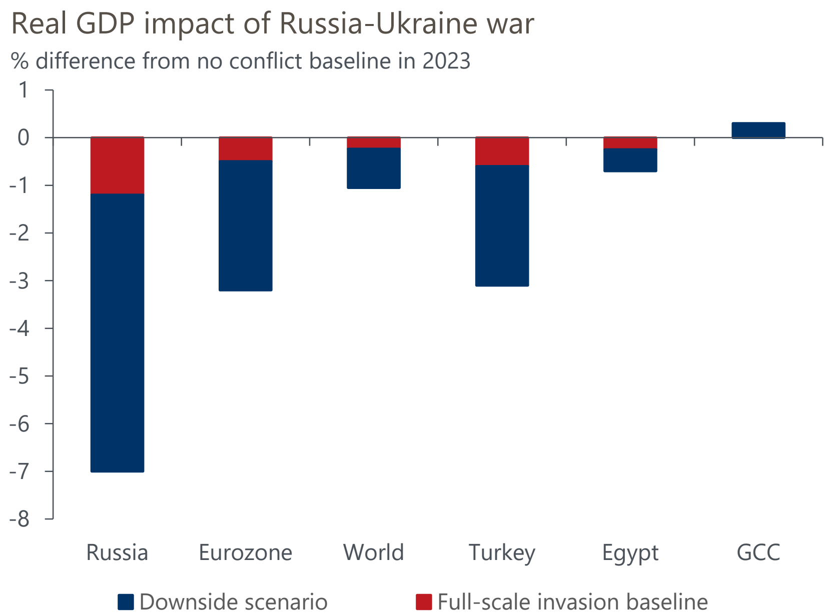
Research Briefing | MENA

Commodity price shock is a mixed blessing for MENA

- **Russia's invasion of Ukraine and the evolving global response will be felt in the MENA economies mainly via the impact on commodity prices. Fuel exporters are near-term beneficiaries of oil around $110pb, which lifts export and budget revenues, but we estimate the higher price leads to a 0.1-0.4pp hit to GDP growth in regional energy importers this year.**
- **Soaring energy and food prices will lead to substantially higher near-term inflation. Energy exporters will be better placed to support households, but importers, Egypt in particular, face a more difficult balance between fiscal challenges and the strain on consumers.**
- **The drop in outbound travel from Russia and Ukraine will undermine tourism recovery in Turkey and Egypt, adding to worries about their external positions and pressuring assets. Meanwhile, the relative outperformance of producers' bonds and stocks will continue whilst commodity prices remain high.**

The Russia-Ukraine war has triggered a significant revision to our global forecasts, which show a 0.3% hit to overall world GDP this year (to 3.7%), on the back of higher commodity and food prices as well as financial market disruption. The impact on growth, inflation and current accounts varies significantly across the world as well as in the MENA region. The GCC and other regional commodity exporters gain from the surge in energy prices, even as the unfolding conflict and intensifying economic sanctions bring us closer to the adverse scenario we recently modelled. Even in the downside scenario, the oil windfall cushions demand in the producing countries, pushing their level of GDP above our pre-invasion baseline. The more import-dependent countries, including Egypt and Turkey, face substantial headwinds, due to stronger trade links (both goods and services, lower tourism in particular) but also indirectly through the negative impact on inflation and budgets.

Chart 1: Apart from the GCC, the conflict pushes the level of GDP significantly below our pre-invasion baseline in 2023



Source : Oxford Economics/Haver Analytics

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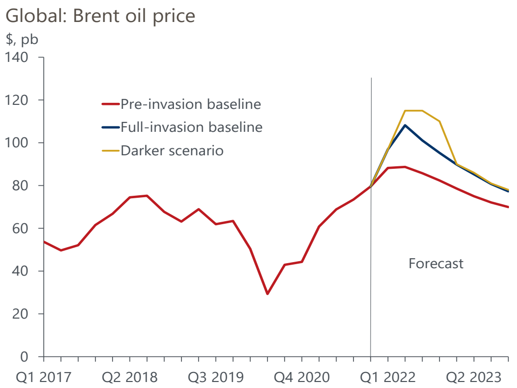
GCC GDP cushioned by higher energy prices…

