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BBVA EAGLEs
Emerging and Growth-Leading economies

Economic Watch
EAGLEs

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Economic Analysis

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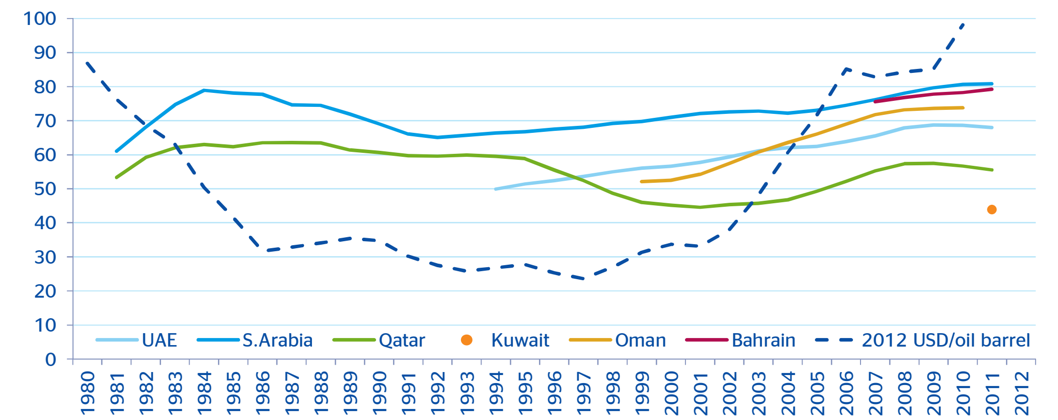
Gulf diversification on hub services and spillovers from abundant liquidity

- **Non-oil activities gain share along with increasing energy prices, but the pace of diversification seems to lose momentum in the aftermath of the global crisis**

After the collapse of oil prices in the early 80s, the real value of an oil barrel remained at minimum levels for 15 years (below 40 constant 2012 USD). Thereafter, rapid growth in the emerging world since the beginning of the 21st century has pushed up energy prices back to high records (above 90 constant 2012 USD). During this time, GCC have started to engage in other activities. However, while the importance of activities other than oil had increased steadily before the crisis, adding 15pp on average to its share between 2000 and 2009, the upward trend stopped in the aftermath of the crisis. In some countries, such as Qatar or the UAE the share of activities other than oil to GDP has actually fallen up to 2012 (Chart 1).

Chart 1
Non-oil GVA/GDP in GCC countries and oil real prices (1980-2012) (% of total real GDP/GVA and constant 2012 USD per barrel)



Note: 3-year centered moving average
Source: BBVA Research, Haver and IMF/WEO

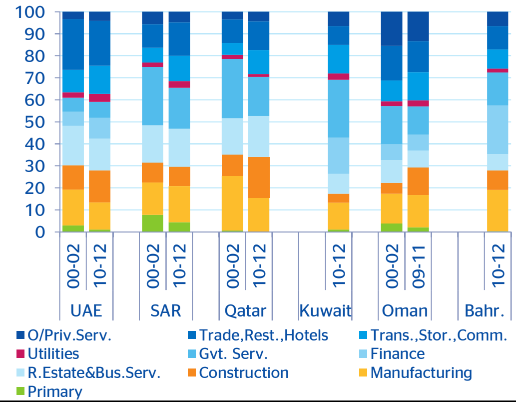
- **Trade surpluses feed money creation, which is behind growth of construction activities, real estate and financial services**

Favorable terms of trade and strong demand from emerging markets have provided the GCC countries with abundant international reserves. The stock money (M3) has strongly accelerated growth in the 00s (around 10% annual real increases for Kuwait and Saudi Arabia and close to 20% for Qatar), doubling rates from references in the 90s. This process of money creation is behind the boom of not only the financial sector as intermediary but also of quite leveraged activities such as construction and real estate. For instance, the construction sector explains in Oman 7 out of the 20pp gain in the share of non-oil activities between 2000 and 2012 (Charts 2 and 3).

