Middle East Economy Watch

OPEC+ extends cooperation, UAE backs Egypt's turnaround and the region advances in AI

September 2024

2024 has seen relatively positive economic developments for countries in the Middle East not directly involved in the Gaza crisis. However, the year has still been challenging for the region, with the economic impact of the conflict extending to neighbouring countries.

In June, OPEC+ overcame internal tensions and agreed to extend its cooperation agreement at least through 2025 and a further adjustment was made in September, reflecting renewed supply-demand dynamics in the oil market. Additionally, non-oil sector growth indicators look solid this year. Fiscal outturns have also been positive so far, with the UAE, Qatar and Oman achieving surpluses and Saudi Arabia narrowing its deficit.

In this report, we also explore two themes in detail. First, Egypt has experienced a remarkable economic turnaround this year, following a US$35bn investment from the UAE. This has enabled the implementation of important reforms, including a liberalisation of the currency regime, which has helped to bring down inflation. As a result, Egypt has managed to unlock additional funding support from multilateral institutions and a more positive view from the market, leading to lower government debt yields. However, significant challenges remain, including the ongoing disruption to trade through the Suez Canal and persistent challenges with poverty and underemployment.

Our second theme looks at another positive development for the region - its growing leadership in the global AI evolution. A combination of robust ICT infrastructure, strategic government leadership and capital have come together to make the GCC an attractive destination for CEOs of leading AI firms. The region is also well positioned to reap some of the economic benefits of AI, enhancing efficiency and driving innovation across various sectors.

However, uncertainty looms over the region, fuelled by ongoing conflict, disruptions in the Red Sea, and reduced oil production. According to the International Monetary Fund (IMF), while lower global commodity prices and vigilant policy responses have helped to ease inflation, policymakers must focus on ensuring economic stability and maintaining debt sustainability, to enhance medium-term growth prospects.

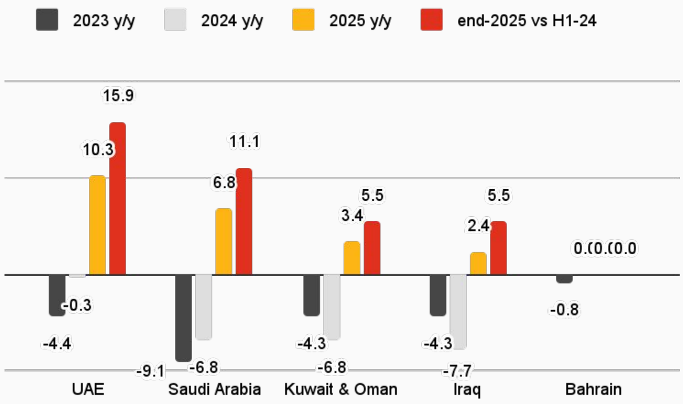
That said, as interest rates ease, especially in countries with currencies pegged to the US dollar, access to credit should improve, fostering growth in the non-oil economy. GDP forecasts from the IMF indicate an accelerating growth rate for the wider region to 2.8% in 2024 (up from 2% in 2023) and 4.2% in 2025. For Gulf Cooperation Council (GCC) members, non-hydrocarbon sectors are poised to be the primary drivers of growth as these countries continue to diversify their economies. The region also stands to benefit from shifting trade patterns by reducing trade barriers, diversifying products and markets, and developing alternative trade corridors.

OPEC+ extends agreement through 2025

The OPEC+ ministerial meeting in Riyadh in June took place amid growing tensions within the alliance of 19 oil exporters because of persistent inequalities in quota levels and overproduction by some countries, such as Iraq and Kazakhstan. This has placed a disproportionate burden on a few countries, particularly the UAE and Saudi Arabia, and to a lesser extent Kuwait and Oman, despite the original purpose of OPEC+ being to foster collaboration among all member states to balance supply and demand.

