EU - Gulf Cooperation Council (GCC) Dialogue on Economic Diversification

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Global and GCC Forecast and Policy Recommendations – Increasing economic resilience during geopolitical and commodity trade fragmentation

Briefing on *International Monetary Fund (IMF) 2023 World Economic Outlook (WEO) – Navigating Global Divergences, IMF Regional Economic Outlook Middle East and Central Asia 2023*

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Global and GCC Forecast and Policy Actions in the context of geopolitical and commodity trade fragmentation

Briefing on *International Monetary Fund (IMF) 2023 World Economic Outlook (WEO) – Navigating Global Divergences, IMF Regional Economic Outlook Middle East and Central Asia 2023*

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Disclaimer

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1 Purpose

This briefing on the *International Monetary Fund (IMF) World Economic Outlook (WEO) 2023* and the *IMF Regional Economic Outlook for Middle East and Central Asia 2023*, includes the global prospects related to economic growth, including the potential impact of geopolitical fragmentation, as well as IMF recommended policy actions for sustainable economic growth, with specific recommendations for Middle Eastern countries.

In addition, the briefing provides visual representations created by the EU-GCC Dialogue on Economic Diversification project for trends in Gross Domestic Product (GDP), inflation, exports and imports pre-COVID-19 and forecasts to 2028 based on the IMF WEO data.

2 Global Prospects – Economic growth and the risk of geopolitical fragmentation

This section provides the 2024 forecast for global growth, inflation, consumption, labour market performance, trade and investment. In addition, a discussion of the potential impact of geopolitical fragmentation is included.

Global growth:

- Global growth is forecast to slow from 3.5 percent in 2022 to 3.0 percent in 2023 and 2.9 percent in 2024. The projections remain below the historical (2000–19) average of 3.8 percent.
- Forecasts for the growth rate of global GDP over the medium term are at their lowest in decades The latest WEO forecast for global growth in 2028 is 3.1 percent.
- For advanced economies, the expected slowdown is from 2.6 percent in 2022 to 1.4 percent in 2024, amid stronger-than-expected US momentum but weaker-than-expected growth in the euro area.
- Growth in the euro area is projected to reach 1.2 percent in 2024. The forecast for growth in emerging and developing Europe is 2.2 percent in 2024.
- Growth in the Middle East and Central Asia is projected to decline from 5.6 percent in 2022 to 3.4 percent in 2024.
- Emerging market and developing economies are projected to have growth modestly decline, from 4.1 percent in 2022 to 4.0 percent in both 2023 and 2024, with a downward revision of 0.1 percentage point in 2024, reflecting the property sector crisis in China.

Inflation:

- Near-term inflation expectations have risen and could contribute—along with tight labor markets—to core inflation pressures persisting and requiring higher policy rates than expected.
- A fall in energy prices and—to a lesser extent—in food prices has driven the decline in headline inflation.

- More climate and geopolitical shocks could cause additional food and energy price spikes. intensifying geoeconomic fragmentation could constrain the flow of commodities across markets, causing additional price volatility and complicating the green transition.
- Global headline inflation is expected to steadily decline from its peak of 8.7 percent in 2022 (annual average) to 6.9 percent in 2023 and 5.8 percent in 2024. On a year-over-year basis, projected global headline inflation peaked at 9.5 percent in the third quarter of 2022 and it is projected to fall to 4.8 percent in the fourth quarter of 2024, still above the pre-pandemic (2017–19) annual average of about 3.5 percent.

Consumption:

- Among advanced economies, private consumption has been stronger in the United States than in the euro area, with households receiving larger fiscal transfers early in the pandemic and spending the associated savings more quickly; being better insulated from the rise in energy prices resulting from the war in Ukraine; and feeling relatively confident amid historically tight US labor markets, which have supported real disposable incomes.
- Among emerging market and developing economies, the consumption shortfall is particularly large in China, reflecting tight restrictions on mobility during the COVID-19 crisis.

Labor market performance:

- Employment and labor participation rates are estimated to exceed pre-pandemic trends in advanced economies but to remain significantly below them in emerging market and developing economies, reflecting more severe output losses and much weaker social protection.
- Among advanced economies, the euro area has seen larger employment gains than the United States. This may reflect more extensive use in the former of worker-retention programs modeled on the German Kurzarbeit short-time work scheme.
- With the projected slowdown in advanced economies, annual unemployment is projected to rise by an average of 0.1 percentage point over 2022–24, although with more pronounced increases in Canada (1.0 percentage point), the United Kingdom (0.9 percentage point), and the United States (0.2 percentage point).

Trade and Investment:

- World trade growth is expected to decline from 5.1 percent in 2022 to 0.9 percent in 2023, before rising to 3.5 percent in 2024, well below the 2000–19 average of 4.9 percent.
- Crude oil prices have declined during 2023 and are well below their June 2022 peak, on the back of lower global demand partly driven by tighter global monetary policy affecting activity. Supply curbs by OPEC+ (Organization of the Petroleum Exporting Countries plus selected non-member countries) were partly offset by strong oil output growth in non-OPEC countries, most notably the United States.

- Natural gas prices also remain well below their 2022 peak, reflecting ample storage and supplies from Norway and northern Africa.
- Food prices have declined modestly in 2023, with lower demand offset by supply reductions, notably those resulting from Russia's withdrawal from the Black Sea Grain Initiative in July, which reduced the supply of wheat to the global market. The normalization of supply chains has further contributed to the decline in headline inflation in most countries.
- Investment has uniformly fallen short of pre-pandemic trends across regions. Businesses have shown less enthusiasm for expansion and risk taking amid rising interest rates, withdrawal of fiscal support, dimmer prospects for product demand, stricter lending conditions, and growing uncertainties.

Commodity markets and the risk of geopolitical fragmentation

Commodity markets are an important channel through which geopolitical fragmentation can affect the economy. Many features of commodities underpin their vulnerability in the event of fragmentation: their highly concentrated and difficult-to-relocate production, hard-to-substitute consumption, and critical role as inputs for manufacturing and key technologies.

