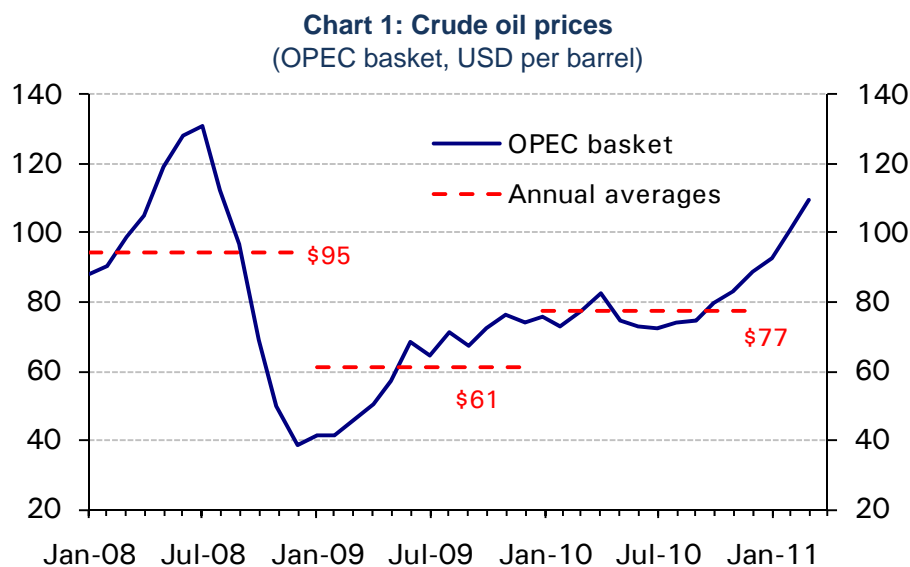


GCC oil windfall boosts government spending power

- Oil prices have risen dramatically over the past few months. This provides extra spending power for GCC governments undertaking emergency measures to ward off social and political unrest, without having to dip into their vast sovereign wealth funds.
- We estimate that each dollar increase in oil prices adds around \$4.5 billion per year to GCC government revenues. An oil price of \$100 pb in 2011 would lift budget revenues by more than \$100 billion compared to last year, or 28% of budgeted spending in 2011. Mirroring the trend in overall US dollar depreciation since June 2010, GCC currencies have declined by an average of 7.8% in 6 months.
- This seems to cover the cost this year of all of the extra spending measures recently announced in Saudi Arabia and Oman. Bahrain, on the other hand, is likely to see its budget position deteriorate as a net result of higher revenues and additional spending. With more than 30% of GCC imports transacted in dollars or dollar-pegged currencies, overall import cost increases may be less severe.

In IBQ's latest GCC Brief: GCC oil windfall boosts government spending power

Oil prices have risen dramatically in the past few months, as political unrest across the energy-exporting Middle East has disrupted Libyan output and added a risk premium to prices at a time when strong growth in global oil demand was already causing markets to tighten. From USD 75 per barrel (pb) in September 2010, the price of the OPEC crude basket increased to \$115 in early March 2011. (See chart 1.) At this level, prices are nearly 50% higher than their average for 2010 and 22% above the average for 2008 – which was the highest ever recorded. Although there is no guarantee that the current price will be sustained, few analysts are predicting a significant near-term drop. Futures markets are pricing in a dip of just \$5 pb by the end of 2012.



Sources: ThomsonReuters Ecowin / NBK

For the energy-exporting Gulf region, higher oil prices raise incomes and provide local governments with extra revenues via oil concessions or state-owned oil companies. In current circumstances, this has an influence beyond narrow economic considerations: it provides extra spending power for those governments undertaking

measures to boost living standards for nationals, in an attempt to address social and political grievances. Of course, governments have to consider the long-term financial sustainability of spending measures, not just short-term affordability. But the issue of how much extra spending can take place without governments dipping into their vast sovereign wealth funds may still be a real one.

How does the recent run-up in oil prices affect the amount of cash at GCC governments' disposal? Table 1 shows some broad estimates of the amount of extra budget revenue generated by each USD 1 pb increase in the price of oil. The estimates are based upon export sales of crude oil and crude oil products (implying that governments get no extra revenue from domestic sales), and assume that – for countries other than Kuwait and Saudi Arabia – the private sector captures a share of incremental oil revenues through oil concessions, production sharing agreements and so on.

Table 1: Estimated impact of \$1 pb oil price increase on GCC budget revenues

	Additional \$1 pb of oil worth...	% 2011 GDP	% 2011 budget spending
	\$ million	%	%
Bahrain	53	0.2	0.8
Kuwait	738	0.5	1.2
Oman	168	0.3	0.8
Qatar	224	0.2	0.5
Saudi Arabia	2,656	0.5	1.7
UAE	680	0.3	0.9
GCC	4,518	0.4	1.2

Sources: NBK estimates

Note: Based upon 2009 exports of crude oil and products. Uses NBK assumptions on the share of marginal oil export revenue that accrues to the government. Before transfers to SWFs.

