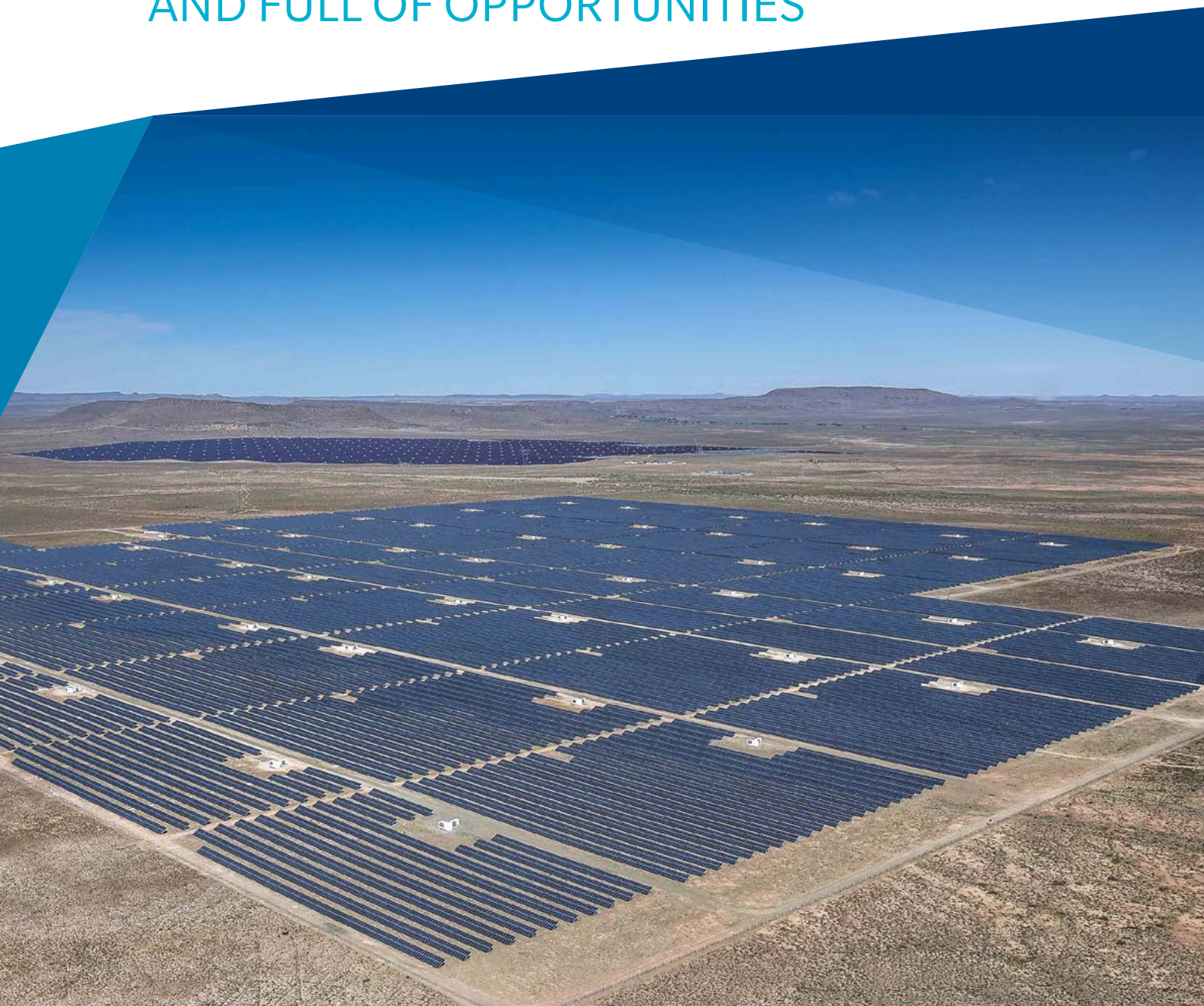


THE ARABIAN GULF ECONOMIES

ASSET RICH, TRANSFORMING,
AND FULL OF OPPORTUNITIES



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SUMMARY

We are frequently asked these days: “Are the Gulf economies entering a period that might lead to deep economic turmoil?” It is a legitimate question. After all, shale oil production has kept oil prices depressed, the replacement of fossil fuels is unstoppable and, in the past, the drive to transform and diversify some of the Gulf economies was, perhaps, half-hearted.