The alliance agreed to extend their production quotas through 2025, maintaining the levels set in October 2022, with a few subsequent adjustments. Additionally, eight of the largest producers - including KSA, UAE, Kuwait, Oman and Iraq - committed to maintaining their voluntary cuts during Q3 2024, and then phase them out over another year. There were two initial adjustments to this plan: the UAE was allocated an additional 300,000 b/d in 2025 due to its rising capacity, while Iraq, Kazakhstan and Russia agreed to make additional cuts to compensate for their overproduction during the first half of the year.

Change in OPEC+ allocations (%)



Source: OPEC+; actual production varies from allocations, including compensatory cuts for Iraq from August 2024 to September 2025.

The most important aspect of the agreement was the commitment to continue cooperation beyond 2024, which was far from assured. Moreover, independent assessments of capacity for each country, which had been due by the end of June, were postponed until late 2025 due to a combination of technical and political reasons. This in turn is a signal that some OPEC+ cuts could continue into 2026, which would mark a remarkable tenth consecutive year of producer action.

As always, OPEC+ plans can be quickly modified if oil market conditions materially change. This happened in September when, having averaged US$82 in the year until August, Brent crude dipped toward US$70, amidst concern about demand growth. In response, the plan to taper voluntary cuts was postponed for two months and will now start in December rather than October. This will have the impact of reducing oil supply in Q4 by about 450,000 b/d compared with the June plan. The current agreement means that overall OPEC+ oil production in December will increase for the first time in over two years, rising by 180,000 b/d, with similar tapering in subsequent months, equivalent to about a 0.45% m/m increase for the eight countries engaged in voluntary cuts. It is possible that further adjustments to this plan will be deemed necessary.

There is a broad consensus on the likely growth in supply from non-OPEC+ countries in the next few years, notably the US and Guyana, but there is a significant divergence in expectations for demand growth.

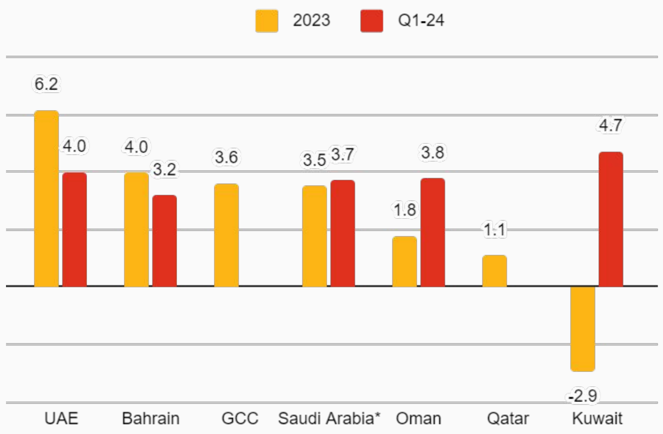
In August, OPEC's monthly demand forecast was reduced for the first time in over a year, but it still sees demand in 2025 as 3.9m b/d higher than in 2023. This is twice as high as the International Energy Agency's estimates, which were recently revised down to reflect tepid growth in demand from China.1 Conversely, there is an inherent risk that potential geopolitical flare ups could disrupt supply as has been seen recently in Libya.

Non-oil growth remains robust

Real non-oil growth across the GCC averaged 3.6% in 2023, robust but down from over 5% in 2021-22. 2023 growth was led by the UAE on 6.2%, which was driven by Abu Dhabi's spectacular 9.1% expansion.

The outturn so far for 2024 is broadly encouraging. Kuwait returned to non-oil growth at 4.7%, its strongest result in years. Other solid results including 4.0% in UAE and 3.8% in Oman, while Saudi Arabia achieved 3.7% in H1 (this is an estimate using the same methodology of non-upstream GDP as Gulf peers, its private sector non-oil GDP grew more strongly by 4.2%).

