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Gulf Cooperation Council

Pursuing Visions Amid Geopolitical Turbulence: Economic Prospects and Policy Challenges for the GCC Countries (2024)

Prepared by Staff of the International Monetary Fund

I N T E R N A T I O N A L M O N E T A R Y F U N D

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EXECUTIVE SUMMARY[1]

The GCC has been resilient to recent shocks and the economic outlook remains favorable. Spillovers from regional conflicts have been limited. Strong non-hydrocarbon activity supported overall growth amid reform implementation. The outlook is positive as the envisaged easing of oil production cuts and natural gas expansion spurs the recovery in the hydrocarbon sector while the non-oil economy continues to expand. Inflation is stabilizing at a low level while external buffers remain comfortable despite current account balances having narrowed. Risks around the outlook are broadly balanced in the near term. More challenging medium-term risks, especially in the context of geoeconomic fragmentation, call for action on policy priorities.

- **Fiscal policy**. In the short term, remain prudent, and rebuild policy buffers especially during good times. In the medium run, continue to balance between fiscal consolidation to achieve and maintain intergenerational equity and sustainability, and implementing investments to support economic diversification. Consolidation efforts should be supported by strengthened fiscal institutions, including through credible medium-term fiscal frameworks, appropriate fiscal rules, fiscal risk assessment, consolidated sovereign asset-liability management frameworks, credible monitoring, and greater fiscal transparency.

- **Monetary policy**. The current monetary policy frameworks—consistent with the currency pegs—have served the GCC well and should be maintained. Reforms to enhance liquidity management frameworks and deepen financial markets would help strengthen monetary policy transmission.

- **Financial sector policies**. The banking system is sound. Focus on adapting to and mitigating "old" (e.g., rapid credit growth, sovereign-bank nexus) and "new" risks (e.g., digitalization, climate change). Monitor and respond to emerging risks.

- **Structural policies.** Reforms to support economic diversification have progressed, including on the business climate, human capital, and digitalization. Implementation should be intensified to achieve the Visions. Greater trade and financial integration should remain a common policy priority to fully reap reform dividends, enhance resilience to geoeconomic fragmentation, and benefit from potential trade diversion. Risks from some policies, including industrial policies and domestic investment by sovereign wealth funds (SWFs), should be carefully managed.

[1] Prepared by Balazs Csonto, Ken Miyajima (co leads), Nordine Abidi, Mohamed Belkhir, Shafik Hebous, Muayad Ismail, Yevgeniya Korniyenko, Nada Hazem Fikry Nasr, Zahra Khalilzadeh Silabi, Haytem Troug, Francis Vitek, and Tongfang Yuan under the guidance of Amine Mati. *The cut-off date for data throughout the note is October 18, 2024*.

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RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