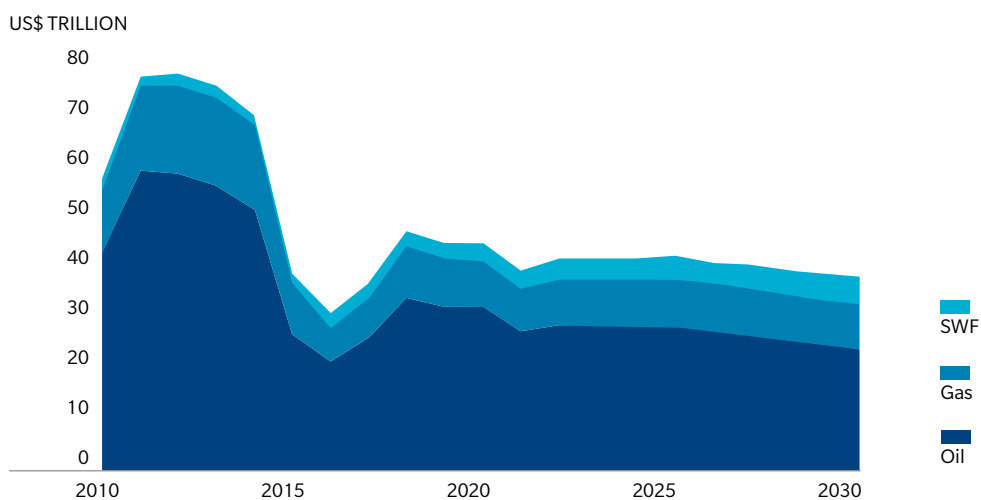
Our answer to this question is, “No”. We believe that the combination of significant reserves of liquid assets and low debt levels can finance the local governments’ ambitious economic transformation programmes, thereby creating a plethora of opportunities for most sectors of the economy. This isn’t the first time there have been questions about the sustainability of the GCC economies. Many other oil & gas producing countries have not been able to deal with economic crises. Yet the Gulf economies have shown themselves to be fundamentally resilient to turmoil.

GCC economies (and societies) will have the precious lead time they need to transform into post-oil economies, because fossil-fuel substitution (a good thing) will not happen as fast as many people believe it will.

STRONG ASSET POSITION

The Gulf economies have \$43.7 trillion in liquid and quasi-liquid assets (\$3.3 trillion in sovereign wealth funds and \$40.4 trillion in proven oil & gas reserves) – which equates to \$1.33 million in such assets per capita (Exhibit 1). This will provide the required collateral to finance the formidable economic transformation and diversification plans they are implementing.

Exhibit 1: GCC total asset values by category (2010-2030)



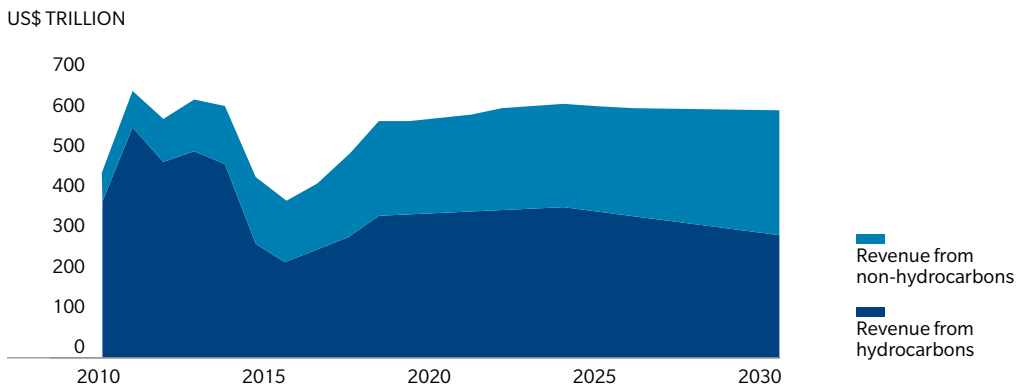
Source: Rystad Energy, Oxford Economics, WSF Institute, Preqin, Oliver Wyman analysis