Real non-oil GDP growth (% y/y)



Source: National agencies; *H1 for KSA

High-frequency indicators suggested that Q2 non-oil growth was also solid, with Saudi Arabia's flash GDP indicating a modest acceleration. However, Purchasing Manager Indices (PMIs) softened in most countries. There was a further softening in July, with PMIs hitting multi-year lows in Saudi Arabia and the UAE, although they were still firmly in expansionary territory. Other leading indicators show a more positive story. Saudi Arabia's manufacturing index showed 8.6% y/y expansion in Q2, and tourist numbers were up by 6% y/y in Dubai, 8% in Oman and 14% in Qatar.

The non-oil outlook in the GCC remains positive. The IMF's most recent forecast from April sees non-oil GDP growth accelerating to 4.5% in 2025, which would be a three-year high and up from an expected 3.6% this year.[2] This acceleration will be supported by looser monetary policy as US interest rates are reduced, enabling GCC states with pegged currencies to also lower their rates, improving access to credit to grow the non-oil economy. Meanwhile, rising oil production could strengthen the fiscal positions of hydrocarbon exporters, provided prices remain favourable.

[1] iea.org Oil Market Report September 2024
[2] IMF's World Economic Outlook report, April 2024

Egypt’s turning point

The UAE’s investments in Egypt, particularly the Ras El Hekma land deal this year, have been a turning point in its economy. They have unlocked additional support from third parties, such as the IMF, World Bank and the EU, and averted a potential crisis. However, while this has provided some breathing space and there has been a short-term improvement in various economic and market metrics, the country still faces significant long-term challenges.

Reliance on external financing

Egypt is the region’s most populous country, with around 106m people – twice as many as the six GCC states combined. Its budget has run sizable deficits for decades and the current account has also been in deficit since 2009, which has made Egypt structurally reliant on external financing. However, in recent years the continuation of those inflows has increasingly been in doubt. External debt has risen dramatically, quadrupling between 2015 and 2023, and the cost of debt service had been draining foreign exchange reserves. Egypt's economic turmoil, in fact, deepened in 2022, triggered by the ongoing war in Ukraine, which caused commodity prices to soar and sharply increased the cost of imported wheat and fuel. This led to a mass exodus of bond investors, who withdrew about US$20 billion from the country.[3] The situation worsened with the conflict in Gaza, further intensifying the economic pressures. The currency was devalued in three managed steps during 2022-23, nearly halving its value, but the decline was even greater on the black market. This pushed up the costs of imports sharply and Egypt suffered from a particularly painful bout of post-COVID inflation, peaking at 38% in September 2023. Egypt turned to the IMF, as it has done repeatedly over decades, and agreed on an Extended Fund Facility in December 2022.[4]

This required significant reforms to unlock tranches of concessional financing, including fiscal consolidation, liberalising the highly managed exchange rate, reducing the state’s role in the economy and privatising assets to raise capital and foreign exchange.

The UAE steps in

Egypt’s privatisation agenda had some successes in 2023, but it only managed to sell a fraction of the 32 assets on its initial list. The largest deals were with the UAE, including US$800m of investments by Abu Dhabi sovereign wealth fund ADQ in three industrial companies and a US$625m investment in Eastern Tobacco by another UAE investment vehicle.[56] There were discussions with other regional investors, such as Saudi Arabia’s Public Investment Fund and the Qatar Investment Authority, but without closing deals. One of the factors thought to have delayed asset sales was the expectation that the Egyptian pound would soon be devalued, which investors expected to be reflected in pricing.

In February 2024, it was announced that the UAE would invest US$35bn in Egypt, an order of magnitude higher than any previous deals. The core of this was US$24bn in new funding (and crucially, new foreign exchange) to buy the rights to develop Ras El-Hekma, a peninsula on the Mediterranean coast west of Alexandria.

