ERF Policy Brief No. 52 | April 2020

ERF Policy Brief

Covid-19 and Oil Price Collapse:

Coping with a Dual Shock in the Gulf Cooperation Council

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In a nutshell

- *Countries in the Gulf Cooperation Council (GCC) face a dual shock—from both the Covid-19 pandemic and the collapse in oil prices.*
- *Authorities should focus first on responding to the health emergency and the associated risk of economic depression and postpone fiscal consolidation linked to the persistent drop in oil prices until recovery from the pandemic is well underway.*
- *A combination of bailouts, eased credit condition and monitoring is needed to support the private sector, including small- and medium-sized enterprises. Cash transfers to vulnerable households, including expatriate workers, would help protect them and support consumption.*

The Effects of the Dual Shock on the GCC

The Gulf Cooperation Council (GCC) countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates UAE)—face the dual shock of a pandemic caused by the novel coronavirus and a collapse in oil prices.

The novel coronavirus—which Chinese authorities first reported to the World Health Organization (WHO) on December 31, 2019—has spread globally. The virus has infected more than 2 million people and caused more than 140,000 deaths as of April 16, 2020. About 540,000 individuals have recovered.

The virus has affected GCC and other MENA countries. As of April 16, 2020, Saudi Arabia had reported 6,380 cases; Qatar, 4,130; Bahrain, 1,700; Kuwait, 1,524; the UAE, 5,825; and Oman, 1,019 [2]. Other countries in the Middle East and North Africa (MENA) have also reported infections, of which Iran has been hardest hit.

The ability to contain the virus depends on the strength of public health systems[3]. GCC's health systems are better prepared than those of other countries in the MENA region[4]. Overall, MENA ranks last among the world's regions in the "epidemiology workforce" and the "emergency preparedness and response planning" components of the Global Health Security Index. Both epidemiology

[1] *The views expressed here do not necessarily reflect the views of the World Bank Group and the countries it represents.*

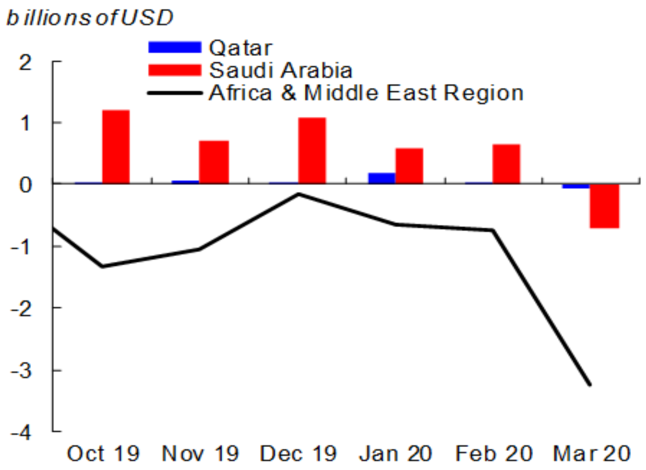
[2] *https://www.worldometers.info/coronavirus/*
[3] *http://data.un.org/Data.aspx?d=WHO&f=MEASURE_CODE%3AWHS6_102*
[4] *See Global Health Security Index at https://www.ghsindex.org/*

and emergency preparedness are critical to fighting the pandemic. Under these circumstances, the need for transparency and freer information flow is pervasive and the region risks dramatic consequences if it does not expeditiously address both during this health crisis (Arezki et al, 2020b).