REVENUE DIVERSIFICATION AND DEFICIT CONTROL

Historically, government revenues in the Gulf region have depended heavily on oil & gas sales. This is still the case today; however, the weight of this support is trending downwards (Exhibit 2) through the introduction of taxes. The VAT launch in the UAE, Saudi Arabia, and Bahrain has proved to be a success beyond the revenue it has generated.

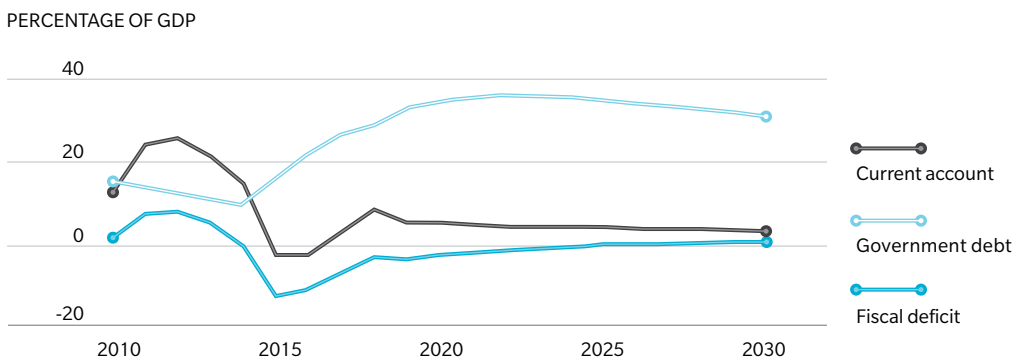
Massive current account surpluses, relevant fiscal surpluses, and low debt levels have made the Gulf economic fundamentals among the strongest in the world (Exhibit 3). After the oil price fall of 2014, there was significant deterioration of these fundamentals. Five years on, they are weaker but have stabilised.

Exhibit 2: GCC government revenues by category (2010-2030)



Source: Oxford Economics, IMF, Bahrain Ministry of Finance, Central Bank of Kuwait, Oman Ministry of the National Economy, Qatar Central Bank, Saudi Ministry of Finance, UAE Ministry of Economy, Haver Analytics, Oliver Wyman analysis

Exhibit 3: GCC fiscal deficit, debt and current account deficit/surplus as percentage of GDP (2010-2030)



Source: Oxford Economics, IMF, Bahrain Ministry of Finance, Central Bank of Kuwait, Oman Ministry of the National Economy, Qatar Central Bank, Saudi Ministry of Finance, UAE Ministry of Economy, Haver Analytics, Oliver Wyman analysis