Fragmentation in commodity markets is on the rise. Measures restricting commodity trade surged in 2022, price differentials across geographic markets have widened for selected commodities, and FDI flows in commodity sectors are in decline—the latter a trend that started before the war in Ukraine.

Critical minerals for the energy transition and some highly traded agricultural goods are highly vulnerable in the event of fragmentation. Fragmentation in critical mineral markets could make the clean energy transition more costly, raising the risks of delaying necessary climate change mitigation. Given the heavy reliance on agricultural imports among many low-income countries, fragmentation of agricultural commodities would raise important food security concerns.

Commodity price volatility could intensify as a result of smaller market sizes and the incentives for producers to switch geopolitical allegiances. This could result in volatile inflation dynamics, making monetary policy more complex.

3 Middle East forecast – GCC focus

This section provides highlights of the IMF Regional Economic Outlook for Middle East and Central Asia 2023 related to the GCC countries.

Governance reforms are trailing in a number of countries, with relatively poor performance across several dimensions (including voice and accountability, political stability, government effectiveness, the rule of law, and control of corruption

Governance shortcomings in voice and accountability are evident in several GCC countries (for example, Qatar and Saudi Arabia).

The specific sequence in which reforms are implemented can play a crucial role in affecting macroeconomic outcomes. In addition, when certain reforms are implemented together, they can amplify each other's positive effects, resulting in more substantial gains than when the reforms are implemented separately.

Box 1. Saudi Arabia – Example of successful bundled reform approach

Saudi Arabia also stands out as an example of a successful bundled reform approach. Through its ambitious Vision 2030 plan launched in 2016, the country achieved greater government efficiency, upgraded trade infrastructure, and better labor market outcomes (including raising the female labor force participation rate from 23 percent in 2016 to 28 percent in 2022, nearing the 2025 target of 30 percent). Moreover, access to credit improved for small and medium enterprises, with bank loans increasing almost fourfold, from 2 percent to 7.7 percent. Robust digital development in Saudi Arabia has bolstered financial inclusion, strengthened the financial sector's resilience, and enhanced government efficacy.

Overall, Saudi Arabia's non-oil growth has accelerated since 2021, averaging 5.3 percent in 2022 spurred by strong domestic demand. Non-oil growth is expected to remain robust and above 4 percent in the medium term, supported by Saudi Arabia's sound macroeconomics policies and strong reform momentum.

Oil production cuts and country-specific factors have started to weigh on oil exporters. Oil GDP growth is slowing after three rounds of deep OPEC+ oil production cuts (October 2022, April 2023, June 2023) and additional temporary cuts by Saudi Arabia. For the GCC countries, crude oil production was cut considerably, driving a deceleration in oil GDP growth.

Crucially, the slowdown of oil GDP has been partially offset by continued strong non-oil GDP growth, driven by robust manufacturing activity (Oman, Qatar, Saudi Arabia, United Arab Emirates) and surging services (Bahrain, Oman, Saudi Arabia, United Arab Emirates).

Despite ongoing efforts to diversify GCC economies away from oil, non-oil growth is projected to be insufficient to offset the decline in oil growth over the medium term, as productivity gaps in the non-oil sector persist, posing challenges for job creation and inclusion.

Lower oil production and oil prices will not only weigh on growth but also drive a marked decline in oil exporters' external positions. Current account surpluses are projected to almost halve from 14.6 percent of GDP in 2022 to 7.5 percent in 2023 and contract further to 6.7 percent of GDP in 2024. But they will remain in comfortable positions over the medium term (except for Iraq).

In this context, several oil exporters are expected to continue consolidating their public finances to mitigate the fiscal impact of lower oil revenue and reduce budget sensitivity to oil price volatility. Planned consolidation efforts focus on rationalizing current expenditures to free up resources for priority spending, including on social safety nets and infrastructure (Bahrain, Oman, Qatar, Saudi Arabia), while also reducing the fiscal deficit in some (Bahrain, Qatar). As such non-oil fiscal balances (as a percentage of non-oil GDP) are expected on average to improve in 2023 by 5.5 percent and further to 1.8 percent in 2024. Conversely, an increase in the wage bill (Kuwait, Iraq) and subsidies (United Arab Emirates) is expected to result in a worsening fiscal position in these economies this year.

4 Gross Domestic Product (GDP) and Trade Forecasts for the GCC countries

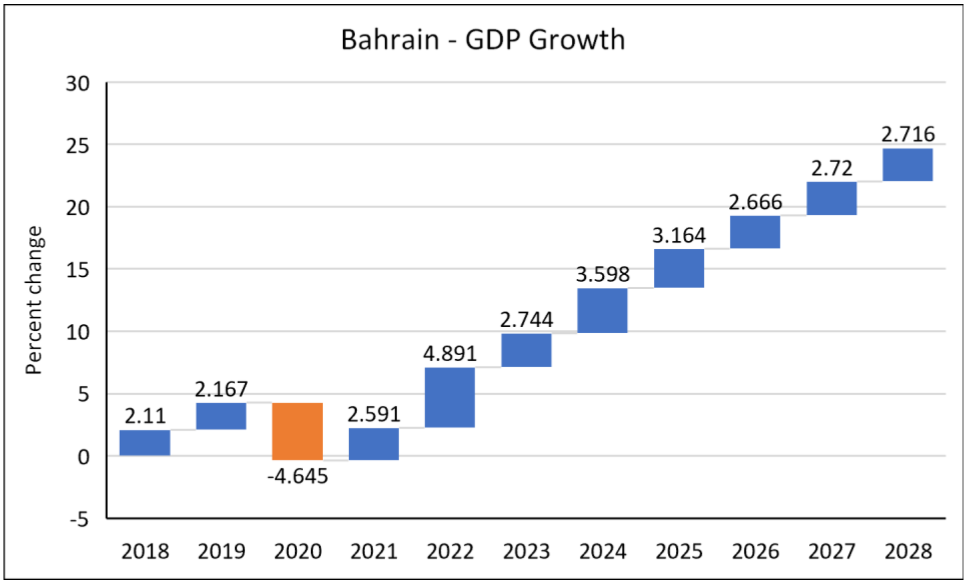
This section provides the GDP growth, imports and exports growth and inflation trends since 2018 and the forecast for each of the GCC countries to 2028.