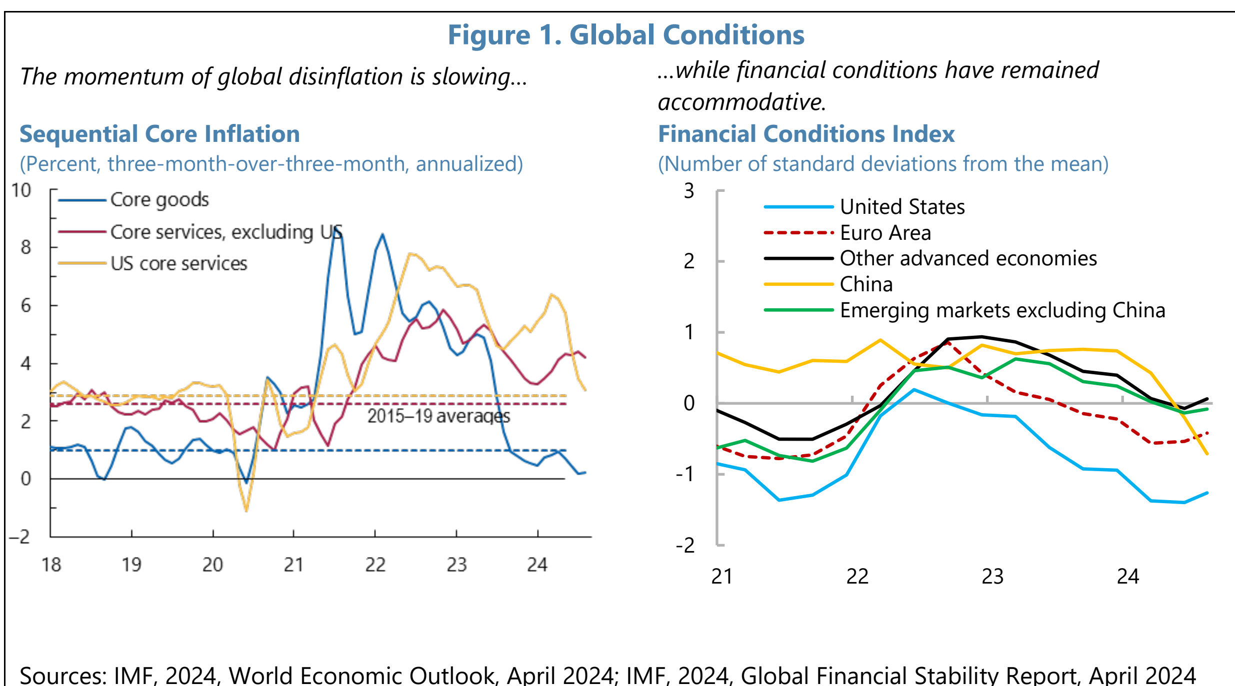
A. Global Growth Spared (for now) from Fragmentation

1. **The global battle against inflation has largely been won with the global economy having remained resilient during the disinflationary process while medium-term growth prospects remain mediocre**. After peaking at 9.4 percent year over year in the third quarter of 2022, headline inflation rates are now projected to reach 3.5 percent by the end of 2025, below the average level of 3.6 percent in 2000–19. Moreover, despite a sharp and synchronized tightening of monetary policy around the world, the global economy has avoided a recession. Growth is projected to hold steady at 3.2 percent in 2024 and 2025, even though a few countries, especially low-income developing countries, have seen sizable downside growth revisions, often as a result of increased conflicts. The global growth forecast five years from now of 3.1 percent is low relative to the pre-pandemic average, held back by persistent structural headwinds in many economies.

2. **Risks to the global outlook are tilted to the downside amid elevated policy uncertainty**. Sudden eruptions in financial market volatility—as experienced in early-August—could tighten financial conditions and weigh on investment and growth. Further disruptions to the disinflation process, potentially triggered by renewed spikes in commodity prices amid persistent geopolitical tensions, could prevent central banks from easing monetary policy, posing significant challenges to fiscal policy and financial stability. Deeper- or longer-than-expected contraction in China's property sector, especially if it leads to financial instability, could weaken consumer sentiment and generate negative global spillovers. An intensification of protectionist policies would exacerbate trade tensions, reduce market efficiency, and further disrupt supply chains. Rising social tensions could prompt social unrest, hurting consumer and investor confidence and potentially delaying the passage and implementation of necessary structural reforms.

3. **Near-term financial stability risks remain contained but accommodative financial conditions facilitate the further buildup of vulnerabilities** (Figure 1, right panel). Asset valuations appear lofty, debt has climbed globally, and the use of leverage among nonbank financial intermediaries has increased. Fragilities remain in corporate and commercial real estate sectors. These imbalances could worsen future downside risks by amplifying adverse shocks.