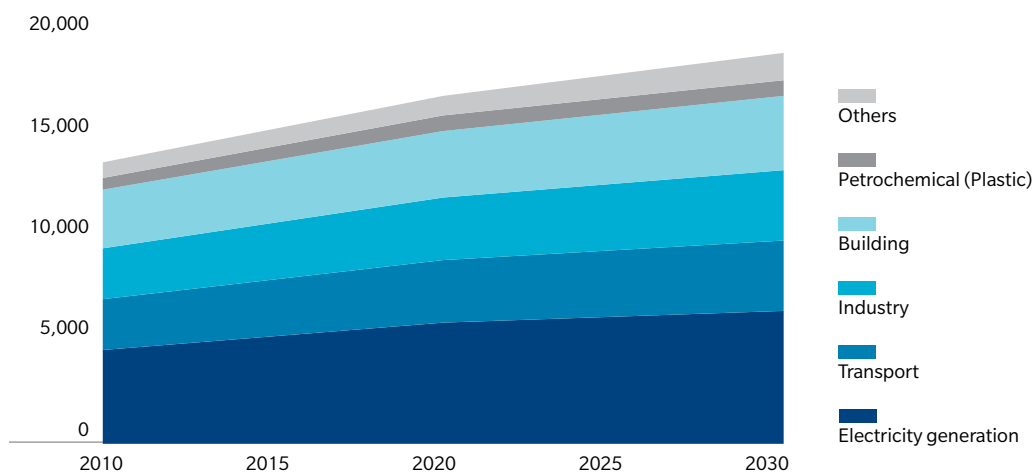
FOSSIL FUEL SUBSTITUTION – GREAT! BUT NOT SO FAST...

Total energy demand will continue to grow steadily in the foreseeable future. However, this will go hand-in-hand with the rise of renewables, which is evidently unstoppable and a boon for the future of our planet.

Fossil fuels are used for many different purposes, with electricity generation being the most important (Exhibit 4). The two categories under most pressure to be replaced are transportation and plastic manufacturing (because of their polluting effects), but they account for only one fifth of the total fossil fuel consumption. Electricity generation and industry consumption will continue to be the key demand drivers for fossil fuels for the foreseeable future.

Exhibit 4: Global fossil fuel usage breakdown (2010-2030)

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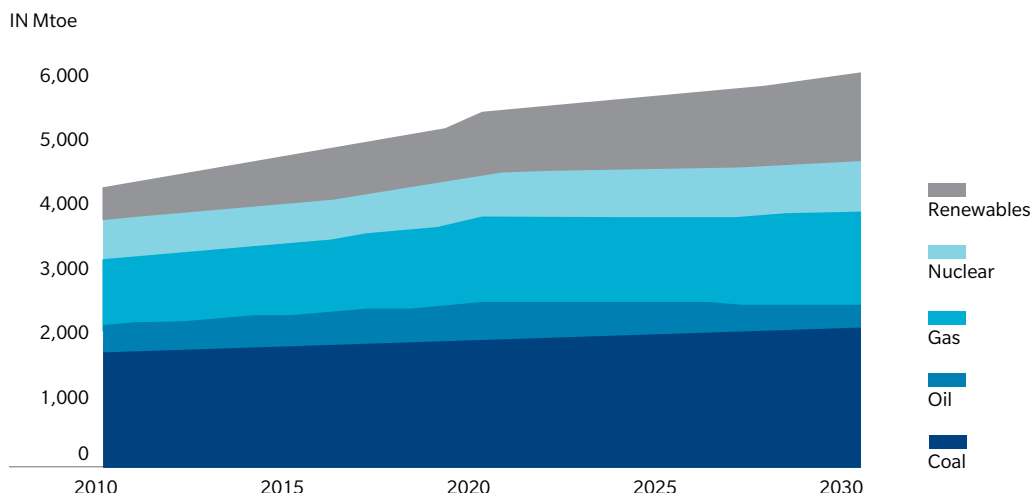


Source: International Energy Agency Annual Energy Outlook 2018

It is expected that over time cleaner sources of energy will assume a larger share of the energy supply (Exhibit 5). For instance, coal – the most polluting of all energy sources – will slowly be replaced by a mix of alternative sources: renewables, nuclear, and natural gas, the least polluting of all fossil fuels. Gas will continue to have an increasingly relevant role in electricity generation for the foreseeable future.

