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Fitch Solutions Middle East And North Africa Key Themes For 2022: Mid-Year Review

17 Jun 2022

MENA (Region)

Economy

In December 2021, we highlighted five themes that we believed would characterise the Middle East and North Africa (MENA) region in 2022 largely focused on our expectations for how the region would emerge from Covid-19. We anticipated a two-speed recovery, with a hydrocarbon exporters and the region's largest economies leading in terms of growth and reform efforts. At the same time, we anticipated that smaller economies would struggle to catch up due to long-standing macroeconomic imbalances and elevated political challenges. Meanwhile, we predicted that geopolitical tensions between key players in the MENA region would ease in 2022, as de-escalation and reconciliation efforts advance, but with occasional flareups of violence.

Half way through the year, we believe that four of the five themes have played out as we had initially expected, while one of them – narrower fiscal deficits – has partially materialised.

HIT OR MISS? KEY MENA THEMES FOR 2022

VIEW	PLAYING OUT?	EXPLANATION
MENA Region Will Buck The Global Trend Of Slower Growth In 2022...	Yes	MENA is on track to be the only region around the world to see growth rising this year
...But Many Smaller Economies Will Still Not Reach Pre-Crisis Output Levels	Yes	The fallout of Russia's invasion of Ukraine, elevated political risks and structural weaknesses will delay the full post-Covid-19 recovery in some countries until after 2022
Sharply Narrower Fiscal Deficit, As Governments Pare Back Spending	Partial	Higher oil revenue for net hydrocarbon exporters will allow for the region's fiscal balance to shift to surplus. However, the position of net hydrocarbon importers will barely budge from 2021 levels
Business-Friendly Reforms Gaining Steam	Yes	Reform drive accelerating, as countries work towards improving their long-term economic outlook (mostly GCC countries) and/or easing external pressures stemming from the Ukrainian conflict

Source: Fitch Solutions

Easing Geopolitical Tensions, But Not Without Bumps	Yes	Reconciliation efforts between MENA powers have gained momentum
Source: Fitch Solutions		

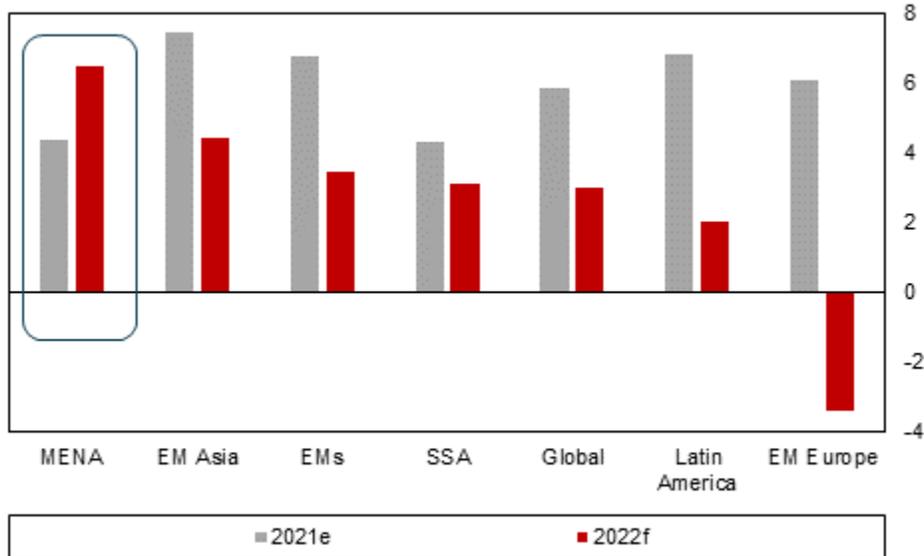
Theme 1: MENA Region Will Buck The Global Trend Of Slower Growth In 2022...

Description: Economic activity in the MENA region will accelerate to 4.1% in 2022, making it the only region worldwide to see rising growth rates. This will be driven by surging hydrocarbon output and robust non-oil economy in the GCC, as well as by strong growth in large economies outside the GCC.

Key Developments: This theme remains on track, as the Russia-Ukraine conflict has further brightened the outlook for net hydrocarbon exporters in MENA, more than offsetting the negative spillovers of the war on net hydrocarbon importers. Indeed, we now expect the region’s economic growth will accelerate to 6.4% in 2022. This is in contrast to other regions around the world where the war or Covid-19 outbreaks and renewed lockdowns have dampened growth prospects, further supporting our view that MENA will be the only region worldwide to see rising growth rates in 2022.