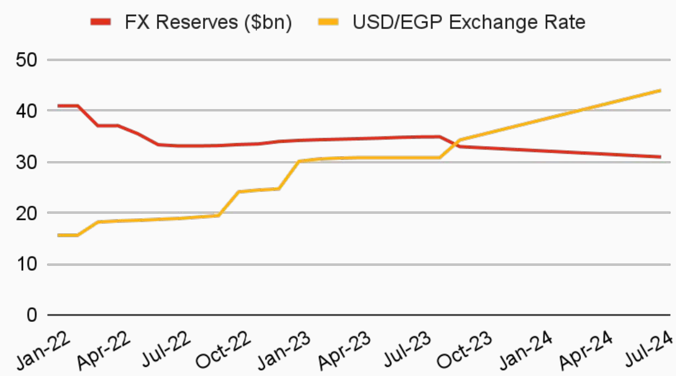
In addition, the UAE converted the US$11bn of deposits it held with the Egyptian central bank, from two rounds of coordinated GCC support in 2014 and 2020., into local currency to use for investment. This provided an immediate boost in foreign reserves, public finances and international confidence in Egypt. Moreover, it is envisaged that the development of Ras El Hekma, set to begin next year, is expected to attract as much as US$150 bn[7] in investments, including building a new airport and tourist resorts, and in turn create significant employment and revenue for Egypt, as well as for ADQ.

The momentum of the deal enabled Egypt to go ahead and liberalise its currency in March, with the pound immediately dropping by over a third. Significantly the central bank did not then resume its intervention to establish a new de facto peg rate against the dollar, as it had after previous devaluations. This, along with other reforms, was welcomed by the IMF which enable it to complete the stalled reviews of the Extended Fund Facility and boost the funding arrangement from US$3bn to US$8bn. There was also additional funding unlocked from other multilaterals, including US$8bn from the European Union and US$6bn from the World Bank.

Macroeconomic indicators have improved with the primary fiscal surplus more than tripling to US$18bn (about 6% of GDP) for the fiscal year that ended in June. Inflation has also declined every month since the deal was announced, despite the weaker official FX rate, including to 26% in July. Foreign exchange reserves have increased to $46bn in July, a record level and nearly a third more than in February.

FX reserves recover and the Egyptian pound depreciates

FX Reserves ($bn) and USD/EGP Exchange Rate



Source: Central Bank of Egypt

The market quickly warmed to Egypt, reflected in the yield on ten-year dollar bonds which had soared from under 15% in 2021 to nearly 28% in early 2024. By August 2024 it had declined to 23%, with local currency bond yields also declining. Although these yields are still expensive in absolute terms, they are making it relatively easier for the government to finance itself. Moreover, all three rating agencies (Fitch, Moody's and Standard & Poor's) have placed Egypt on a positive outlook and if these do lead to upgrades then there could be a further reduction in borrowing costs.

Challenges remain but tourism booms

Despite all the positive momentum, Egypt still faces significant challenges ahead. Even with the rising primary surplus, the interest bill is still nearly 10% of GDP. Although the official unemployment rate has been declining, underemployment and poverty levels remain high.

In the short-term, Houthi attacks on shipping in the Red Sea have diverted traffic away from the Suez Canal, causing traffic and revenue to drop by about half in the first half of 2024.

However, the impact of the Gaza conflict on tourism has not been as significant as might have been feared, with visitor numbers and revenue hitting new records in H1 2024, with tourist nights and revenue up by around 4% y/y.[8] It is possible that Egypt has benefited from a diversion of tourists from countries more directly impacted by the conflict. Additionally, the weaker pound should provide a further boost to tourism.

[3] Gulfnews.com, March 2024 Egypt makes economic turnaround with billions in investments
[4] IMF, 16 December 2022 Egypt IMF Executive Board approves 46-month USD3b extended arrangement
[5] Enterprise.news, 1 November 2023 ADQ-finalizes-acquisition of stakes in Egyptian state-owned companies
[6] Reuters.com, 16 November 2023 Egypt-sells stake tobacco firm eastern co UAE company.
[7] Egypt Independent, 24 February 2024 UAE agree to invest US 50 billion into Ras al Hikma project
[8] Egypt Today, 2 July 2024 Egypt's tourism revenues record to 6 6B in H1

Primed for transformation

Although various forms of AI have been around for decades, the emergence of Generative AI (GenAI) in the last few years has been transformative for the region's business landscape. C-suite leaders have been eager to leverage this opportunity to gain a substantial competitive advantage.

