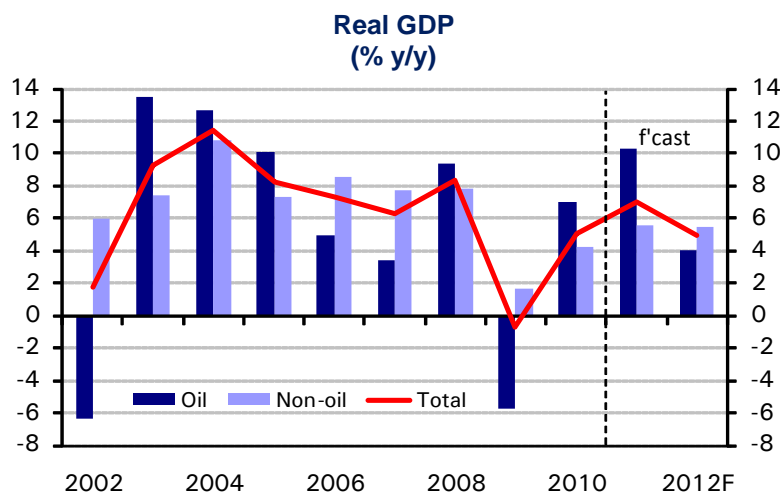


GCC growth revised up...high oil prices generate another round of huge budget surpluses

In IBQ's latest GCC Brief: The recent unrest in the MENA region in early 2011 has, ironically, boosted the GCC's short-term growth outlook, in our view. Real GDP growth for the GCC is now seen at 7%, up from the 5.5% expected before. While growth in the region's two smallest economies - Bahrain and Oman - has been revised down following disruptions to trade, tourism and investment, activity in other GCC countries is likely to be stronger thanks to a combination of rising oil output and higher government spending. The medium-term implications of the unrest, however, are less clear.

GCC forecast summary:		2011f	2012f
Real GDP	%y/y	7.0	5.0
- Non-oil	%y/y	5.5	5.4
Inflation (yr avg)	%	3.6	4.3
Budget balance	% GDP	14.0	13.1

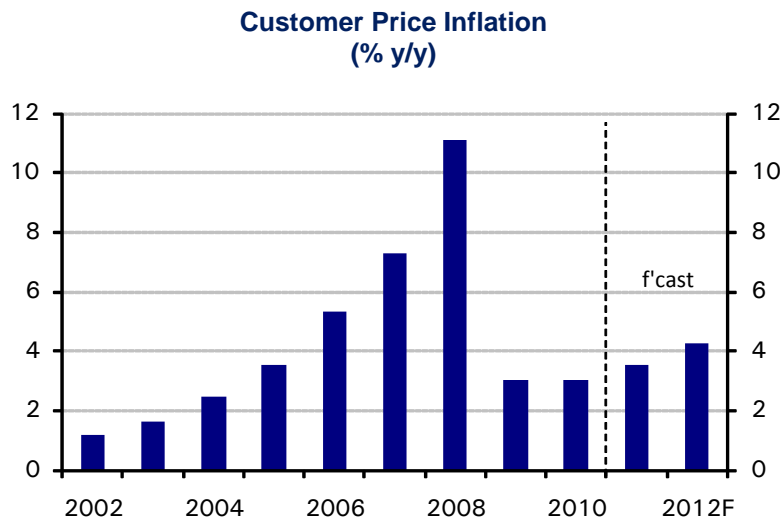


Source: National Sources, NBK

GCC crude oil production has risen sharply in recent months, not least to compensate for a sharp drop in output in war-ravaged Libya. Although OPEC, led by Saudi Arabia, remains doubtful of the need to raise output any further, strong economic growth in emerging markets and the threat of a destabilizing price spike could cause it to soften its position. If so, the bulk of any output increases are likely to come from Gulf countries, which may hold more than 80% of OPEC's spare production capacity. We assume that the oil market will remain tight and that oil prices average \$110 per barrel (pb) both this year and next.

Meanwhile, we estimate that the recently-announced government spending measures aimed mostly at boosting GCC nationals' living standards could be worth more than \$60 billion this year (5% of GDP), largely from Saudi Arabia. This could push the total increase in government spending this year to 22% – a massive contrast to the budget cuts taking place in other parts of the world. Not all of this extra spending will translate into stronger domestic demand, but it will help maintain growth at a decent pace while activity in the private sector– including sluggish borrowing - gains momentum.

Although rising government spending, high food prices and the improving economic environment have heightened inflationary concerns, the short-term outlook is reasonably encouraging. Food price inflation has already started to decelerate, new supply is keeping housing rents subdued, while broader monetary conditions remain soft. GCC inflation in 2011 is now expected to be lower than previously forecast, at 3.6%, though accelerating into 2012. One risk stems from the effect of a weaker US dollar on GCC import prices. But so far, the impact of the falling dollar seems to have been small.



Source: National Sources, NBK

Finally, the return of \$100-plus oil prices almost assures the region of another round of huge fiscal and current account surpluses; both could be in the range of 10-20% of GDP over the next couple of years. Even in Bahrain – the least resource-rich country in the region – any budget deficit is likely to be small and easily financed. Large budget surpluses, however, run the risk of masking the need for structural fiscal reform, particularly in light of the latest ratcheting-up of public spending levels as well as the risk that oil prices will – at some stage - fall back.