- ## Governments have reduced their participation in non-oil production but fiscal support recently increased and so did risks to energy shocks

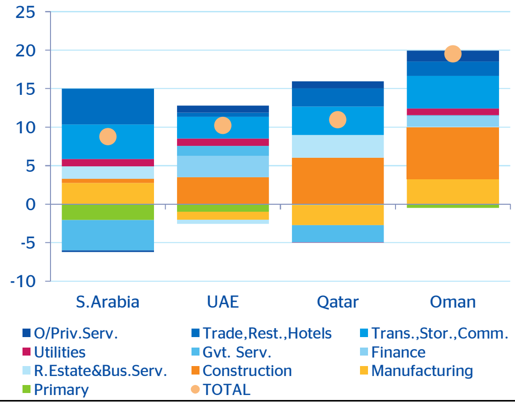
The share of government services in total GDP has decreased on average since the beginning of the century. The loss of relevance is much more acute relative to non-oil activities; around 7pp for Saudi Arabia, Qatar and Oman, while the UAE is a noticeable exception since it recorded an increase in both ratios (Charts 2 and 3). Despite its decreasing trend, the role of the government has increased during the last years. Public expenditure has grown fast on the impact of the crisis and the Arab Spring, in particular through the wage bill. In addition, two thirds of national employees work today in the public sector. On the risk side, break-even oil prices have substantially increased and thus exposure to shocks[1].

Chart 2
Industry composition of non-oil GVA/GDP in GCC countries (%): average for 2000-02 and 2010-12



Note: Real estate, business and financial services together for Saudi Arabia and Qatar
Source: BBVA Research and Haver

Chart 3
Change in share of non-oil industries in GCC countries between 2000-02 and 2010-12 (pp of total GVA/GDP)



Note: Real estate, business and financial services together for Saudi Arabia and Qatar
Source: BBVA Research and Haver

- ## UAE has become a regional trade and transport hub supported by good quality infrastructure

Abundant financial resources from oil exports and availability of skilled foreign workforce are behind extensive infrastructure investments during the last decade. According to the WEF, the quality of overall infrastructure in the GCC countries is much better than the world average and shows developed standards. This is even truer in the UAE, which ranks 6th out of 144 countries; by 2015, Dubai is expected to have the world's busiest airport and Emirates to become the largest wide-bodied carrier. In addition, its geographical position, the development of the financial system and, last but not least, the political will have boosted the area as a regional hub for service activities such as trade and transport. Accordingly, "transport, storage and communication" industries gained an average share of 4pp over total GDP since 2000, whereas "wholesale and retail trade, restaurants and hotels" services also increased by more than 2pp. The process has been particularly intense in Saudi Arabia (Charts 2 and 3).

[1] IMF Regional Economic Outlook for Middle East and Central Asia, November 2013. http://www.imf.org/external/pubs/ft/reo/2013/mcd/eng/pdf/mreo1113.pdf

- **Increasing purchasing power channeled through higher consumption and investment, although domestic manufacturing remains marginal**

  Imports of consumer and capital goods by GCC countries more than tripled in the 00s, increasing from USD 38bn in 2000 to 131bn in 2010 for the aggregate of Oman, Qatar, Saudi Arabia and the UAE. During that period, reliance of imported goods remained high, especially in the smallest economies, while the share of manufacturing activities is still low in international standards (15% of non-oil activities and 10% of total GDP) and even declined in Qatar and the UAE (Charts 2 and 3).

- **Further export diversification is harder to achieve and needs reform momentum**

  As pointed out at the beginning, diversification in the Gulf seems to be facing difficulties in moving up to the next milestone. At this point some questions arise beyond the economic impact of the crisis and some particular financial problems in the region. Are spillovers from the oil price shock in the 00s fading away? Or is it that oil prices have reached such high levels that incentives are stronger to exploit further their endowment comparative advantage? Asian rapid growth will be (and keep) contributing to these incentives[2] [3].

  In any scenario, productive structures in the GCC countries need continuous reform momentum. In particular, malfunctions in the labor market need to be addressed, including the improvement of the education system and turning neutral for nationals the choice between private and public jobs. The hub role that the area already plays in financial, transport and trade should be used to generate non-oil value, while enormous resources managed by SWFs could be decisively contributing to a healthy diversification strategy. It's not about losing the energy comparative advantage but to reinforce their benefits.

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[2] "EAGLEs increasing demand turns energy security into a South-South issue", BBVA Research, May 2013. www.bbvaresearch.com/KETD/fbin/mult/EW_EnergyMay13_i_tcm348-386066.pdf?ts=20112013

[3] "Asia-driven South-South trade intensifies specialization patterns in the rest of the emerging regions", BBVA Research, May 2013. http://www.bbvaresearch.com/KETD/fbin/mult/EWSouthSouthTrade_i_tcm348-390302.pdf?ts=20112013

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