The GCC region is particularly well-positioned to capitalise on the AI revolution due to several key advantages:

Abundant investment capital: The region has significant capital for investment, particularly through its sovereign wealth funds, family offices and venture funds. It has a track record of investing in technology at home and abroad.

World-class ICT infrastructure: Even before AI became a priority, the GCC states already had some of the best ICT infrastructure in the world, including the fastest internet connections and extensive data centre capacity. This supports domestic demand and leverages the region's geographical location as a hub for fibre-optic cables connecting Europe, Asia and Africa.

A keenness to embrace new technologies: By leveraging AI, businesses in the Middle East have been able to automate time-consuming and labour-intensive tasks. In our 27th Annual CEO survey, 73% of CEOs in the Middle East are keen to embrace new technologies.[9] Business leaders recognise that technologies, such as GenAI will change the way businesses create, deliver, and capture value over the next three years. Nearly half of CEOs surveyed indicated they have already changed their tech strategy to leverage opportunities that are enabled by GenAI.

Strong international relationships: GCC states have strong links with countries and companies that are central to the AI revolution, such as Microsoft, Oracle and Amazon. To position itself as a top destination for tech investment, the UAE has offered incentives and access to its rapidly advancing AI-powered infrastructure.

Proactive government initiatives: Governments in the region recognised the potential of AI early on. The UAE launched a national AI strategy in 2017 and appointed the world's first minister for AI. Following this, other Gulf states introduced their own AI strategies and invested in educational institutions, such as the Qatar Centre for Artificial Intelligence.

These five advantages have positioned the GCC ahead of the curve since the AI boom got underway. As a result, businesses in the region have been leaders in integrating AI into their products and daily processes. Abundant access to capital, computing power, and data have led experts to believe that the UAE could emerge as the third-most-important country for AI, following the United States and China.[10]

The GCC partners with US AI firms

GCC companies entered the AI era with already established relationships with major US tech companies, such as Google, Microsoft and Amazon, which had mainly been focused on delivering cloud computing data centres. This has provided a basis for cooperation in AI, most notably the announcement in April 2024 that Microsoft would invest US$1.5bn in Abu Dhabi's G42. This follows a US$800m investment in G42 by US private equity firm Silver Lake in 2021.[11]

The US is also interested in capital investment in the sector. OpenAI's CEO, Sam Altman, has argued that trillions of dollars of investment is needed to reshape the global semiconductor industry to provide the capacity required to deploy AI, which was discussed in his recent visit to the UAE where OpenAI has partnered with G42.[12,13]

Several GCC sovereign wealth funds have already invested in US AI firms. In 2021, one of the first investments made by the newly launched Abu Dhabi Growth Fund was in chipmaker Cerebras, as a lead investor in a US$250m funding round,[14] and then this year Mubadala bought a 3% stake in Anthropic, a leading GenAI firm founded by OpenAI alum, for US$500m this year.[15] The most substantial announcement came in March, when it was announced that Mubadala and G42 would team up to launch a new AI investment vehicle, MGX, which has envisaged doing over US$100bn in deals in the coming years, potentially including chip manufacturing in the UAE.[16]

There are also partnerships between US firms and other regional players. In June, Qatar's Ooredoo announced a partnership with NVIDIA to roll out its AI technology across its data centres in Qatar, Kuwait and Oman. Alat, Saudi Arabia's advanced manufacturing champion, has a focus on sectors including AI infrastructure and semiconductors and has indicated an interest in partnering with US companies.

The energy dynamic

As the region positions itself as a major player in the global AI industry, the rapid expansion of AI technologies is driving significant energy demand, particularly in data centres. The International Energy Agency (IEA) forecasts that global data centre electricity demand will more than double from 2022 to 2026.[17]

In the Middle East, where AI and digital transformation are rapidly advancing, this energy dynamic presents challenges that require proactive solutions. By leveraging renewable energy and implementing energy-efficient technologies, the Middle East has the potential to meet AI's growing energy demands while minimising its environmental impact.