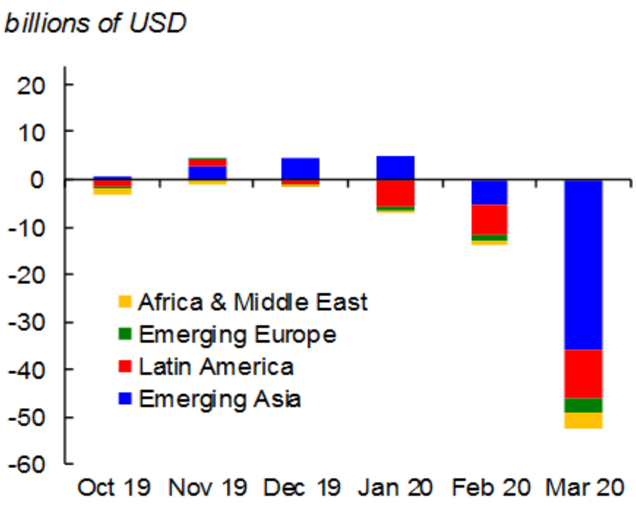
The virus will not only claim lives. Its spread will confront GCC with both a negative supply shock and a negative demand shock (Baldwin and Weder di Mauro, 2020). The negative supply shock comes first from a reduction in labor—directly because workers get sick with Covid-19, the disease caused by the virus, and indirectly due to travel restrictions, quarantine efforts, and workers staying home to take care of children or sick family members. Supply will also be affected by a reduction in materials, capital, and intermediate inputs due to disruptions in transport and businesses.

The negative demand shock is both global and regional. Economic difficulties around the world and the disruption of global value chains will reduce demand for the GCC's goods and services, most notably oil. Domestic demand will also decline as a result of the abrupt reduction in business activity and as concerns about infection reduce travel. In addition, uncertainty about the spread of the virus and the level of aggregate demand will hurt the domestic investment and consumption. Collapsing oil prices further depress demand in the GCC, where oil and gas is the most important sector in many economies. Finally, potential financial market volatility could further disrupt aggregate demand. Early evidence suggests net equity outflows of assets from the GCC and other emerging markets (see Figure 1).

Figure 1: Portfolio Outflows
Panel A: Africa & Middle East



Panel B: Emerging Markets

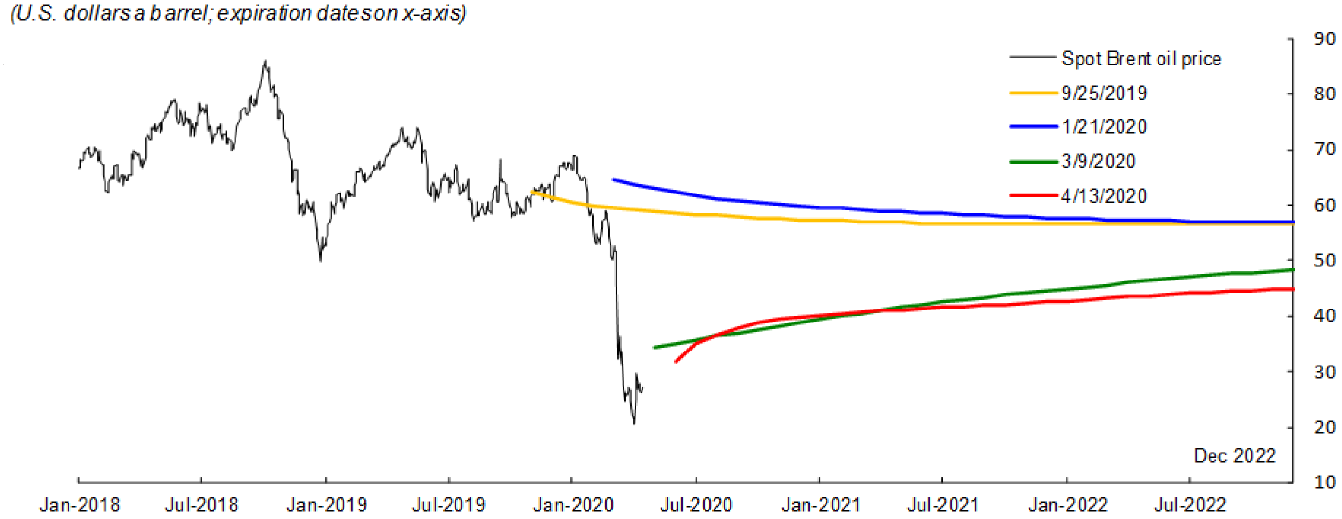


Sources: Institute of International Finance's Capital Flow Tracker and Bloomberg.
Note: Portfolio equity flows refers to net non-resident purchases of emerging markets' stocks. Among GCC countries, data are only available for Qatar and Saudi Arabia.