MENA On Track For Stronger Growth In 2022

World – Real GDP Growth, %

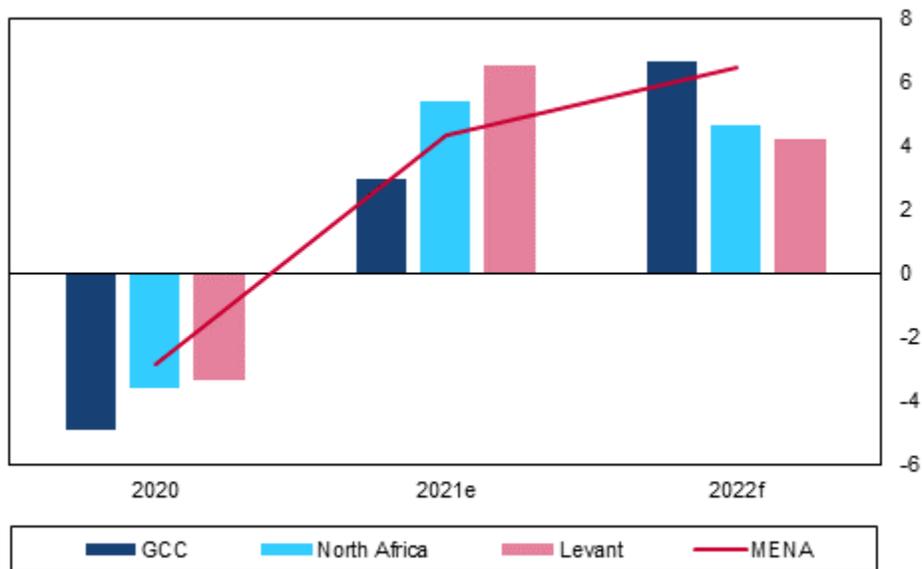


e/f = Fitch Solutions estimate/forecast. Source: National Sources, Fitch Solutions

Hydrocarbon production has increased as OPEC+ supply restrictions have eased – a trend which will continue in the coming months – while the surge in energy prices has boosted sentiment and investment activity. Indeed, our Oil & Gas team has increased its 2022 forecast for average Brent prices from USD76.0 per barrel (/bbl) in December 2021 to USD100/bbl currently. As a result, the GCC will see growth accelerate to 6.6%, from 3.0% in 2021. Saudi Arabia is on track to post growth of 7.6%, one of the fastest growth rates among major economies, while the UAE’s economy is set grow by 6.2%, the fastest growth since 2011.

GCC Is The Bright Spot In MENA

MENA – Real GDP Growth, %



e/f = Fitch Solutions estimate/forecast. Source: National Sources, Fitch Solutions

While net hydrocarbon importers, especially in North Africa, will continue to struggle with soaring inflation, and slower tourism activity and exports, slowing their economic activity, this will not be enough to offset the stronger growth outlook across the GCC.

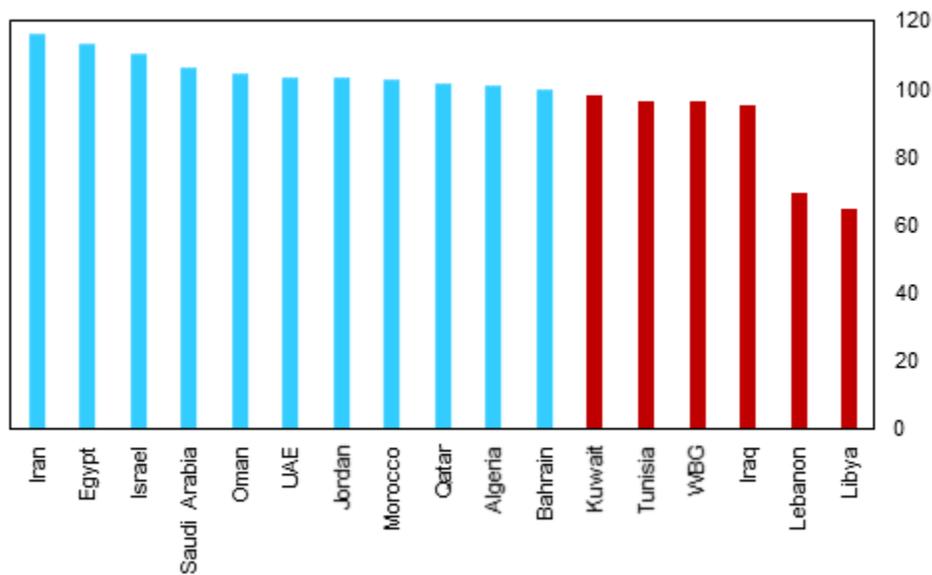
Theme 2: ...But Many Smaller Economies Will Still Not Reach Pre-Crisis Output Levels

Description: Even though MENA's regional real GDP growth is set to accelerate in 2022, structurally, many of the region's smaller countries will not fully recover from the impacts of Covid-19. This is largely due to political challenges and slower vaccination campaign.