Note for this section's charts:

- Annual percentages of constant price GDP are year-on-year changes; the base year is country-specific.
- Percent change of volume of imports/exports of goods refers to the aggregate change in the quantities of imports/exports of goods whose characteristics are unchanged. The goods and their prices are held constant, therefore changes are due to changes in quantities only.
- 2018 to 2022 values are actual, with several exceptions where 2021 values are forecasted; 2023 to 2028 are forecasted.

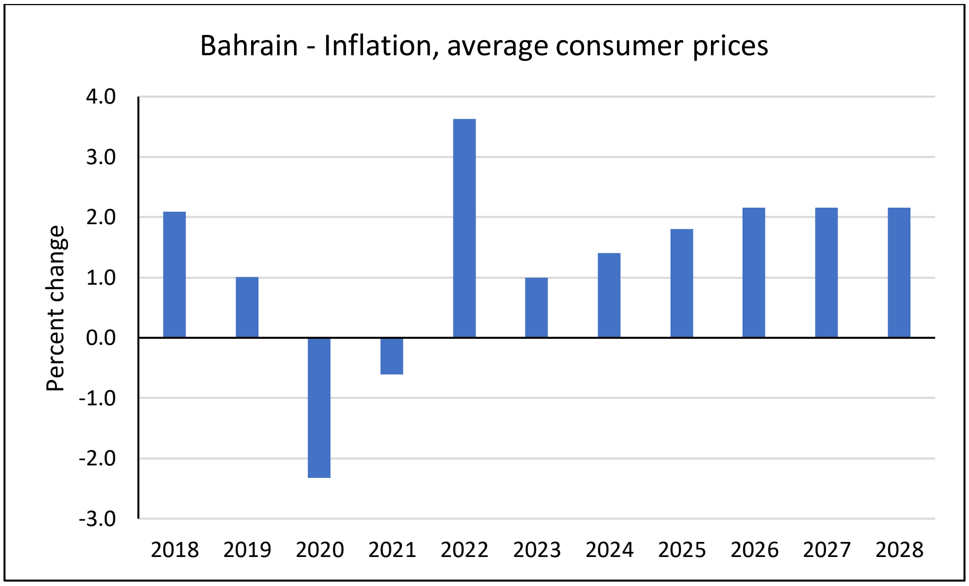
Bahrain

Figure 1. Bahrain - GDP growth, percent change, 2018-2028



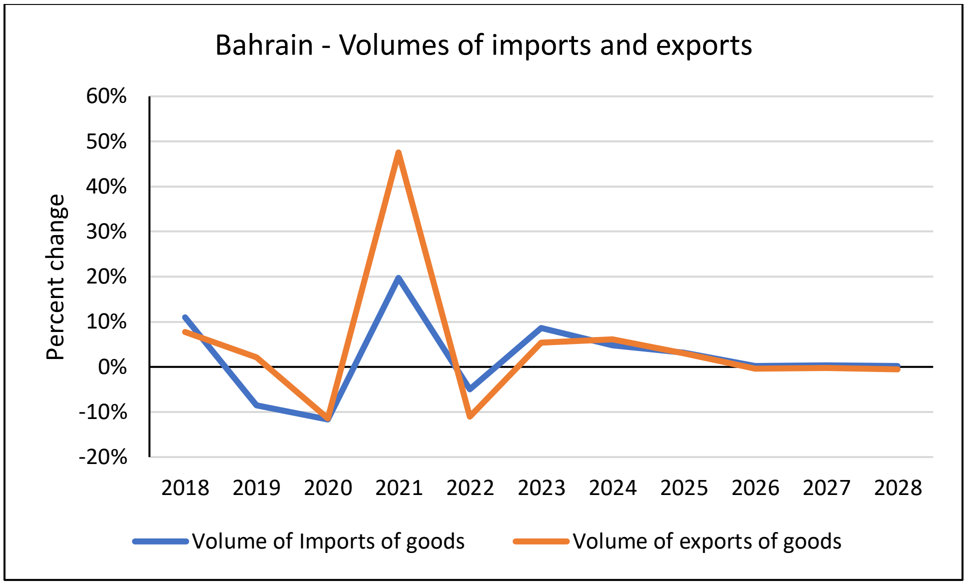
Source: Author's chart, based on IMF World Economic Outlook data

Figure 2. Bahrain - Inflation, average consumer prices, 2018-2028



Source: Author's chart, based on IMF World Economic Outlook data

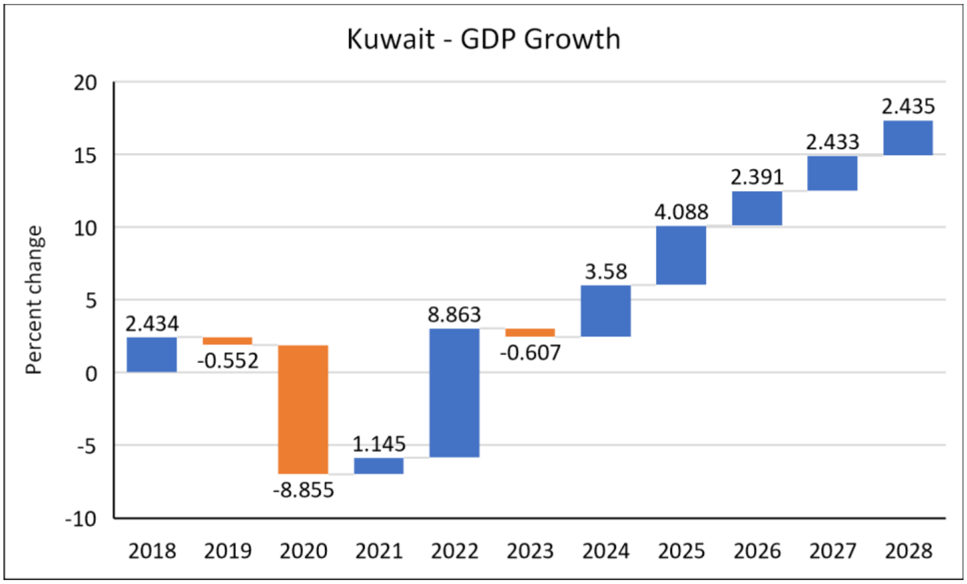
Figure 3. Bahrain - Volumes of imports and exports, percent change, 2018-2028