Economic impact

Assessing the likely economic impact of AI in the future is difficult, despite numerous bold projections. However, there is good reason to believe that AI's impact could surpass previous technological developments.

In the region, there are significant opportunities for AI integration to enhance business performance. In the UAE, for example, ADNOC has estimated that its use of AI tools improved its efficiency in ways that saved US$500m in 2023 and reduced its carbon emissions.[18] Other companies that have reported gains from AI deployment include Emirates NBD - one of the first firms in the region to use an AI chatbot ("Eva") for customer service calls, launched back in 2017. Meanwhile, Kuwait Oil Company has developed AI tools with IBM to enhance its reservoir management, reducing operational downtime.

On a smaller scale, payments firm Magnati is using AI analysis of merchant transactions to improve analysis of the creditworthiness of SMEs, which may improve their access to credit - is an area that has long been recognised as a weakness for the GCC banking sector and economic development.[19]

As well as deploying foreign-made AI, there have been several GenAI tools developed within the GCC, using Arabic large language models such as Jais in the UAE (developed by G42 and academic partners) and Bayan by the Saudi Data and AI Authority. The Technology Innovation Institute, a leading global scientific research centre and the applied research pillar of Abu Dhabi's Advanced Technology Research Centre, has also launched a second iteration of its renowned large language model Falcon 2. Tested against several prominent AI models in its class, Falcon 2 surpasses the performance of Meta's Llama 3 with eight billion parameters.[20]

Looking ahead, the GCC will continue to play a leading role in the global AI landscape, driven by concerted investments and strategic initiatives. For example, the national visions of regional governments are driving the region's efforts towards AI research, attracting global investment, while governments are also fostering an environment where startups and tech companies can thrive.

Sovereign wealth funds are also likely to contribute substantial capital to invest in building AI infrastructure, including chip manufacturing and data centres, some of which could be hosted in the region. However, as data continues to drive innovation, efficiency, and competitiveness, organisations must be mindful of scalability constraints, a shortage of skilled professionals, and concerns around energy sustainability.

[9] PwC Middle East, 27th CEO survey Middle East findings, 2024
[10] The Economist, 23 November 2023" Lessons from the ascent of the United Arab Emirates"
[11] G42.ai, 14 April 2024 G42 announces investment by Silver Lake
[12] " Wall Street Journal, 8 February 2024 Sam Altman seeks trillions of dollars to reshape business of chips and ai
[13] G42.ai, 18 October 2023 G42 and OpenAI launch partnership deploy advanced ai capabilities optimized UAE and broader region
[14] Arabian Gulf Business Insight, 21 June 2024 Abu Dhabi backed chipmaker Cerebras plans IPO/
[15] CNBC, 25 March 2024 FTX estate sells majority stake in startup Anthropic for $884 million.
[16] www.ai-cio.com, 13 March 2024 Abu Dhabi launches artificial intelligence tech investment vehicle MGX.
[17] time.com, ai data centers energy usage climate change
[18] ADNOC.ae news and media 5 March 2024 '$500 million in value generated by ADNOC through deployment of ai solutions in 2023'
[19] Financial Times "Fintech in AU deal with Brookfield backed Abu Dhabi payments group
[20] Technology Innovation Institute, Tii.ae, Falcon models