In addition to the shock from Covid-19, the breakdown in negotiations between the Organization of the Petroleum Exporting Countries (OPEC) and its allies in the first week of March led to a collapse in oil prices. At the end of March, the benchmark Brent crude oil price was $22.04 per barrel—less than half the price at the beginning of the month. In April 12, 2020, OPEC+ (which includes allied producers, most notably Russia) struck a deal to cut production by 9.7 million barrels a day in May and June. The deal, while sizable, may still be smaller than the shortfall in oil demand (Reuters, 2020). The futures curve suggests that the market expects oil prices to recover slowly—not reaching $45 per barrel until the end of 2022 (see Figured 2).

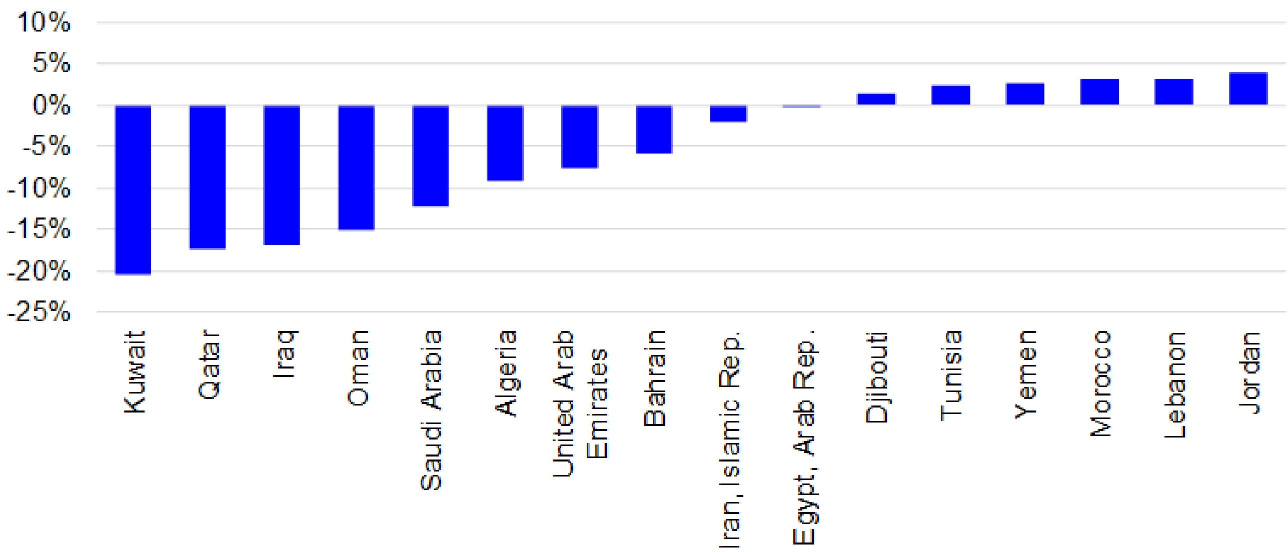
The oil price collapse directly reduces GCC's income. A simple way to get a sense of the size of the real income effect of an oil price change is to multiply the difference between production and consumption (net oil exports) as a share of GDP by the percentage point change in the oil price. For instance, based on hypothetical assumption that oil prices will stay 48 percent below the 2019 level, Kuwait— where net oil exports account for 43 percent of GDP—would experience a decline in real income of about 20 percent of GDP (see Figure 3).

Figure 2: Spot and Forecasts of Brent Oil Price



Source: World Bank MENA Chief Economist Office; and Bloomberg, L.P.
Note: The black line indicates spot price of Brent crude oil. The colored lines illustrate the futures prices of Brent crude oil on, respectively, September 25 2019, when October 2019 MENA Economic Update was produced; January 21 2020, when the first case of coronavirus was reported in the United States; March 9 2020 after the disintegration of the OPEC+ alliance; and April 13 2020 after the new OPEC+ deal.