Source: Author’s chart, based on IMF World Economic Outlook data

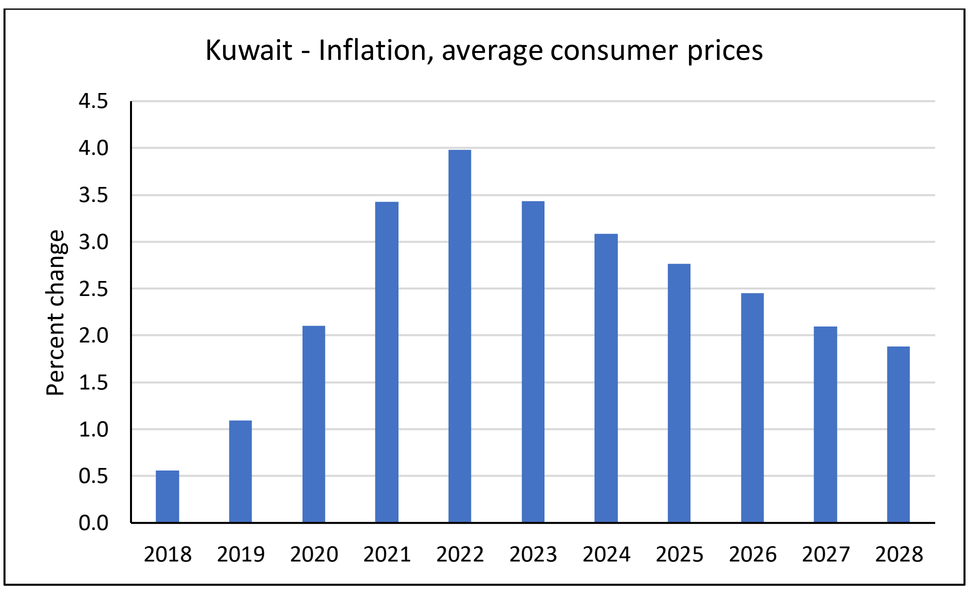
Kuwait

Figure 4. Kuwait - GDP growth, percent change, 2018-2028



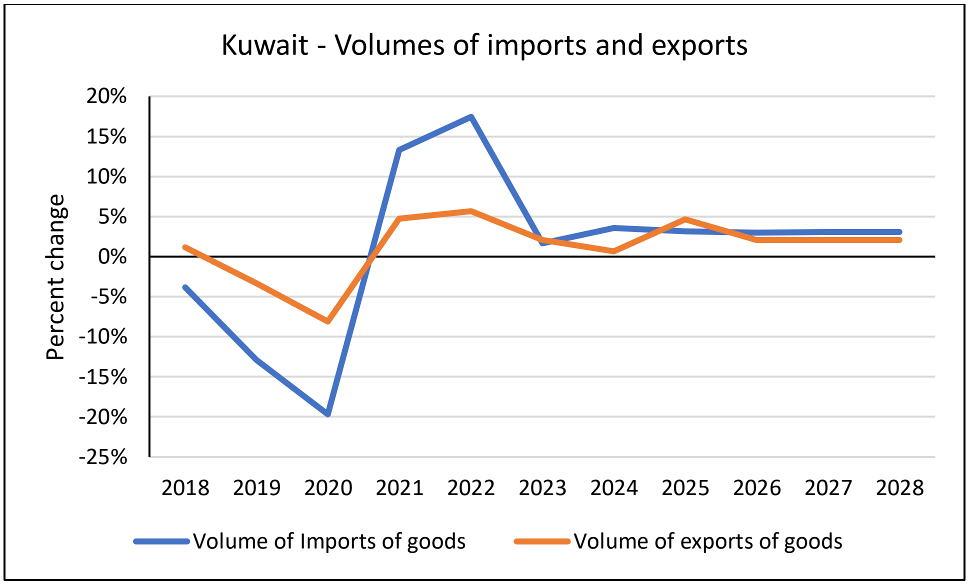
Source: Author's chart, based on IMF World Economic Outlook data

Figure 5. Kuwait - Inflation, average consumer prices, 2018-2028



Source: Author's chart, based on IMF World Economic Outlook data

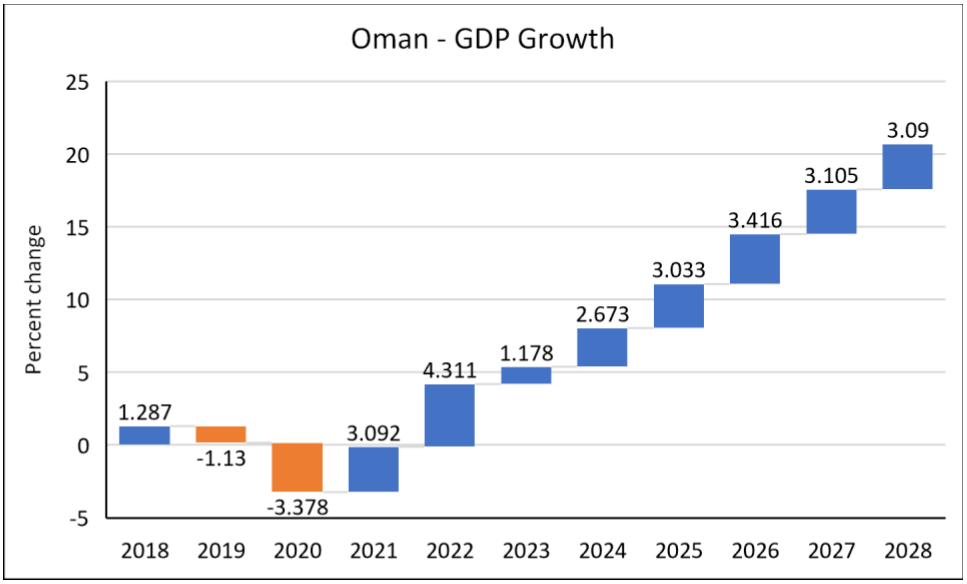
Figure 6. Kuwait - Volumes of imports and exports, percent change, 2018-2028