Each USD 1 increase in oil prices yields extra budget revenues of USD 4.5 billion for the GCC as a whole. More than half of this is attributable to the region's largest oil exporter, Saudi Arabia, which exports more than 7 million barrels per day (mbpd) of crude oil and products. Bahrain – which has net exports of less than 0.2 mbpd – sees just USD 50 million in additional revenues.

Note that these figures are shown before any transfer of revenues to the region's various sovereign wealth funds. In addition, we take no account of any potential rise in gas revenues, even though they are an important part of total state revenues in countries like Oman and Qatar. In current circumstances, however, this might be reasonable. Because of a global supply influx, natural gas prices have not shared in the run-up in crude oil prices in recent months, implying less of a windfall for gas exporters. In energy equivalent terms, the barrel of oil equivalent price of natural gas stood at around USD 22 pb in March, just below its average of USD 23 pb for last year.

Table 2: Estimated budget revenue gains under different oil price assumptions

	Scenario 1 (USD100 minus budget assumption)				Scenario 2 (USD100 minus USD77*)	
	2011 budget assumption (1)	USD100- (1)	Revenue gain per year	% of 2011 budget exp.	Revenue gain per year	% of 2011 budget exp.
	USD pb	USD pb	USD billion	%	USD billion	%
Bahrain	80	20	1.1	15.5	1.2	17.8
Kuwait	60	40	29.5	46.2	17.0	26.5

Oman	58	42	7.0	33.3	3.9	18.2
Qatar	55	45	10.1	24.5	5.2	12.5
Saudi Arabia	55	45	119.5	77.3	61.1	39.5
UAE	60	40	27.2	35.0	15.6	20.1
GCC	-	-	194.4	53.2	103.9	28.4

Note: Budget assumptions for Qatar, Saudi Arabia and the UAE are estimates.

** USD 77 pb is the average oil price for 2010.*

Source: NBK estimates

Table 2 provides some indications of what an increase in oil prices to USD 100 pb (on average) in 2011 might mean for government revenues in relation to two different benchmarks. Scenario 1 shows the revenue gained in comparison to the oil prices assumed in each government's budget for 2011 (the figures for Qatar, Saudi Arabia and the UAE are estimates). These government price projections tend to be conservative, and for 2011 they range between USD 55 – USD 80 pb. An oil price of USD 100 pb would imply additional state revenues (above budget) of a massive USD 194 billion this year. This is equivalent to 17% of regional GDP, or more than half of budgeted expenditure. Some USD 120 billion of this would go to Saudi Arabia, while USD 1 billion would go to Bahrain.

This does not imply that USD 100 oil would generate government budget surpluses of the same magnitude, since under their respective price projections, most GCC governments are projecting budget deficits for this year. Rather, it represents the potential improvement in the budget position.

Scenario 2 shows the extra revenues generated in comparison to a crude oil price of USD 77 pb, which was the average price of the OPEC basket last year. In this case, the additional revenues amount to a smaller – but still very significant – USD 104 billion. This is equivalent to 9% of regional GDP and 28% of budgeted government spending for this year.

These are huge sums, but are they likely to be enough to finance the additional emergency spending measures announced recently, without radically changing the budget position or forcing governments to dip into their vast sovereign wealth funds? The near-term budgetary impact of the various spending measures can only be estimated in broad terms, since the cost of some of the measures have not yet been revealed, while others – such as house building programs - will be spread out over a number of years. Nevertheless, the revenue increases described in the two scenarios above should be comfortably enough to pay for the measures announced to date in Kuwait and the UAE. Qatar has not yet announced any spending measures.

The positions of Bahrain, Oman and Saudi Arabia are less clear cut. The Saudi Arabian government has announced by far the most extensive – and expensive - series of supplementary spending measures in the GCC. Those range from a 15% pay increases for public sector workers to a commitment to build 0.5 million new homes. Estimates of the total amount of extra spending are above USD 130 billion, half of which could be spent this year. This would account for more than the increase in revenues generated by USD 100 oil this year compared to the USD 77 of 2010. But the government would still be left with a substantially better fiscal position than that implied by its budget oil price assumption.

The IBQ report concluded: Meanwhile, we estimate that the major new spending measures in Bahrain might add around USD 2 billion to budget spending in 2011, close to double the additional revenues generated by higher oil prices this year. Short of higher revenue from other sources, the Bahraini government is likely to see its financial position deteriorate as a net result of the spending and oil revenue increases. Finally, we estimate that the main measures announced by the Omani government should cost in the USD 1-2 billion range, which would absorb half of the extra revenues generated by higher oil prices this year than last.