The main impact of the conflict on demand in MENA economies is through the shift in the oil price. As the war in Ukraine spreads and sanctions against Russia intensify to include US and UK bans on Russian oil, Brent crude shot up above $130pb. Prices have eased since, as the UAE indicated it will encourage OPEC+ to increase oil production and fill the supply gap. Although we believe Saudi Arabia and the UAE, the two countries with spare capacity, will eventually consider stepping in as 'suppliers of last resort', there are upside risks to our 2022 oil price forecast of $100pb.

Chart 2: Oil prices remain well above $100pb



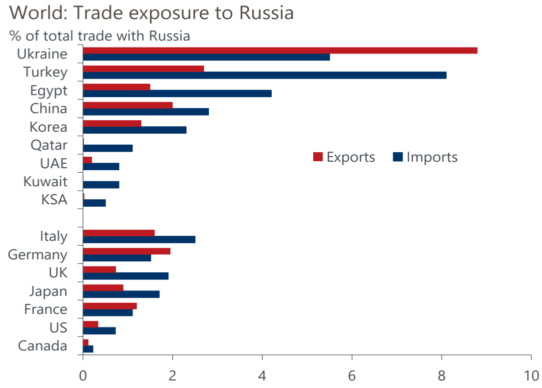
Source : Oxford Economics/Haver Analytics

The current oil price is well over double the price assumed in most regional budgets for this year. Although we do not expect a fiscal bonanza in the GCC – discipline shown in the last two years suggests the extra revenue will mostly be saved – there might be room for additional spending to dampen impact of rising prices on businesses and consumers.

…and limited trade links…

The region's trade links with Russia and Ukraine are relatively weak. GCC economies have almost no exposure to Russia on the export side, with two-way exposure only around 0.3-0.6% of total trade. Exposures are bigger for Egypt and Turkey, with imports from Russia making up 4.2% and 8.1% of total imports, respectively (**Chart 3**).

Chart 3: Trade exposure varies widely in the region



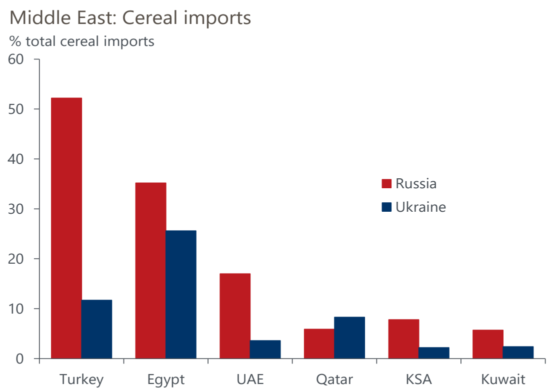
Source : Oxford Economics/UN Comtrade

…but food fall-out may be dramatic in some grain importers…

Turkey's imports from Russia are dominated by energy – Russia supplies a third of Turkey's oil and gas needs. But elsewhere, food imports account for a large share of imports from Russia and Ukraine. Both countries are major exporters of agricultural commodities such as wheat (about a quarter of global supply) and corn.

Egypt and Turkey are particularly vulnerable to any disruption in supply; grain imports from Russia and Ukraine account for over 60% of their total grain imports. In the four larger GCC countries, the share ranges from 8.1% in Kuwait, to 20.6% in the UAE.