Source: Author's chart, based on IMF World Economic Outlook data

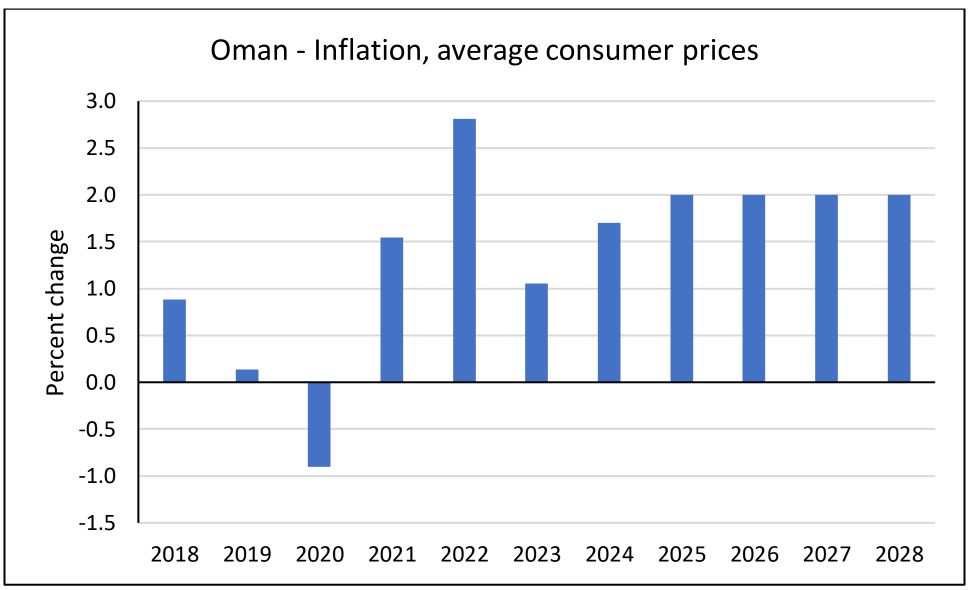
Oman

Figure 7. Oman - GDP growth, percent change, 2018-2028



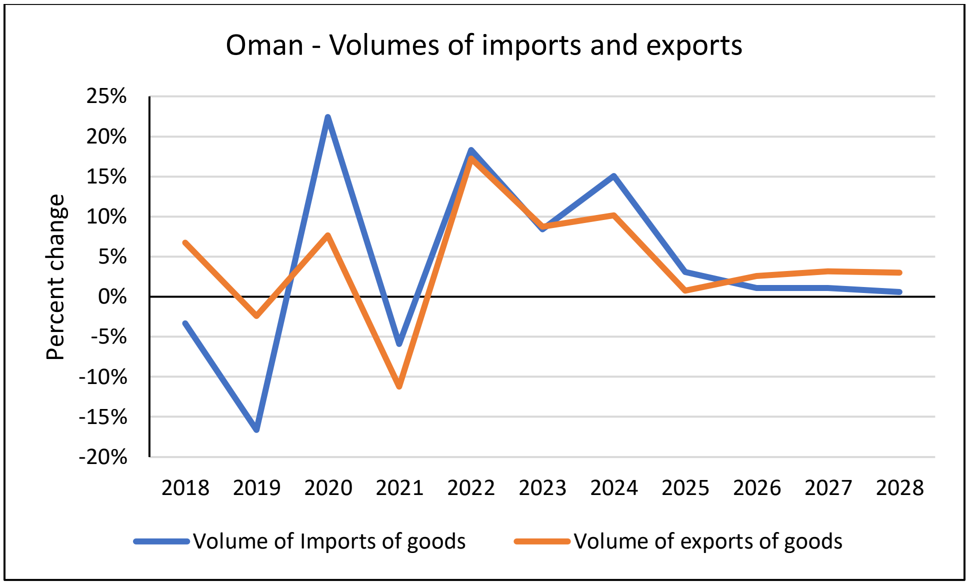
Source: Author's chart, based on IMF World Economic Outlook data

Figure 8. Oman - Inflation, average consumer prices, 2018-2028



Source: Author's chart, based on IMF World Economic Outlook data

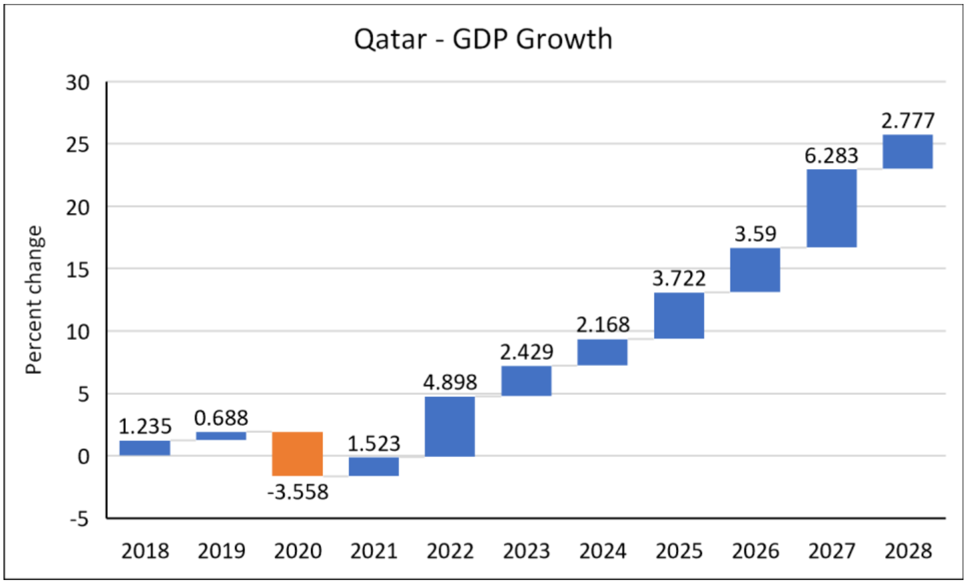
Figure 9. Oman volumes of imports and exports, percent change, 2018-2028