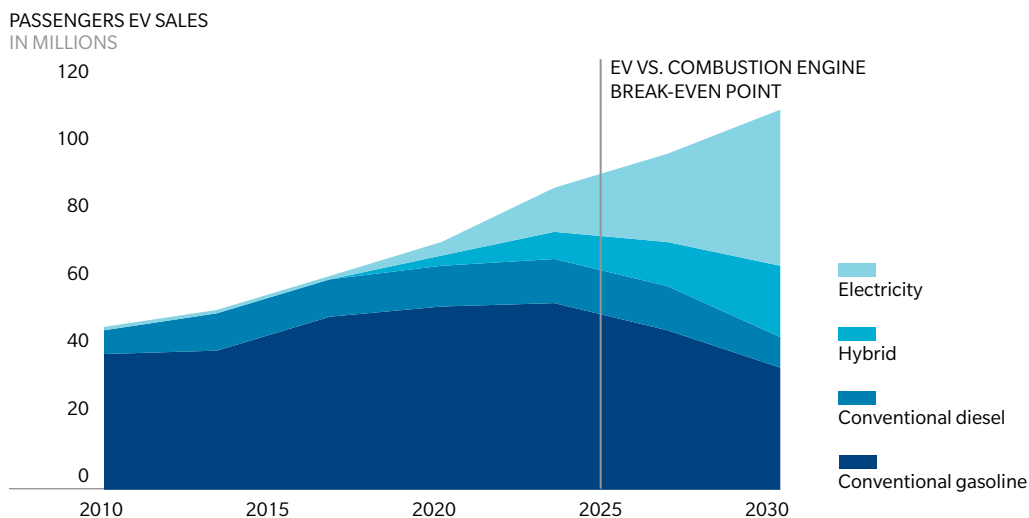
Market penetration of electric-powered vehicles (again, a good thing) is rising fast but such vehicles will still only represent 13 percent of total vehicle sales by 2025. The take-up rate will only increase significantly when battery production costs come down and electric vehicles become competitively priced without government subsidies (Exhibit 6). More importantly, transportation will represent only 18 percent of global fossil fuel usage by 2020.

Exhibit 5: Energy sources for global electricity generation (2010-2030)



Source: US Energy Information Administration Energy Outlook 2018

Exhibit 6: Global transportation powering – breakdown by type (2010-2030)

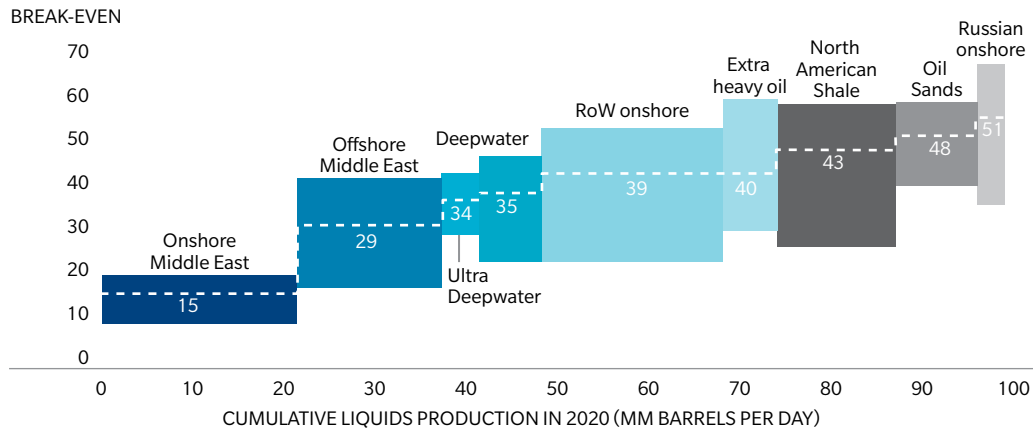


Source: International Energy Agency Annual Energy Outlook 2018, US Energy Information Administration

Moreover, while it is expected that the substitution of fossil fuels with cleaner sources of energy will continue unabated, it is worth noting that the Gulf region's cost per barrel is the lowest in the world (Exhibit 7). This means that the last barrel of oil will be extracted in the Gulf.

