True, policymakers across the GCC are rolling out stimulus measures to support businesses and the economy. Central banks have focused on assisting small and medium-size enterprises by deferring loan repayments, extending concessional loans, and reducing point-of-sale and e-commerce fees. And GCC authorities have unveiled stimulus packages to support companies in the hard-hit tourism, retail, and trade sectors. The UAE has a consolidated package valued at AED126 billion ($34.3 billion), while Saudi Arabia's is worth $32 billion and Qatar's totals $23.3 billion. Moreover, policymakers are supporting money markets: Bahrain, for example, recently slashed its overnight lending rate from 4% to 2.45%.

But the camel in the room remains oil, especially the immediate impact on demand of the Chinese and global economic slowdown. The International Energy Agency optimistically estimates that global oil demand will fall to 99.9 million barrels per day (bpd) in 2020, about 90,000 bpd lower than in 2019 (in the IEA's pessimistic scenario, demand could plunge by 730,000 bpd). Indeed, successive production cuts had already led to OPEC's global market share falling from 40% in 2014 to about 34% in January 2020, to the benefit of US shale producers.

The weakening outlook for oil demand has been exacerbated by the Saudi Arabia-Russia oil-price war, with the Saudis not only deciding to ramp up production, but also announcing discounts of up to $8 per barrel for Northwest Europe and other large consumers of Russian oil. Although the Kingdom's strategic aim is to weaken shale-oil producers and regain market share, the price war will also hit weaker oil-dependent economies (such as Algeria, Angola, Bahrain, Iraq, Nigeria, and Oman), and put other major oil producers and companies under severe pressure. Indeed, in the two years after oil prices' last sharp fall, in 2014, OPEC member states lost a collective $450 billion in revenues.

That episode prompted GCC governments to pursue fiscal consolidation by phasing out fuel subsidies, implementing a 5% value-added tax (in the UAE, Saudi Arabia, and Bahrain), and rationalizing public spending. Nonetheless, GCC countries continue to rely on oil for government revenues, and their average fiscal break-even price of $64 per barrel is more than double the current Brent oil price of about $30 per barrel. The UAE and Saudi Arabia have estimated break-even prices of $70 and $83.60, respectively, while Oman ($88), Bahrain ($92), and Iran ($195) are even more vulnerable in this regard. More diversified Russia, by contrast, can balance its budget with oil at $42 per barrel.

The near-halving of oil prices since the start of 2020, the sharp fall in global growth, and the effects of the COVID-19 pandemic will put severe strains on both oil and non-oil revenue. As a result, GCC governments' budget deficits are likely to soar to 10-12% of GDP in 2020, more than double earlier forecasts, while lower oil prices will also result in substantial current-account deficits.

Governments will respond by cutting (mostly capital) spending, magnifying the negative effect on the non-oil sector. Some countries (Kuwait, Qatar, and the UAE) can tap fiscal and international reserves, while others (Oman, Bahrain, and Saudi Arabia) will have to turn to international financial markets.

But will GCC governments be able to borrow their way out of this phase of lower oil prices? Global equity and debt markets currently are close to meltdown; with investors fleeing to safe government bonds, liquidity is drying up.

The GCC countries will suffer a negative wealth effect, owing to losses on their sovereign wealth funds' portfolios and net foreign assets. And, given bulging deficits and the prospect of continued low oil prices, sovereign and corporate borrowers will find it harder and more expensive to access markets. The ongoing financial crisis will therefore exacerbate the effects of the oil-price shock and the pandemic.

The pandemic itself is still unfolding, and its eventual global impact will depend on its geographical spread, duration, and intensity. But it is already clear that in the coming weeks, there will be heightened uncertainty about global growth prospects, oil prices, and financial-market volatility. And as the pandemic continues its deadly march, the GCC economies – like many others – will be unable to avoid recession.