Key Developments: Russia's invasion of Ukraine has triggered downward revisions to our forecasts for most of MENA's smallest economies, most of which are net hydrocarbon importers, further slowing their post Covid-19 economic recovery. This has been particularly true in Tunisia, where we now expect output to recover to 2019 levels by 2024 rather than in 2023. At the same time, Lebanon continues to struggle with deep structural economic imbalances and a challenging political landscape which is blocking reform efforts, delaying the prospects of meaningful economic recovery. Similarly, political gridlock and elevated security risks in Iraq and Libya will prevent a more significant recovery in the economic output of these countries.

Smaller Economies Will Not Surpass 2019 Output Levels

MENA - 2022 Real GDP As A % Of 2019 Real GDP



Source: Fitch Solutions Forecast

Among hydrocarbon exporters, even though we revised Kuwait's 2022 growth forecast from 5.0% in December 2021 to 6.7%, this will not be enough to recover the significant output losses seen during the pandemic. This is in line with our expectations in December. That said, new data show that some economies have surprised to the upside. Algeria positively surprised us with stronger growth in 2021 than we had estimated. This, along with upward revisions to 2022 headline growth, will help the economy recover to its pre-Covid-19 size in real terms this year, earlier than we had expected in December. Moreover, Iran's national accounts showed that the economy has not contracted during Covid-19, in sharp contrasts to our and other analyst expectations.

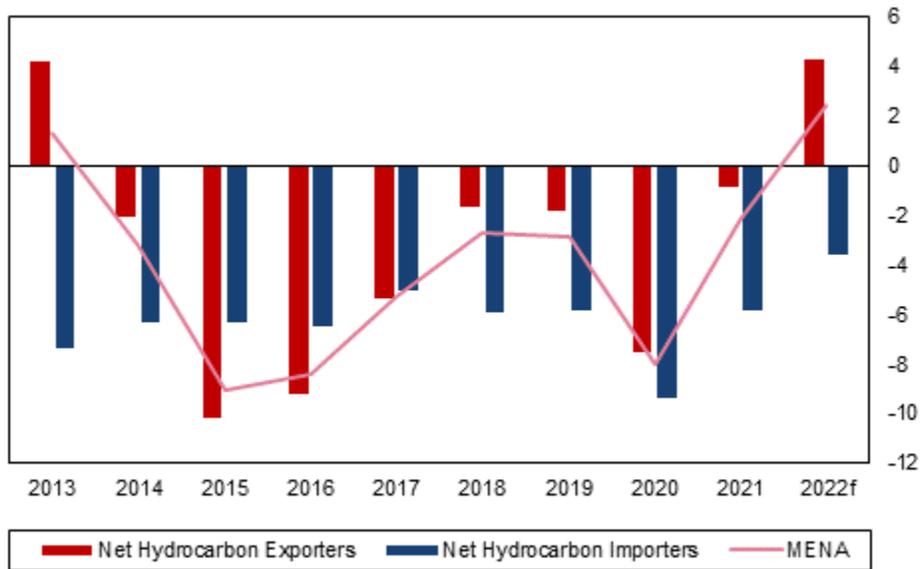
Theme 3: Sharply Narrower Fiscal Deficit, As Governments Pare Back Spending

Description: We had projected MENA's fiscal deficit in 2022 at 1.4% of GDP, the smallest in nearly a decade. The sharp reduction in the deficit will be supported by the paring back of pandemic-related expenditure and strong hydrocarbon revenues in oil exporters.

Key Developments: We now expect MENA's fiscal balance will improve even more than we had initially anticipated, shifting from a deficit of 2.1% of GDP to a surplus of 2.1% of GDP in 2022, the first since 2013. However, this improvement will mostly be driven by the region's net hydrocarbon exporters. The surge in commodity prices following Russia's invasion of Ukraine prompted our Oil & Gas team to revise up their 2022 forecast for Brent crude by 32.0% from the December 2021 forecast to USD100/bbl. This significant revision will boost hydrocarbon revenues more than we had expected this year.