Exhibit 7: Production cost per oil barrel, in US\$ (2020)

GLOBAL LIQUIDS COST OF SUPPLY WEIGHTED
AVERAGE PRICE (US\$/BARREL)



Source: Rystad Energy, Evercore ISI Research

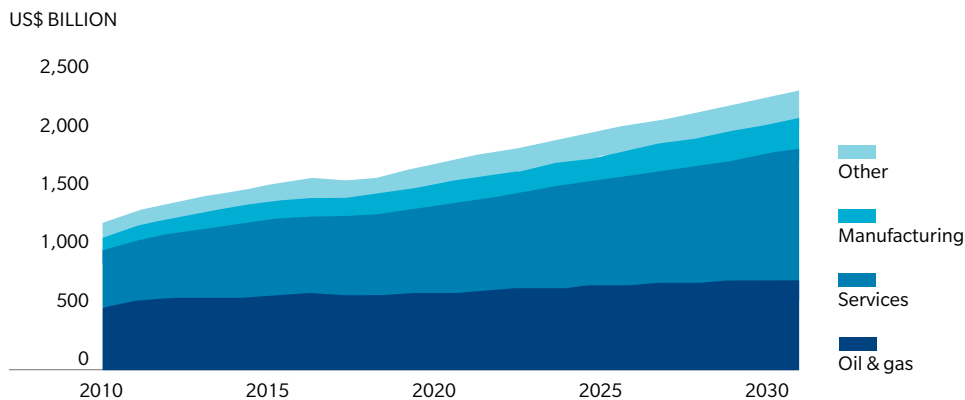
We can conclude that the pace of substitution of fossil fuels is not going to be as rapid as many expect. This will provide the Gulf economies with the precious lead time they need to transform and diversify.

TRANSFORMATION AND DIVERSIFICATION IN FULL SWING!

Most Gulf countries have now embarked on ambitious transformation and diversification programmes, and this will result in a declining contribution of the oil & gas sector to GCC GDP (Exhibit 8). The UAE, a pioneer for change in the region, has a diversified economy with oil & gas representing only 30 percent of its total GDP. All other Gulf countries have also started major programmes, albeit at different speeds. In Saudi Arabia, which makes up almost half of the region's GDP, changes are currently in full swing. They have, globally, one of the most ambitious programmes being implemented – one that is delivering a visible impact on the country's economy and society.

There is more to foster the transformation ahead than just the strong assets position and the lead time from fossil fuel substitution: a growing population, substantial fixed capital investments, and the GCC countries' stability in general, are – and will continue to be – key enablers of this transformation.

Exhibit 8: GCC GDP breakdown by sectors (2010-2030)



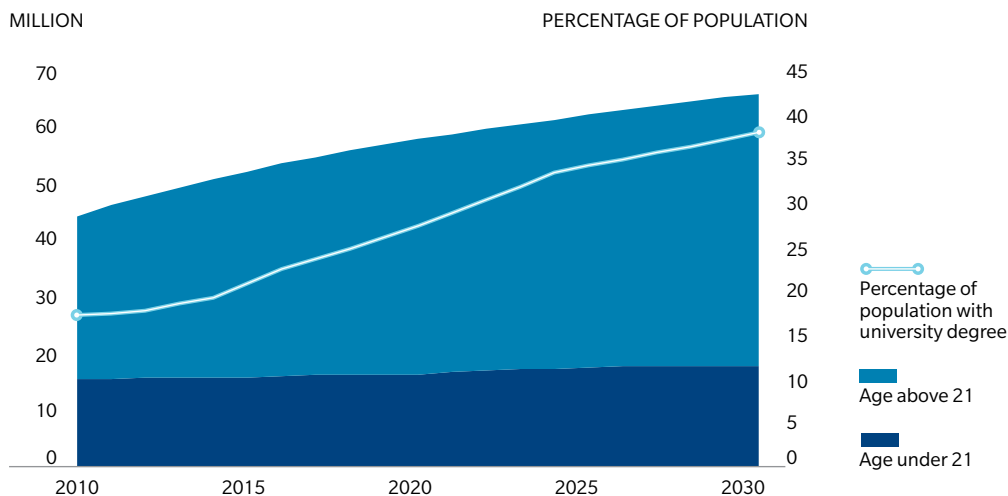
Source: Oxford Economics, IMF, Bahrain Ministry of Finance, Central Bank of Kuwait, Oman Ministry of the National Economy, Qatar Central Bank, Saudi Ministry of Finance, UAE Ministry of Economy, Haver Analytics, Oliver Wyman analysis