Data and projections

	GDP share 2023		Real GDP growth (% y/y)			Inflation (% y/y)			Fiscal bal. (% GDP)	
	PPP	MER	Q1-24	2023	2024p	Jun-24	2023	2024p	2023	2024p*
Middle East	100%	100%	-	0.8	2.1	5.9	5.5	6.7	-0.8	-2.5
GCC	59.7%	73.1%	0.3	0.4	1.9	1.7	2.2	2.3	1.2	-0.3
Saudi Arabia	33.3%	36.8%	-1.7	-0.8	1.7	2.2	2.3	2.3	-2.0	-3.3
UAE	13.3%	17.4%	3.4	3.6	3.5	2.3	1.6	2.1	7.6	4.5
Qatar	4.8%	8.1%	-	1.2	2.0	1.0	3.0	2.6	5.4	5.1
Kuwait	3.9%	5.6%	2.7	-3.6	-1.4	2.8	3.6	3.2	-3.1	-3.8
Oman	3.0%	3.8%	1.7	1.3	1.2	0.7	0.9	1.3	2.2	3.7
Bahrain	1.4%	1.5%	3.3	3.0	3.6	1.4	0.1	1.4	-4.8	-6.9
Non-GCC	40.3%	26.9%	-	1.9	2.6	17.5	14.6	18.6	-6.1	-8.4
Egypt	26.8%	13.6%	2.2	3.8	3.0	27.5	24.4	32.5	-7.1	-10.9
Iraq	7.6%	8.8%	-	-2.2	1.4	3.6	4.4	4.0	-7.7	-7.6
Libya	2.5%	1.6%	-	10.2	7.8	2.3	3.4	2.9	8.5	5.2
Jordan	2.0%	1.8%	2.0	2.6	2.6	1.8	2.2	2.7	-5.3	-7.7
Lebanon	1.2%	0.8%	-	-	-	41.8	-	-	-	-
Palestinian Territories	0.3%	0.5%	-35.0	-6.1	n/a	54.0	5.9	n/a	-1.1	n/a

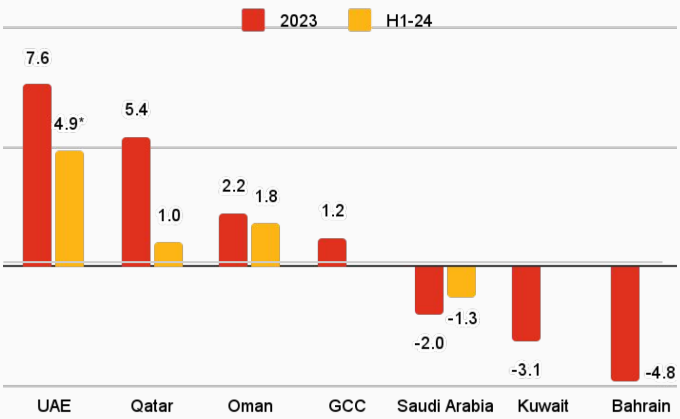
Sources: PwC analysis, National statistical authorities, IMF estimates and forecasts (WEO, April 2024, Article IV Consultation for Saudi Arabia). *Inflation: UAE estimated based on Dubai and Abu Dhabi; Fiscal balance: Kuwait 2024p from Moody's. Notes: The Middle East region is defined here based on PwC Middle East's business coverage (which excludes non-Arab countries, Syria and Yemen).

Chart of the quarter

In 2023, the GCC achieved an aggregate fiscal surplus of 1.2% of regional GDP. This was down from the 5.8% achieved in 2022 but was still the second-strongest result since 2013. The narrowing is no surprise given that oil prices fell by about a fifth and OPEC+ also cut production. Hydrocarbon revenue overall declined by -15% and expenditure rose by 8%. More positively, non-oil revenue increased by 5%, led by Saudi Arabia at 11%.

Moving into 2024, Qatar's surplus narrowed to about 1% of GDP in H1 and Oman's dipped slightly to 1.8%. Conversely, Saudi Arabia's deficit narrowed to -1.3% of GDP, supported by the Aramco performance dividend. In Q1, the UAE posted a strong surplus of nearly 5%. Spending growth was modest in most of these states, including just 2.1% y/y in Oman and 1.3% in Qatar, but Saudi Arabia's continued to grow rapidly, up 12%. Given that oil prices have dipped towards $70 a barrel in September, and spending is usually skewed to the second half, full year balances are likely to be weaker than in H2, except perhaps for Qatar given timing lags in its LNG revenue relative to oil revenue in the region.

Fiscal balance (% GDP)



Sources: Ministries of finance; actual or estimated GDP; Kuwait's fiscal year ends in March. *Q1-24 for UAE.

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