Figure 3: Income Effect Estimates of the Oil Price Collapse in the GCC and other MENA countries



Note: Oil prices are from March 13, 2020 with a forecast of $33.4 per barrel for 2020 (48 percent below the 2019 level).

The economic fortunes of other countries in MENA are likely connected to those of GCC. It is likely that lower oil prices will hurt both oil importers and exporters—exporters directly and importers indirectly from reduced foreign direct investment, remittances, tourism, and grants from exporters.[5,6] Table 1 displays the five MENA countries that are most dependent on tourism and on remittance receipts, as well as the five MENA countries most important as sources of remittances. Lebanon would be hit most by collapsing tourism, while West Bank and Gaza would most affected by declining remittances. GCC countries are the major remittance source.

[5] Arezki and others (2020a) show that aggregate spillover from the oil exporters group to the oil importers group in MENA is positive. Depending on the geography, the country-to-country spillovers can be positive and very large.
[6] Reduced remittances from MENA oil exporters affect countries beyond MENA such as India, Bangladesh, Sri Lanka and Philippines (see bilateral remittance flows: https://www.knomad.org/data/remittances).

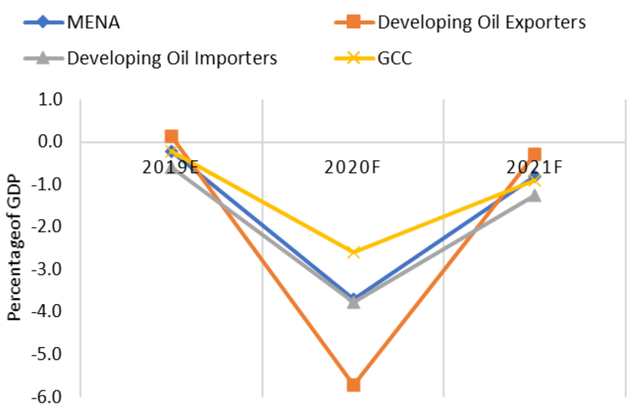
Table 1: Top 5 MENA countries as tourism destination, remittances destination and source

International tourism, receipts		Personal remittances, received		Personal remittances, paid	
Country	*% of exports*	*Country*	*% of GDP*	*Country*	*% of GDP*
Lebanon	45	West Bank and Gaza	17	Oman	13
Jordan	41	Yemen	12	Kuwait	10
Egypt	25	Lebanon	12	Bahrain	9
Morocco	22	Jordan	11	Lebanon	9
Qatar	15	Egypt	10	Qatar	6

Sources: World Development Indicators and World Bank Staff calculation

Because of the dual shock, the growth downgrade for GCC as a whole is 2.6 percentage points in 2020 (Arezki and others, 2020b). This can be considered as the cost of the dual shock. In U.S. dollars, this amounts to about $41 billion. Note, though, that despite the oil price collapse, the growth downgrades for GCC countries are the smallest among MENA country groups (see Figure 4). This shows the importance of public health systems, which are more advanced in the GCC, and of policy responses, which we will turn to in Part II.

Figure 4: Costs of the dual shock – Growth Downgrades (April 2020 versus October 2019)



Source: Arezki and others (2020b)

On the Policy Responses in the GCC

While Covid-19 caused a severe supply shock that raised unemployment and poverty, there are sizable demand feedback loops as well. Besides the loss of human lives, inaction also risks massive disruptions in supply and demand and illiquidity in the financial sector. In other words, the Covid-19 shock could lead to household and corporate bankruptcies with lasting scars on the economy and society. In contrast, the oil price collapse is a commodity terms-of-trade shock that affects the economy through reduced export receipts and less revenue in government coffers. The shock is expected to be persistent and lead to widening twin deficits—in a country's current balance and its government budget—and increased debt if there is no fiscal consolidation.