Figure 1. Global Conditions



Sources: IMF, 2024, World Economic Outlook, April 2024; IMF, 2024, Global Financial Stability Report, April 2024

B. GCC Demonstrates Resilience to Recent Shocks

Real and Fiscal Sector Developments

During times of turbulence and oil production cuts, the GCC economies have been resilient, as the non-hydrocarbon economy has been supported by strong project and reform implementation and broader economic diversification efforts. Spillovers from regional conflicts have been limited. Inflation has been broadly contained. Fiscal accounts remained strong, benefiting from favorable hydrocarbon prices and fiscal consolidation efforts, albeit to a different extent across countries.

4. The GCC countries witnessed weak hydrocarbon and more robust non-hydrocarbon activity generally in 2023, with cross-country variations. Overall real GDP growth in the GCC decelerated in 2023, to somewhat below 1 percent, primarily driven by the hydrocarbon economy. Specifically, with the exception of Qatar, stagnant or declining hydrocarbon activity amid OPEC+ and voluntary production cuts weighed on growth across the region. Against this backdrop, real economic activity contracted in Kuwait (-3.6 percent). Contraction was less pronounced in Saudi Arabia (- 0.8 percent) as domestic demand was supported by economic diversification efforts and project implementation. In the UAE, real GDP growth remained robust (3.6 percent) as non-hydrocarbon growth, supported by continued rebound in tourism, ongoing policy support, capital inflows, and increased capital spending, more than counterbalanced negative hydrocarbon growth. Similarly, in Bahrain, hydrocarbon output contracted due to oil field maintenance, but it was more than offset by robust activity in the non-hydrocarbon sector, led by financial services, leading to overall growth of 3 percent.[2] Finally, economic activity grew at a similar rate (1¼ percent) in Oman and Qatar. In Oman,

[2] In August 2024, the Bahraini authorities published revised GDP series with an expanded coverage of economic activities, in parallel with a transition to the ISIC rev. 4 sectoral classification.

non-hydrocarbon economy decelerated, albeit remaining strong. In Qatar, non-hydrocarbon activity normalized in the aftermath of strong growth due to the 2022 FIFA World Cup.

5. Spillovers from regional conflicts have been limited. Tensions in the Red Sea have so far had a muted impact on GCC economies, with trade, investment, and tourism flows remaining largely unaffected. The daily export volume from major GCC ports has rebounded, albeit to the lower end of historical levels (Figure 2, upper left panel). Some countries adapted to shipping disruption quickly owing to flexible shipping and storage network (e.g., Kuwait). Moreover, high-frequency indicators show a quick rebound in net portfolio inflows (Figure 2, upper right panel), supported by strong reform momentum (Box 1). Flight arrivals have been robust, reaching record levels in some cases (e.g., Qatar, Saudi Arabia; Figure 2, lower panels). The region's insignificant trade and financial linkages with Gaza and Israel have limited spillovers.

Box 1. Resilience of GCC Financial Markets

GCC stocks and bonds have exhibited resilience during periods of market stress based on event studies using daily data for the past two decades. While this resembles the performance of traditional safe haven assets (e.g., U.S. bonds and equities), the finding could also be driven by other factors such as less active trading in GCC financial markets or more involvement of domestic investors in periods of stress (e.g., sovereign wealth funds, or SWFs). Nonetheless, continuing to implement prudent policy within sound institutional frameworks would help safeguard financial markets against adverse shifts in market sentiment.

Safe haven countries' assets tend to appreciate or maintain their value at times of global financial stress. The canonical safe haven country is the U.S., as global investors flock to its sovereign bonds to seek refuge during periods of heightened global risk aversion, compressing their yields amid falls in riskier asset prices. Global safe haven status confers major economic benefits, including through lower and more stable financing costs for households, firms and governments. Assets issued in the GCC countries could have safe haven characteristics to the extent that they have a track record of macroeconomic and geopolitical stability, underpinned by large financial buffers.

Our analysis indicates that the performance of GCC bonds is comparable to that of US bonds, while GCC equities outperform US equities during risk-off periods.[1] These results are robust to different thresholds for identifying global risk-off and oil price jump events.