MENA Fiscal Balance Will Swing To Surplus In 2022

MENA – Weighted Fiscal Balance, % of GDP



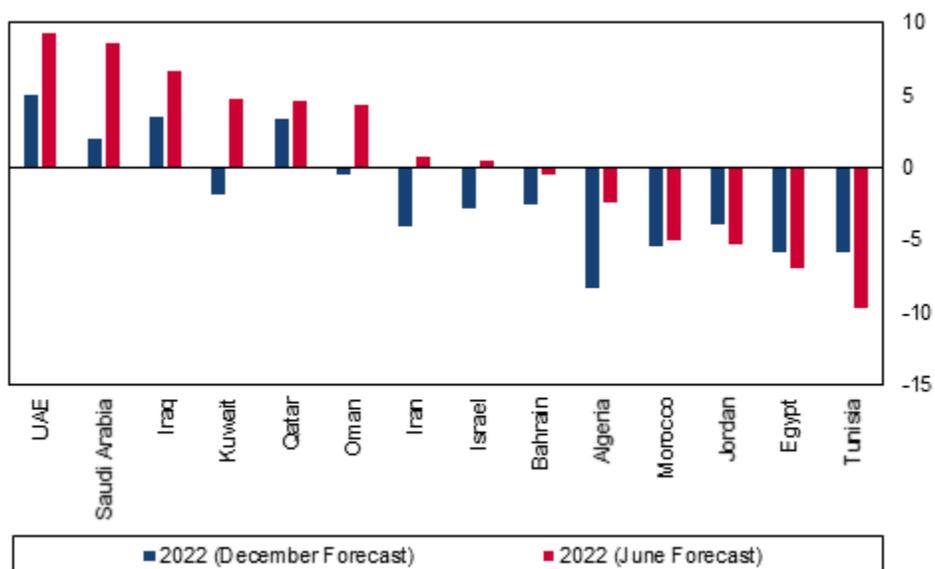
f = Fitch Solutions forecast. Source: National Sources, Fitch Solutions

While the pressure on subsidy bills has increased across most MENA countries, the impact on net hydrocarbon exports will be more than offset by higher oil revenues, improving their fiscal position in 2022 compared to our December 2021 forecasts. Moreover, even with higher oil prices, GCC countries are likely to continue to show fiscal restraint, focusing on pro-growth spending rather than short-term handouts (which has historically been the case when oil prices surge) or using hydrocarbon gains to reduce their debt load. For instance, Saudi Arabia and Bahrain stated that they will use hydrocarbon revenues to boost the assets of their sovereign wealth funds, while Oman has prioritised debt repayment.

By contrast, most net hydrocarbon importers will see wider 2022 fiscal deficits than we had initially anticipated. Indeed, the rally in food and energy prices will inflate their subsidy bills, putting increased upward pressure on spending. Morocco is the only exception as we now foresee a narrower fiscal deficit than we had expected in December 2021 as higher phosphate sales will more than offset the increase in the subsidy bill. In Egypt, the fiscal impact will be contained due to fiscal consolidation in the first half of the fiscal year. Meanwhile, Tunisia will see its fiscal deficit reaching around 10.0% of GDP in 2022, the widest in MENA.

MENA Fiscal Outlook Split Among Two Divergent Trends

MENA – Fiscal Balance, % of GDP



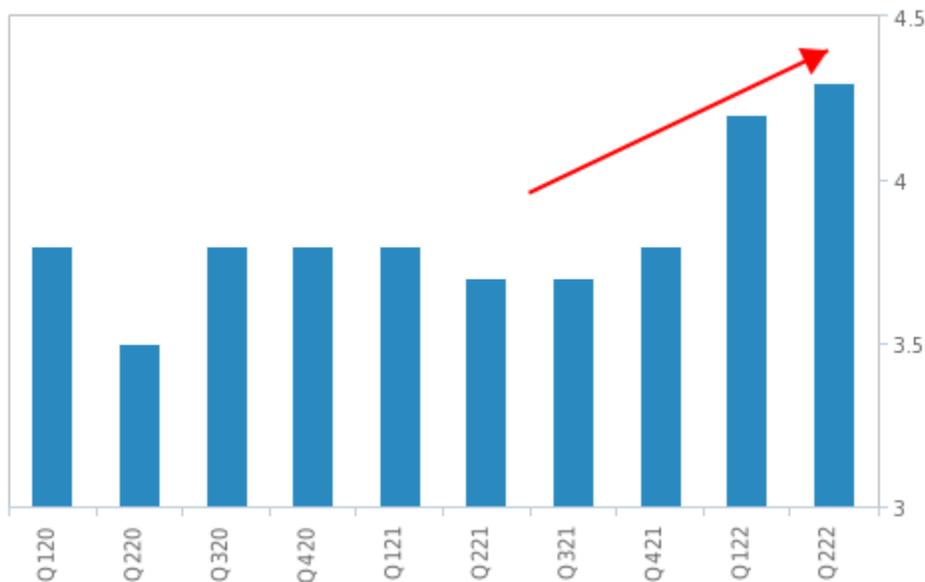
Theme 4: Business-Friendly Reforms Gaining Steam