The GCC's population is young (30 percent were below the age of 21 in 2019) and it is expected to continue growing over the next 10 years. Alongside this, there is a positive trend in the population's literacy level, with 32 percent expected to have completed tertiary education by 2025 (Exhibit 9). This young, more-educated group will be the workforce of the future, needed by both corporations and governments to operate under a new economic model. The population growth will also increase internal consumption and therefore support the GDP growth.

Substantial investments in fixed assets have enabled the remarkable transformation of the UAE economy, and the same is now happening with other GCC countries, with KSA leading the pack. These investments are putting in place a state-of-the-art infrastructure that will make the Gulf countries one of the most attractive regions in the world to live, work, invest, and create (Exhibit 10).

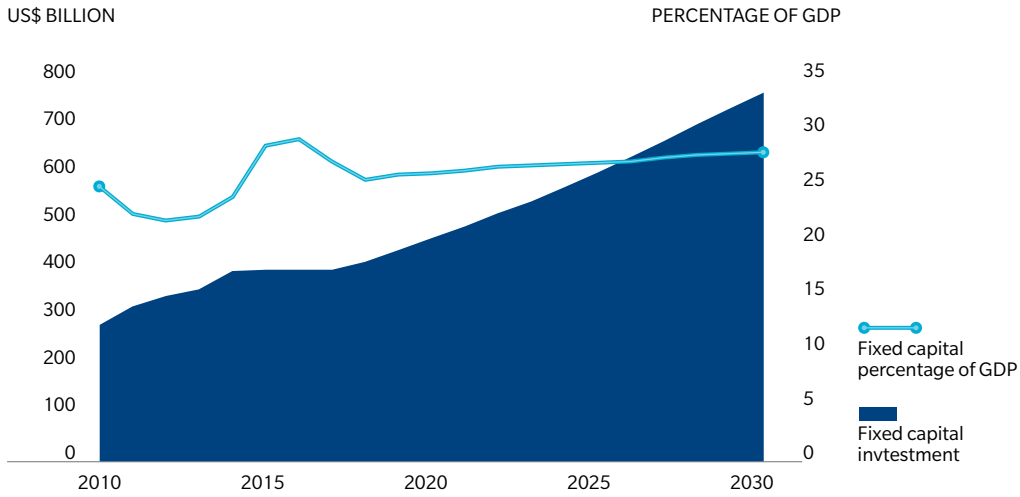
In a region plagued by conflicts and general instability, the GCC is an island of stability and predictability (Exhibit 11). Business friendly regulations, low tax regimes, and relaxed immigration policies have contributed to the ease of doing business. A notable illustration of this is that the UAE has moved from #68 to #11 in the World Bank ease of doing business index, in just ten years. The GCC will continue to be a magnet for both people and businesses, not only from the Middle East and Africa region but also from the rest of the world.

Exhibit 9: GCC population growth and percentage of population with tertiary education