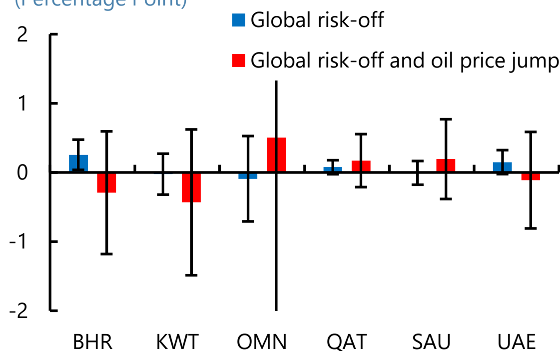
Bonds. The impact of global risk-off events on the GCC's relative bond yields are statistically insignificant at the 95 percent confidence level, regardless of concurrent oil price jumps, despite corporate bonds, which tend to be riskier than sovereign credit, representing about 1/3 in GCC bond indices on average.

Equities. GCC equities tend to outperform US equities at times of global financial stress. The estimated impacts of global risk-off events on relative GCC stock returns are uniformly positive and statistically significant at the 95 percent confidence level. The impacts are economically significant, with GCC stock returns exceeding US stock returns by 0.8 percentage points on average across countries during global risk-off events. The effects are larger when oil prices also jump, by 0.3 percentage point on average across countries. The results are uniform across the GCC countries, indicative of a regional pricing factor.

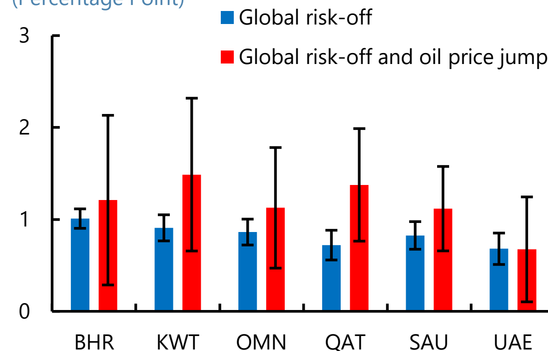
Box 1. Resilience of GCC Financial Markets (concluded)

Box 1. Figure 1. Estimated Impacts of Events on GCC Relative Bond Yields and Equity Returns 1/

GCC yield response to risk off and oil price jump is similar to that of US Treasury yields…



…while GCC equities show better performance than US equities.



Sources: IMF staff.
1/ Vertical lines represent 95 percent confidence intervals. That for Oman's bond yields during global risk-off and oil price jump exceeds +/-4.

The notable resilience of GCC financial markets could be driven by several factors. For example, the observed resilience could have been supported by the lower volume of trading in the context of a high reliance on domestic investors, including SWFs.

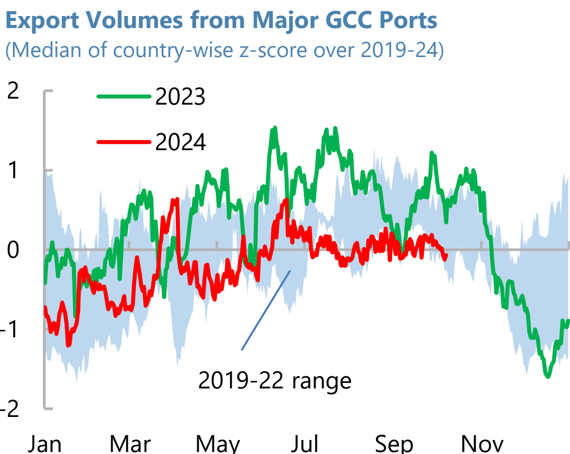
Policymakers in GCC countries should continue implementing prudent policy measures within sound institutional frameworks. It would help safeguard domestic macroeconomic and financial stability and the resilience of GCC financial markets to adverse shifts in global financial conditions. This is especially important as the recent relaxation of foreign investor participation, the high volume of IPOs, and the increasing integration into international bond markets are likely to expose equity and bond markets to global market sentiment to a larger extent.