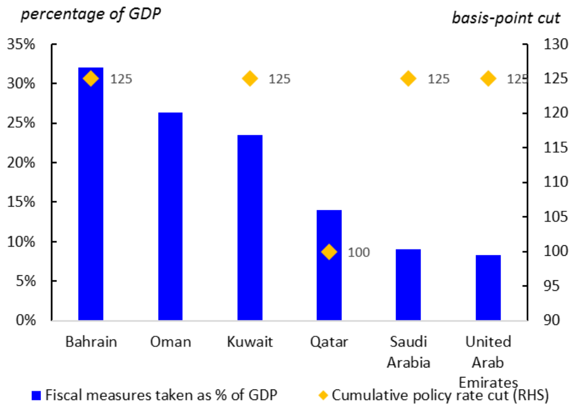
GCC countries have put unprecedented policy responses in place (see Figure 5 and Table 2), which helped soften the effect of the dual shock (see Figure 4). The authorities could also consider the following:

- Tailoring policy responses: To deal with the dual shock, authorities in the GCC should order and tailor their responses to the severity of the shock. They should focus first on responding to the health emergency and the associated risk of economic depression. Authorities should postpone fiscal consolidation associated with the persistent drop in oil price and its spillovers until the recovery from the pandemic is well underway. Instead, current emphases should be on budget reallocation and more efficient spending. In responding to Covid-19, authorities should boost spending on health—including producing or acquiring test kits, contact tracing technology, mobilizing and paying health workers, adding health infrastructure, and preparing for vaccination campaigns. Scaling up of testing and contact tracing for COVID-19 are especially important to determine the scale of the infection, detect and isolate cases which will be a factor in deciding whether and how to reopen the economy without causing a second wave of infections.
- Supporting the private sector: A combination of bailouts, eased credit condition and monitoring is needed to support the private sector, including small- and medium-sized enterprises. The support, with relevant conditions, will help firms survive the income crunch and prevent mass layoffs. Prioritization on strategic sectors—most notably network industries and services such as transport, logistics, distribution and finance—is critical to protect production capacity and support a future recovery. Governments should focus on elements of business environment regulation, especially out of bankruptcy work out and bankruptcy reforms (see Lyadnova and others, 2019) to resolve

corporate difficulties and associated corporate debt restructurings. The role of sovereign wealth funds, money printing where inflation is low (Gali, 2020) and international borrowing can all be utilized to support the private sector and soften corporate distress. Taking advantage of low interest rates, Qatar and UAE raised US$10 billion and US$7 billion respectively (Bloomberg- April 8, 2020) to bolster finances and address liquidity issues. Bailout measures of strategic firms and sectors could be also considered while ensuring it does have lasting impact on market contestability.

- Supporting vulnerable households including expatriate workers. Cash transfers to vulnerable households would help protect them and support consumption. This is relevant for the large expatriate labor force in the GCC countries. Making expatriate workers eligible for government cash transfers is not only an act of solidarity with the workers but also would enhance the reputation of the GCC as a good place to work. As importantly, supporting the expatriate labor force especially the low skilled would speed up economic recovery and prevent further spread of Covid-19 when the workers return to their home countries or when they come back to the GCC for work. Successful models of quickly deploying technology, including digital, to fight Covid-19 and target assistance should be analyzed and replicated[7]. As mentioned earlier, freeing information flows, increasing transparency, and data disclosure to reduce leakages, are crucial elements in in target cash transfers, which themselves will be essential to ensuring a flattening of the spread of the virus, hastening the economic recovery, and limiting the rise in poverty.
- Supporting regional and global effort to contain the crisis. Many MENA countries including Bahrain and Oman face large balance of payments and fiscal gaps. Many also carry high sovereign-risk premiums. For those countries, additional foreign borrowing on private markets will be difficult. Oman and many other countries in the region will need much international support to help it navigate an extremely rough patch. The GCC—considering the importance of its bilateral aid—has an important role to play to further the initiative to limit the ballooning of future cost and the risk of failed states entailed by delaying the rapid response to Covid-19. The G20, currently under Saudi Arabia's Presidency, has agreed debt relief to low-income countries to help free up funds to fight the pandemic (Financial Times, 2020). The GCC can also play a role in anticipating further risks and coordinating policy responses. For example, a food crisis, especially during Ramadan when prices typically go up, could emerge. A combination of lowering duties and coordinating across countries would be helpful to avoid hoarding and bans of agricultural exports from food-producing countries.