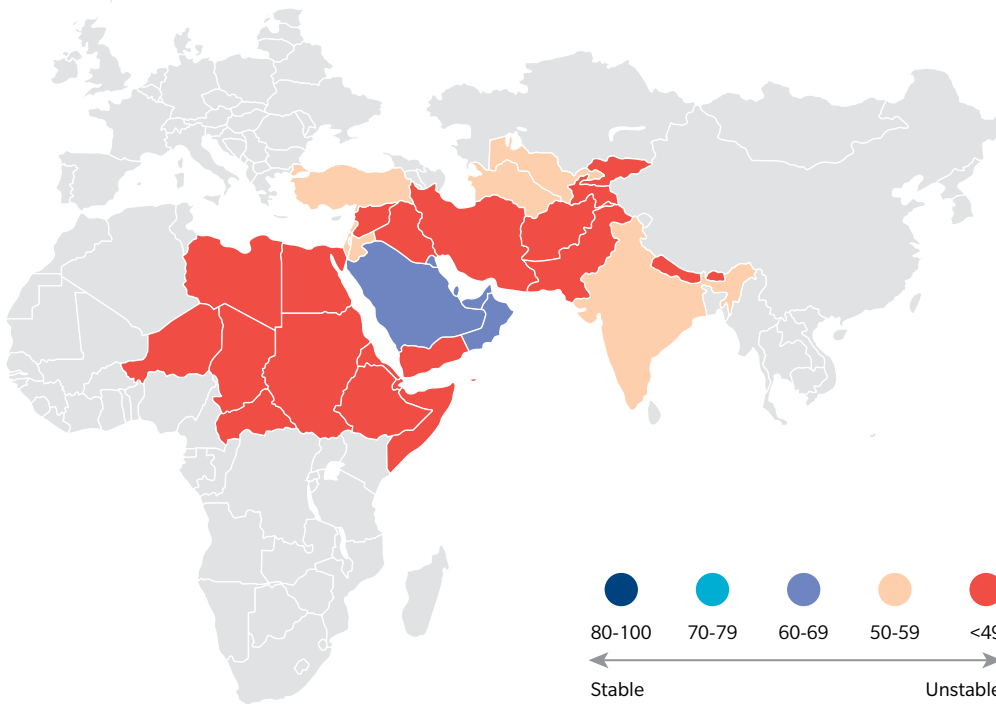
Source: OECD, UNESCO

Exhibit 10: GCC fixed capital investment



Sources: UN, Ministry of Finance and National Economy, Fitch Solutions

Exhibit 11: 2019 Marsh Risk Map



Source: Political Risk Map, Marsh 2019

LOOKING AHEAD

We see a plethora of opportunities for most economic players – both domestic and international – with limited associated risks.

The areas which we see providing the most relevant growth opportunities over the next five years are as follows:

- Overall restructuring of the public sector;
- Diversification into renewables and petrochemicals by the national oil companies and utilities;
- Fintech boom, and consolidation among financial services players;
- Revamping of the transportation sector and the construction/modernisation of the associated infrastructure;
- Expansion of tourism in terms of both what is on offer for tourists and source markets for tourism;
- Transformation of the private and public sectors driven by digitalisation and analytics.

In our view, the two biggest risks to take into consideration for the GCC economies are: governments slowing down the pace of change (in terms of diversifying their economies), and a steep reduction in the prices of fossil fuels. In our opinion, neither of these scenarios is impending at the moment. That said, a global recession – one which the market expects to start within the next two years – will temporarily create constraints on the Gulf governments' abilities to spend. As such, a recession will have multifold, adverse impacts on the region's economies, not least through the decline in demand for oil & gas.

CONCLUSION

It is our view that the Gulf's governments', societies' and corporations' unshakable willingness to transform their economies, combined with a massive stock of liquid assets and low debt levels, will enable the financing of this transformation and help to create a prosperous future for the region.

It is imperative that governments and corporations alike take advantage of the precious lead time at hand in the transition from fossil fuels to other energy sources. To do so, they must accelerate the implementation of their various transformation programmes and ensure they are delivered as planned.

Many people state that the only reason why the Gulf countries have developed and are wealthy, is because they have immense oil & gas reserves. However, there are many other countries that have even bigger oil & gas reserves, and abundant water and farmland, and yet struggle to feed their populations. The oil & gas wealth of the Gulf countries has enabled one of the biggest economic booms in human history, but this has only materialised because these countries also had – and still have – the willingness to advance and improve themselves!



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