Source: Author's chart, based on IMF World Economic Outlook data

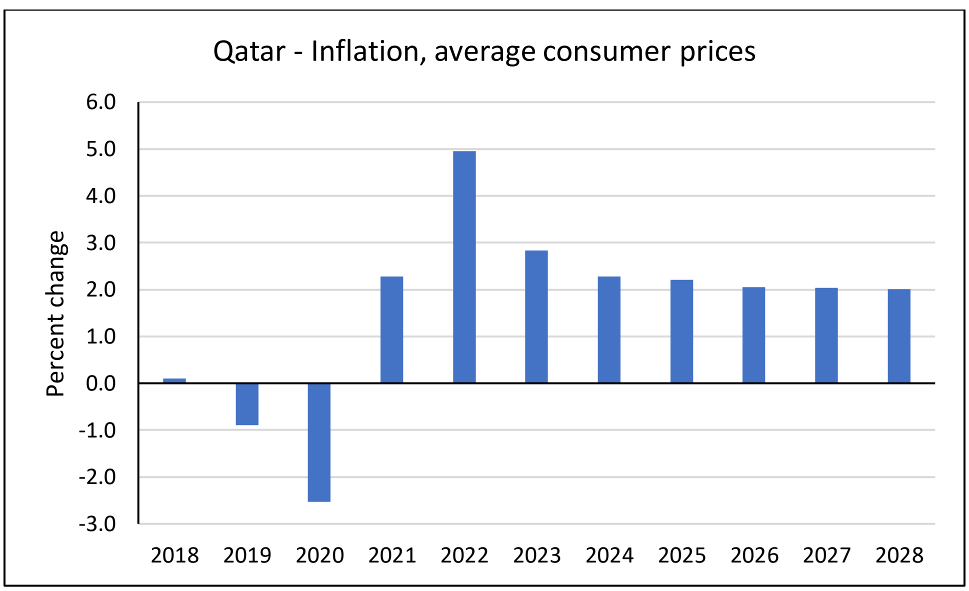
Qatar

Figure 10. Qatar - GDP growth, percent change, 2018-2028



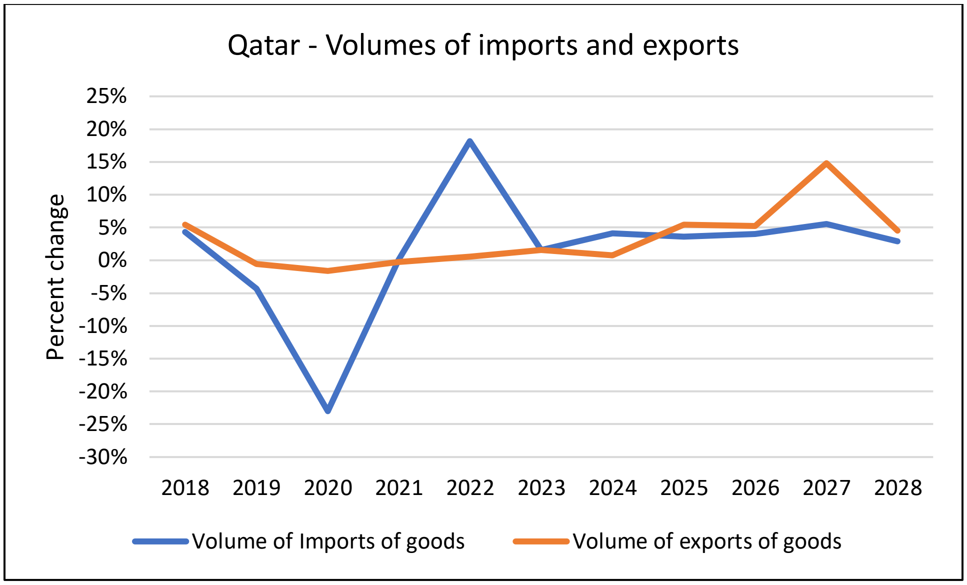
Source: Author's chart, based on IMF World Economic Outlook data

Figure 11. Qatar - Inflation, average consumer prices, 2018-2028



Source: Author's chart, based on IMF World Economic Outlook data

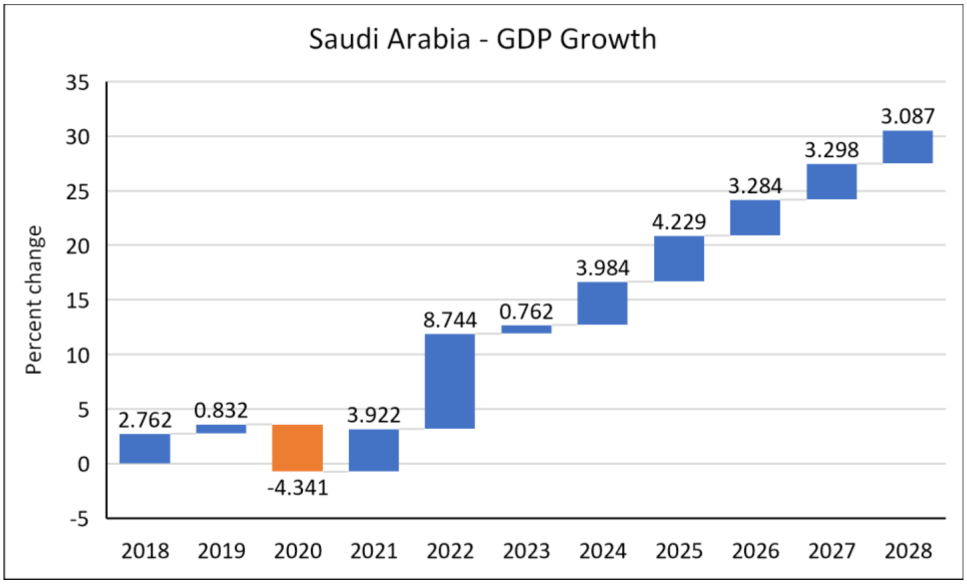
Figure 12. Qatar - Volumes of imports and exports, percent change, 2018-2028