Figure 5: Fiscal and Monetary Measures Taken in GCC Countries



Source: JP Morgan and Kingdom of Saudi Arabia Authorities, as of April 15, 2020.
Note: The information is fluid as countries are adding measures to respond to the dual shock.

[7] *See Foreign Affairs (2020) for the experience of East Asian countries.*

Table 2: Summary of Policy Responses in the GCC

GCC countries	Health-related measures	Monetary and fiscal measures
Bahrain	– Closure/bans of schools/non-essential businesses/public gatherings/international flights to infected areas. – Entry into the country limited to citizens; mandatory 14-day self-isolation.	– Delay of bank loan instalments for six months for those impacted by the virus. – Waiver on electricity and water bills for all accounts—both individual and commercial—for three months. – Unemployment fund used to sustain wages of 100,000 workers. – Cumulative policy rate cut of 125 basis points.
Oman	– Closure/bans/cancellation of schools/non-essential businesses/public gatherings/international flights. – Isolation of governorate of Muscat. – Free Covid-19 tests and treatments. – Entry into the country limited to citizens; mandatory 14-day self-isolation.	– Measures amounting to $20 billion. – Reduction in capital conservation buffer to 1.25 percent from 2.5 percent, raising loan-to-financing ratio to 92.5 percent from 87.5 percent, deferring loan instalments, and lowering interest rates
Kuwait	– Closure/bans/cancellation of schools/non-essential businesses/public gatherings/international flights. – Mandatory curfew. – Public holiday extended. – Isolation of two districts.	– $1.6 billion allocated by parliament to support government efforts to combat the virus. Additional $31.9 million added from Kuwaiti banks support the efforts. – Central bank cut capital adequacy requirements by 2.5 percent and eased the risk-weighting for SMEs to 25 percent from 75 percent. It also raised the maximum lending limit to 100 percent from 90 percent and increased the maximum financing for residential real estate developments to the value of the property or the cost of development. – Cumulative policy rate cut of 125 basis points.
Qatar	– Closure/bans/cancellation of schools/non-essential businesses/public gatherings/international flights/public transport modes. – Entry into the country limited to citizens. – Private sectors to have 80 percent of staff work from home.	– $22.6 billion stimulus package. – The response includes customs, utility bill exemptions, and loan payments suspended for six months. – In addition, the authorities announced $2.7 billion in stock purchases. – Cumulative policy rate cut of 100 basis point.
United Arab Emirates	– Closure/bans/cancellation of schools/non-essential businesses/public gatherings/international flights/partial ground public transport. – Entry into the country limited to citizens. – Public sectors work from home.	– Raised loan-to-value ratio for first time mortgages by 5 percentage points. – Banking sector exposure limit for real estate to 30 percent from 20 percent. – $13 billion in collateralized lending at 0 percent. – Lower capital requirement on loans to small- and medium-sized enterprises. – Banks allowed to tap capital buffers. – Cumulative policy rate cut of 125 basis points.
Saudi Arabia	– Closure/bans/cancellation of schools/non-essential businesses/public gatherings/international flights/part of ground public transport. – Public and private sectors work from home. – Mandatory curfew.	- A SAR 70 billion private sector support package that includes the suspension of government tax payments, fees, and other dues to provide liquidity to the private sector. - SAR 50 billion to support the private sector, particularly SMEs, by providing funding to banks to allow them to defer payments on existing loans and increase lending to businesses. - SAR 9 billion to compensate citizens working in facilities affected by the pandemic; a monthly compensation of 60 percent of the registered wage in social insurance for three months - SAR 50 billion to expedite payment of the private sector dues, offering facilities to commercial, industrial and agricultural sectors, postponing payment of electricity bills and paying salaries of those engaged in passenger transport activities. - SAR 47 billion to raise the health sector's readiness. - Cumulative policy rate cut of 125 basis points.

Sources: International Monetary Fund, Nasser Saidi & Associates, JP Morgan and Kingdom of Saudi Arabia Authorities

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