Description: At the beginning of the year, we expected strong reform momentum in MENA's largest economies in 2022, as the shift from pandemic to endemic in the region would allow authorities to improve operating environments and attract foreign direct investment.

Key Developments: MENA's largest economies have continued to make significant progress in enacting market-friendly reform, and we expect this trend will continue in the months ahead. We raised MENA's score in our proprietary Reform Tracker, both in Q122 and Q222, underpinning the fast pace at which authorities are pushing ahead with efforts to improve their business environments. GCC countries led the way in advancing reforms, mostly as part of their diversification strategies. For instance, Saudi Arabia and the UAE have focused on reforming their labour markets and opening up new sectors for investment. In Oman, authorities reinstituted talks about privatisation, announcing plans to list three state-owned entities on the Muscat Stock Exchange in the short term and about 35 companies over the next five years. There has also been a strong push towards reform in Egypt and Iran, in a bid to counter heightened pressure on their external and fiscal positions.

MENA Reform Momentum Keeps Pace

MENA - Reform Tracker Scores



Note: Score out of 10. 10 implies stronger progress. Sources: Fitch Solutions

We expect that the reform momentum in MENA's largest economies will remain strong in the coming months, as most countries aim to alleviate weaker investor sentiment against a backdrop of sluggish global growth and improve their long-term economic outlooks. For instance, the UAE will likely continue to prioritise laws aimed at attracting and retaining population, including both talented workers and wealthy retirees, and becoming a technology-enabled and entrepreneur-friendly market. This is in line with the goals set in the country's 'Strategy for The Future', announced in November 2021. At the same time, Saudi Arabia will accelerate progress under Vision 2030, opening up key sectors such as entertainment, tourism and technology for foreign investment. We also anticipate some further modernisation in the judicial system, in line with the strong momentum seen in the past year. We also expect Egypt will continue to pass reforms to attract foreign direct investment in a bid to improve its long-term growth outlook and ease the pressure on its external and fiscal positions. We foresee strong progress towards its recently announced privatisation plan that

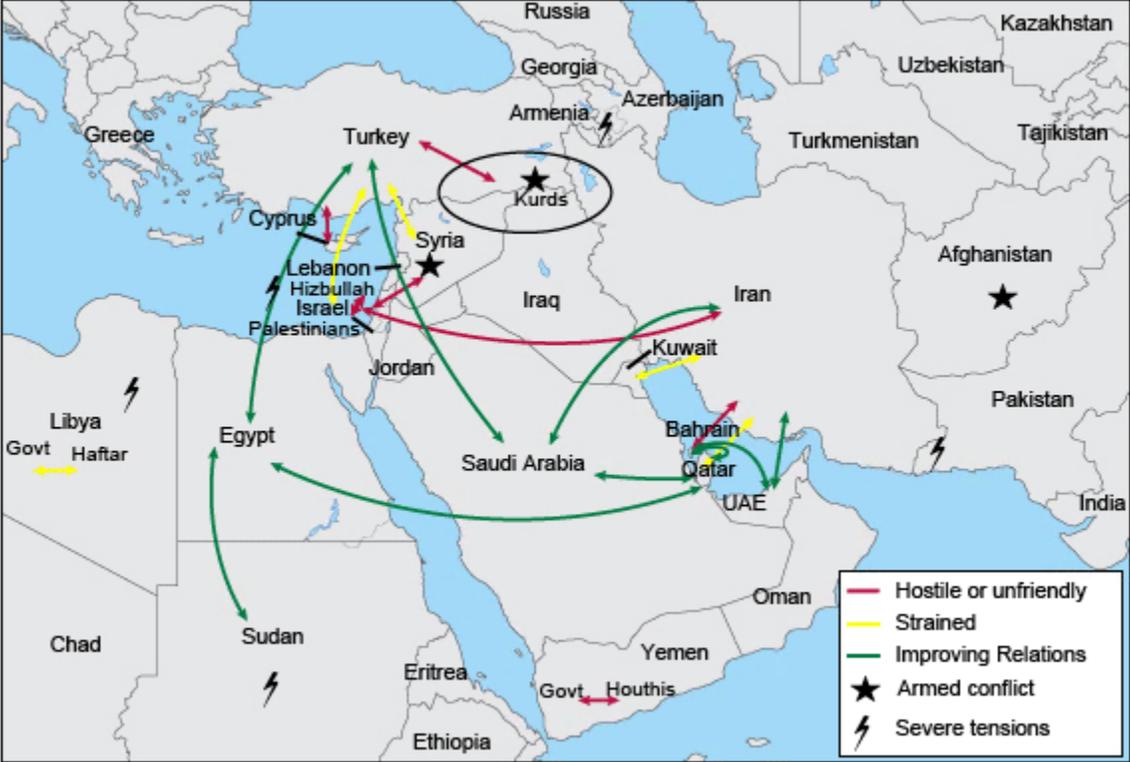
aims to reduce the state's footprint in the economy. We see some positive momentum coming from Iran too in anticipation of the lifting of the US sanctions. That said, our outlook is less upbeat for Israel, Iraq and Algeria, where a challenging political environment will act as a drag for to implement anticipated reforms.