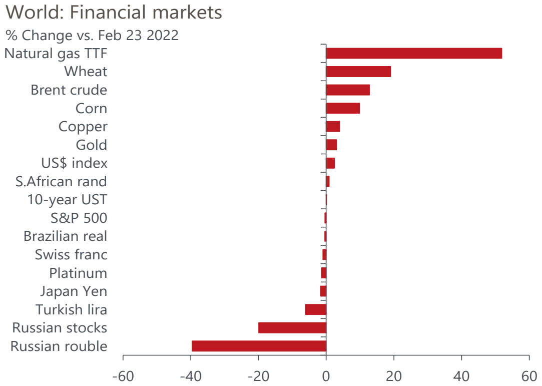
Chart 4: Russia and Ukraine account for the bulk of regional grain imports



Source : Oxford Economics/UN Comtrade

A wheat crisis would be a major negative for the region. Wheat hit their highest since March 2008, having climbed almost 50% over the course of two weeks (**Chart 5**) amid concerns over impeded harvest in Ukraine (due to fighting, fertiliser supply problems and currency weakness). Transport prices have also risen due to disrupted exports.

Chart 5: Wheat prices had spiked to a 14-year high



Source : Oxford Economics/Haver Analytics/Barchart.com

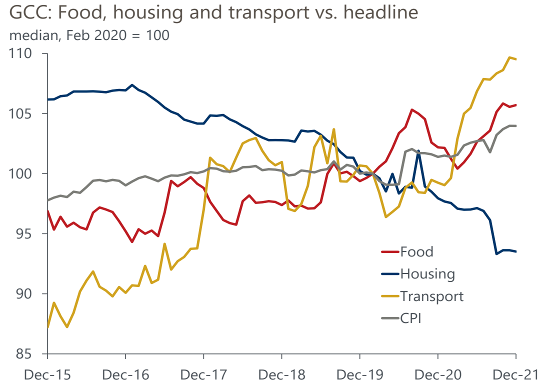
As a result, consumers in the region's big wheat importers, including Egypt, the world's largest, face the prospect of higher prices. Supply shortages are already starting to be felt – the state grain buyer recently struggled to secure an international wheat shipment – which may again lead to political upheaval, similar to unrest in 2010/11.

For Egypt, the crisis comes at a time when the government is re-evaluating long-standing bread subsidies, largely fixed since 1970s. It is unclear if the surge in wheat prices alters the pace of the overhaul (the price of unsubsidised bread rose 50% in the last week). It may not be fiscally viable to maintain the bread subsidy, but subsidy cuts will pile further costs on the vulnerable consumer.

...magnifying inflation risks

Inflation looks set to become a bigger issue as soaring energy and food prices, the two main drivers of price pressures over the past year, feed through to regional prices (**Chart 6**).

Chart 6: Inflation will become even more of a problem



Source : Oxford Economics/Haver Analytics

Food accounts for the biggest share in most regional importers' CPI baskets – with a median share of around 26.5%, 10pp higher than the GCC median. We estimate 2022 inflation will be pushed 0.2-1.5pp above our pre-conflict baseline as a result. In Egypt, inflation will now probably exceed the MPC's target of 7% +/- 2% by Q4, following a rise to 8.8% y/y in February.

The oil-driven budget boost leaves some countries better-placed to cap price rises, particularly as Ramadan approaches. Nonetheless, we are nudging down our non-oil GDP forecasts expecting inflationary pressures to constrain consumer spending in Q2 and beyond.

Tourism is also set to suffer

Travel from Russia and Ukraine will drop due to the conflict and sanctions, dashing hopes for a recovery in tourism. Destinations popular with visitors from the two countries, such as Turkey, Egypt and the UAE (Dubai), are set to suffer.