Source: Author’s chart, based on IMF World Economic Outlook data

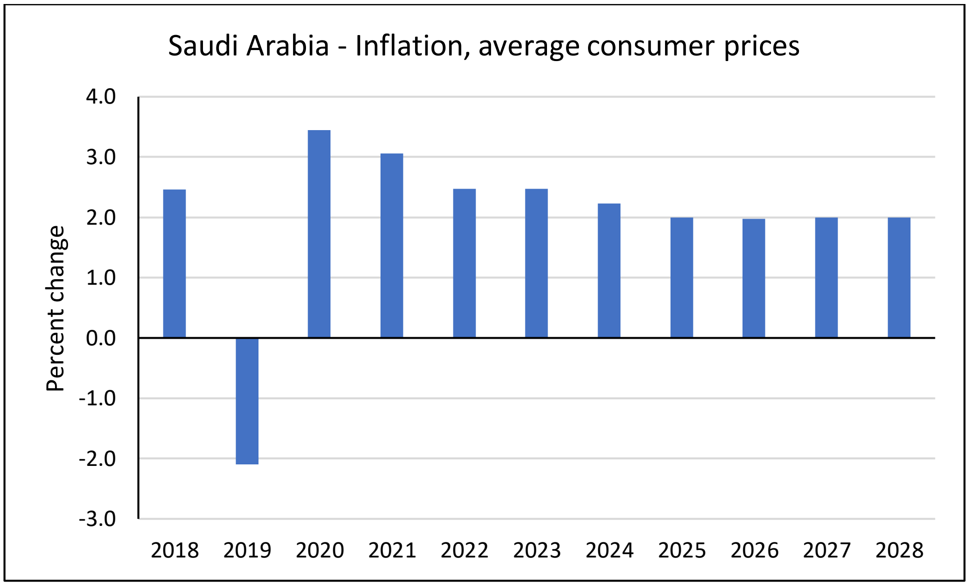
Saudi Arabia

Figure 13. Saudi Arabia - GDP growth, percent change, 2018-2028



Source: Author's chart, based on IMF World Economic Outlook data

Figure 14. Saudi Arabia - Inflation, average consumer prices, 2018-2028



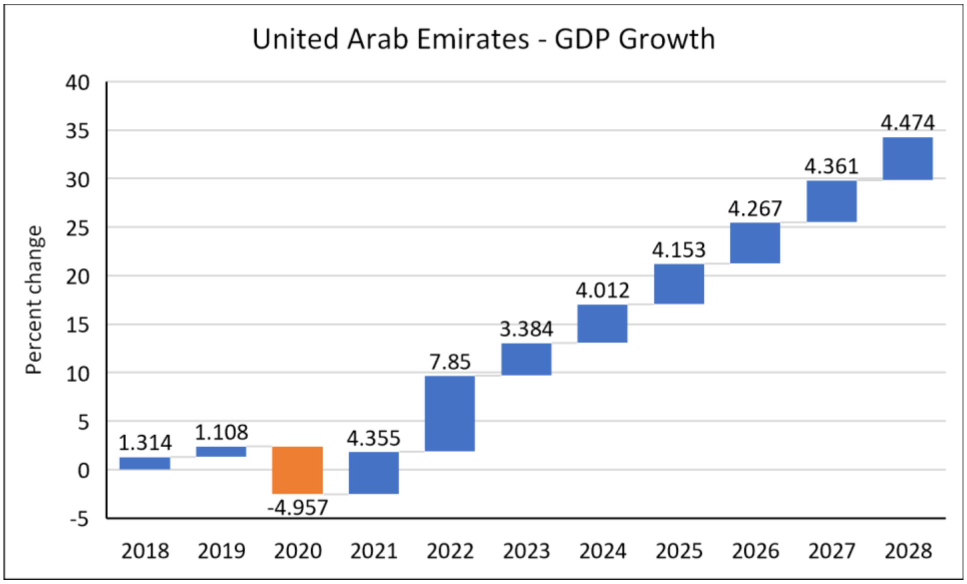
Source: Author's chart, based on IMF World Economic Outlook data

Figure 15. Saudi Arabia - Volumes of imports and exports, percent change, 2018-2028