Theme 5: Easing Geopolitical Tensions, But Not Without Bumps

Description: We believe that geopolitical tensions between MENA key players will ease in 2022, with occasional flares of violence in Iranian proxy battle-grounds. We also expect the US and Iran will reach a nuclear deal.

Key Developments: In H122, we saw a series of developments supporting our key theme and underpinning our view for a continued, albeit gradual, easing of geopolitical tensions across MENA. The most important development has been in the Yemeni conflict. While Yemen-based Houthi rebels (which are backed by Iran) intensified their attacks on the UAE and Saudi Arabia early in the year, the Houthis and the Saudi-backed coalition reached a cease fire in early April and surprised us to the upside by renewing it. Meanwhile, reconciliation efforts between MENA countries continue to advance. Most notably, Syrian President Bashar Al Assad visited the UAE in March, marking a considerable improvement in the relations of the two countries since they long fought on opposing sides in the Syrian conflict. Moreover, Turkey's President Recep Edip Erdogan visited the UAE in February and Saudi Arabia in April, after years of elevated tensions between Ankara and the GCC countries. Also, the Iranian foreign minister visited the UAE to pay respect following the passing of Sheikh Khalifa bin Zayed in May. This marks the second visit in nine years of a senior Iranian official to the UAE. Meanwhile, Israel's ties with neighbouring countries like the UAE, Bahrain and Morocco have continued to strengthen under the Abraham Accords, while relations with Egypt and Jordan have also continued to improve through the energy channel and the signing of few investment partnerships. Even Saudi Arabia and Israel have seen their relations improve somewhat, with senior Israeli officials reportedly visiting the kingdom in May and Saudi Arabia allowing Israeli planes to fly over its airspace.

Regional Tensions Will Keep Easing
Map of the Middle East



Source: Fitch Solutions

In the second half of the year, we believe the geopolitical environment in the region will keep improving. The most important development is perhaps [the rekindling of ties between the US and Saudi Arabia after two years of cooler relations between the two countries](#). This will ease Riyadh's concerns over Washington's commitment to Saudi Arabia's security. We also expect the UAE and Turkey will further strengthen their ties under the upcoming comprehensive agreement to boost bilateral trade. We also foresee greater steps towards the readmission of Syria in the Arab League, which would provide the Assad government with an official diplomatic channel to regain international recognition and improve relations with neighbouring countries. Finally, we continue to believe that the US and Iran will reach a nuclear agreement this year, marking a significant step towards the easing of tensions between the two countries. In the short term, the lifting of sanctions on Iran would provide greater geopolitical balance among the major MENA powers with positive knock-on effects on regional stability. It would also lead to lower intensity violence in proxy battlegrounds, where we nonetheless will likely keep seeing occasional flare-ups of violence. This will come mostly as a result of the indirect confrontation between Iran and Israel in Iraq and Syria. [The most imminent risk to our theme stems from the possibility of delays in reaching an agreement over Iran's nuclear programme](#).

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