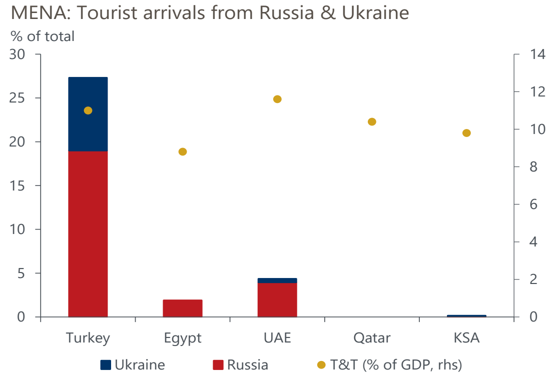
For Turkey, Russia and Ukraine are key source markets with a 19% and 8% share of total foreign arrivals in 2021 (**Chart 7**). Cancellations will bring losses; tourism income has remained well below pre-pandemic levels despite doubling in 2021.

Egypt can also bid goodbye to the expected influx of Russian tourists. Although the ban on direct flights meant only small numbers visited since a Russian aircraft was bombed in 2015, the lifting of the ban in 2021 raised expectations of a strong return. Prior to the fatal accident, Russians accounted for over a third of all inbound arrivals.

Consequently, their external positions and assets will come under further pressure. The Turkish lira has been among the currencies most affected since the onset of the conflict. Meanwhile, Egypt's central bank might again be forced to devalue the Egyptian pound (EGP) given portfolio capital exit and declining FX reserves. The EGP is now almost as overvalued (by about 13%) as in the months before the 2016 devaluation.

Dubai, which generates about 25% of GDP from tourism, is also vulnerable to a drop in visitors from the two countries – Russia is in the top three origins for visitors and Ukraine in the top twenty.

Chart 7: Absence of visitors from Russia and Ukraine will weigh on tourism recovery

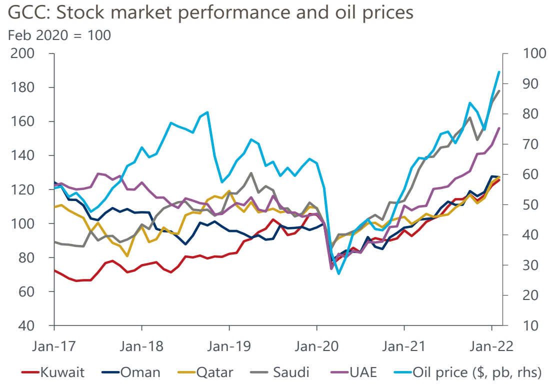


Source : Oxford Economics/Tourism Economics

Oil drives outperformance

Similar to trade exposure, direct financial links between Russia and the GCC are small relative to financial assets. In the short run, GCC bond and equity markets will remain uniquely positioned to continue enjoying support from strong commodity markets (**Chart 8**), in contrast to outright declines elsewhere in EMs. In the longer run, this relative outperformance will be vulnerable to increases in supply and/or demand hit and moderation in prices.

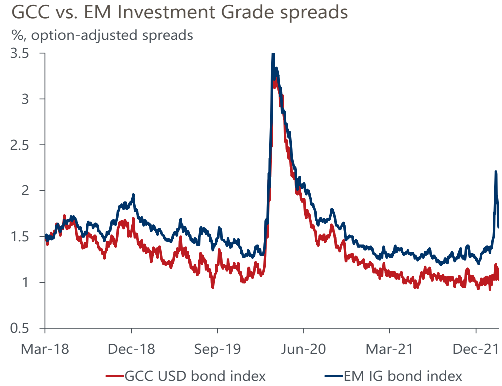
Chart 8: GCC equity markets have tracked oil prices higher



Source : Oxford Economics/Haver Analytics

Regional bonds have likewise been quite resilient amid market volatility (**Chart 9**), with sovereign spreads relatively flat. But we believe the prospect of policy tightening as well as concerns over potential fiscal spending will cap the upside.

Chart 9: GCC spreads have been calm



Source : Oxford Economics/Bloomberg

Overall, exposure varies across the region but, barring a global recession, the impact of the war will largely depend on the balance of higher imported inflation and the amount of oil revenues that can be recycled. Thus, the GCC could gain, whereas the impact on Turkey, Egypt and other importers will be firmly negative.

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