PRESS RELEASE

Gulf countries benefit from higher energy prices, but inflationary pressures are increasing

Paris, April 27, 2022 – **Oil prices stabilized around $100 - the highest level since 2014 - are unsurprisingly benefiting the Gulf countries. However, rising agricultural commodity prices are putting upward pressure on consumer price inflation.**

Despite diversification efforts, hydrocarbons still represent a major source of revenue for the Gulf countries. Hydrocarbon production accounts for around 30% of GDP in the UAE, 40% in Qatar and Saudi Arabia, 20% in Bahrain and 45% in Kuwait and Oman. **Higher oil prices should thus allow to increase public sector spending and investment throughout the region.** These account for nearly 40 percent of total final consumption expenditures and 20 percent of total investment in Saudi Arabia.

Higher energy prices will also boost the sentiment in the private sector, helping to increase investment in non-oil activities. The PMI data indicates that output growth remains strong in the UAE and Saudi Arabia. Both countries remain in competition to attract the foreign direct investment needed to diversify their economies. Rising hydrocarbon revenues are also expected to support the contribution of net exports to GDP growth, particularly in Kuwait and Qatar (hydrocarbons account for around 90% of total exports), Saudi Arabia (70%) and Oman (65%).

Despite the improved economic performance, especially for exports, **higher prices for all commodities, including food, will strengthen inflationary pressures in the region**. These pressures will be exacerbated by high shipping costs. **The Gulf countries import 85% of their food needs**. To increase the food supply stability, governments have opted to buy lands in producer countries, mostly in Africa and Asia. However, food accessibility can become a challenge as many producing countries have started to cap their exports to meet domestic needs and moderate inflation. Thus, **while inflation in the Gulf countries will remain lower than in other areas, mainly on the back of cheaper domestically produced energy, it is expected to increase above 2.5% on average.** Saudi Arabia should be an exception, as it will benefit from a favorable VAT base effect.

Furthermore, although higher energy prices will improve fiscal balances in the GCC countries, high wage bills, due in part to the number of people employed in the public sector, will continue to weigh on budgets. For example, Kuwait's budget allocates 55% of its total expenditure to wages and benefits by 2022, according to the World Bank.

Overall, the **outlook for growth and inflation will make central bankers in the Gulf countries confident in implementing rate hikes.** In March, the central banks of Qatar, Kuwait, Saudi Arabia, the United Arab Emirates and Bahrain raised rates by 25 basis points following the Fed's decision. If the Fed tightens more aggressively than expected, **the tightening of financial conditions could weigh on the momentum of domestic consumption and investment in the region.**

Finally, it seems unlikely that the Gulf countries will be able to compensate for the partial withdrawal of Russian oil from international markets. Saudi Arabia's share of EU crude oil imports is almost 7.5%, while that of the UAE is less than 1%. These countries have been able to secure long-term contracts with their Asian customers through long-standing relationships. For example, 90 percent of Qatar's exports are tied with long-term contracts with Asian customers. Nevertheless, Qatar and Germany agreed on a long-term energy partnership in March to progress discussions on long-term LNG supplies. The EU now imports 5% of its natural gas from Qatar, compared to 41% from Russia and 16% from Norway.

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