Source: Author's chart, based on IMF World Economic Outlook data

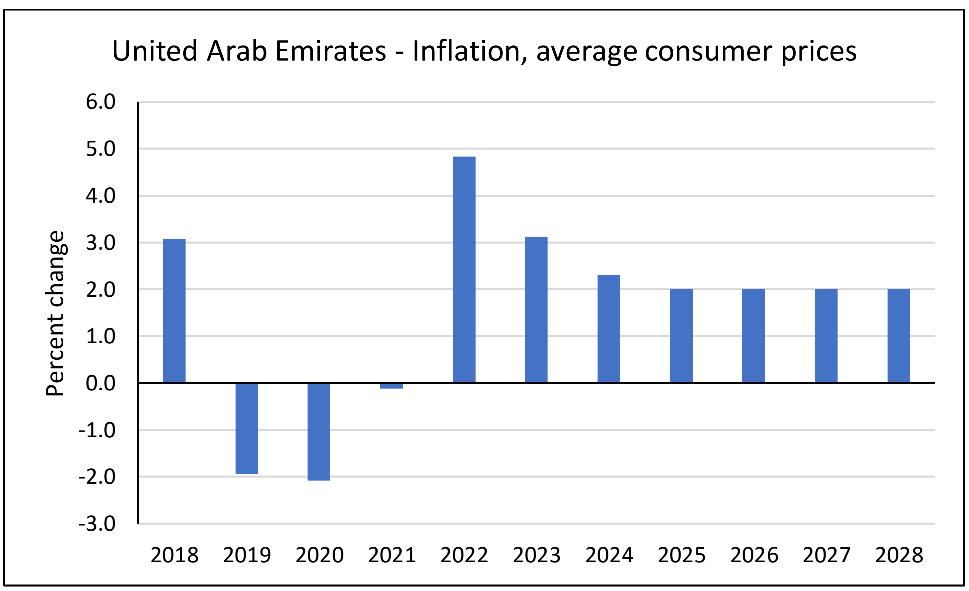
United Arab Emirates

Figure 16. United Arab Emirates - GDP growth, percent change, 2018-2028



Source: Author’s chart, based on IMF World Economic Outlook data

Figure 17. United Arab Emirates - Inflation, average consumer prices, 2018-2028



Source: Author’s chart, based on IMF World Economic Outlook data

Figure 18. United Arab Emirates- Volumes of imports and exports, percent change, 2018-2028

Source: Author's chart, based on IMF World Economic Outlook data

5 Recommendations

Monetary policy and financial supervision:

- Central banks need to restore price stability while using policy tools to relieve potential financial stress when needed. Effective monetary policy frameworks and communication are vital for anchoring expectations and minimizing the output costs of disinflation.
- Fiscal policymakers should rebuild budgetary room for maneuver and withdraw untargeted measures while protecting the vulnerable.
- Reforms to reduce structural impediments to growth—by, among other things, encouraging labor market participation—would smooth the decline of inflation to target and facilitate debt reduction.
- Faster and more efficient multilateral coordination is needed on debt resolution to avoid debt distress.
- Reforms to deepen the financial sector would strengthen liquidity conditions and help spur investment and growth. In some GCC countries, policies to guard against unexpected liquidity stress related to foreign liabilities would help ensure financial sector stability.
- The fast pace of monetary policy tightening continues to put the financial sector under pressure. Strengthened supervision (through implementation of Basel III and removal of forbearance measures) and the monitoring of risks to anticipate further episodes of banking sector stress are warranted. The intensity of supervision should be commensurate with banks' risks and systemic importance, and it is essential to rapidly close oversight gaps in the nonbank financial sector.

Price stability:

With global core inflation still high and declining slowly, central banks should generally maintain a tight stance and avoid prematurely easing monetary policy. At the same time, there are fewer cases in which sizable interest rate hikes are warranted, with increasing differentiation across countries' policy needs for ensuring price stability. Although the primary responsibility for restoring price stability lies with central banks, legislated government spending cuts or tax increases aimed at ensuring public debt sustainability can, by reducing aggregate demand and reinforcing the overall credibility of disinflation strategies, further ease inflation.

Commodity markets:

Multilateral cooperation can contribute towards preventing the fragmentation of commodity markets. The cooperation could prevent a vicious spiral of countries imposing restrictions as a risk management effort to mitigate the economic fallout from fragmentation.

- Solutions include enhanced rules within the World Trade Organization on quantitative restrictions, export tariffs, discriminatory subsidies, local-content requirements, and other commodity-related trade measures. This is crucial for food commodities, as food insecurity affects a large percentage of the population in low-income countries.

- Given the potentially adverse effects of fragmentation on the energy transition, a minimum "green corridor" agreement should be established to preserve integrated markets for minerals that are critical for decarbonization. Safeguarding the flow of these minerals can be part of a foundational minimum agreement across countries. Without underestimation of the political difficulties, such a corridor agreement could be easier to agree on, because it would focus on a smaller set of commodities and countries.
- Similar "food corridor" agreements could provide guardrails in essential agricultural commodity markets, ensure equal access to food across countries of all income levels, and reduce the likelihood of humanitarian disasters in a world of more frequent supply shocks. trade restrictions aimed at reducing domestic prices could worsen global food insecurity and create shortages for the world's poorest people. Bans on food exports should be lifted as soon as feasible to safeguard the global flow of food supplies.
- Industrial policies are only the third-best approach and must be designed carefully to ensure equal treatment of firms across competitive markets to avert adverse cross-country spillovers, minimize distortions and inefficiencies, and mitigate fiscal risks and harmful political economy outcomes. "Friend-shoring" policies can also be market distorting and costly. Both sets of policies should be used only under particular conditions, such as in the presence of clear market failures or narrowly defined national security concerns.

Solutions at country level:

Even as policymakers strive to mitigate the risk of fragmentation, countries can take steps to minimize the potential economic fallout. The geographic concentration of production and lack of diversification of commodity suppliers call for (1) fostering investment in domestic mining, exploration, and recycling of critical minerals; (2) diversification of supply sources; and (3) investing in infrastructure to reduce trade costs and improve market integration. Support for innovation to speed technological progress—and develop substitutes—would enhance efficiency in the use and buildup of strategic reserves. Multilateral cooperation would enhance efficiency and prevent negative cross-country spillovers.

Industrial policies are only the third-best approach and must be designed carefully to ensure equal treatment of firms across competitive markets to avert adverse cross-country spillovers, minimize distortions and inefficiencies, and mitigate fiscal risks and harmful political economy outcomes. "Friend-shoring" policies can also be market distorting and costly. Both sets of policies should be used only under particular conditions, such as in the presence of clear market failures or narrowly defined national security concerns.

Labor supply:

Reforms that reduce labor market tightness—by encouraging participation and reducing job search and job matching frictions—would facilitate fiscal consolidation and contribute gradually to easing inflation. Such reforms include short-term training programs for professions experiencing shortages and labor laws and regulations that increase work flexibility through telework and leave policies. Policies that encourage more women and older people to join the workforce, reduce labor market duality, and improve mobility would further enhance labor supply. Active immigration policies in advanced economies can address labor shortages as well as longer-term headwinds to growth, including those from population aging.

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