____

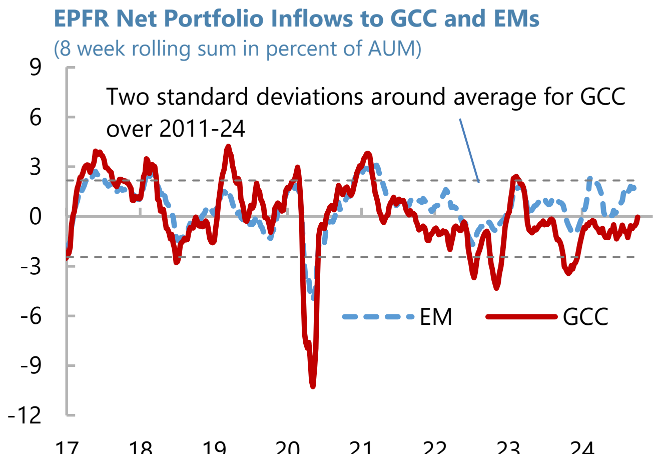
1/ High-frequency event studies are used to estimate the impact of jumps in global risk aversion and oil prices on GCC bond yields and equity returns relative to their US counterparts. Jumps in global risk aversion are identified by large abrupt increases in the commonly used "global fear index", or VIX. The role of oil prices is also assessed by considering events with 2-standard-deviation jumps in both global risk aversion and oil prices (e.g., due to oil supply disruptions). Daily observations for trading days during January 1, 2004–April 23, 2024, are collected for the six GCC countries. Relative bond yields are calculated using US dollar-denominated external debt securities issued by GCC sovereigns, quasi-sovereigns, and corporates (the MECI indexes by JP Morgan) and maturity-matching US Treasury yields. Relative equity returns are calculated using daily returns in percentage changes of GCC equities and S&P 500.

Figure 2. GCC Countries' Resilience to Recent Shocks

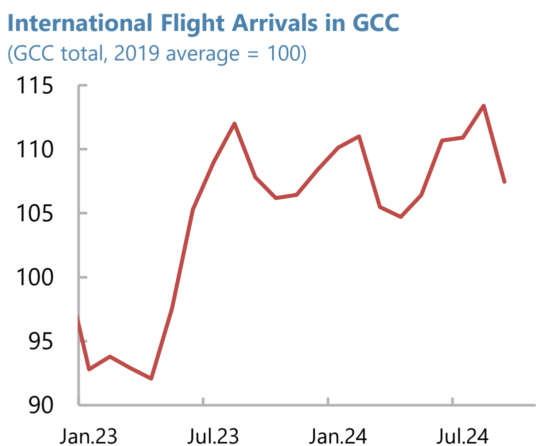
Exports from major GCC ports have recovered, albeit remaining relatively subdued...



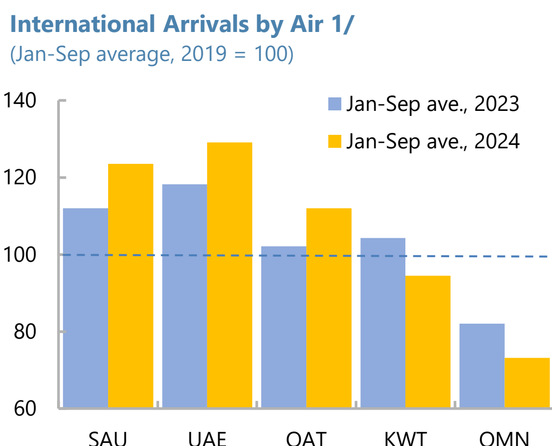
...so did net portfolio inflows from their trough in Q4 last year.



International flight arrivals have held up well since the onset of the conflict in Gaza and Israel...



...and have surpassed pre-COVID-19 pandemic levels in some GCC countries.



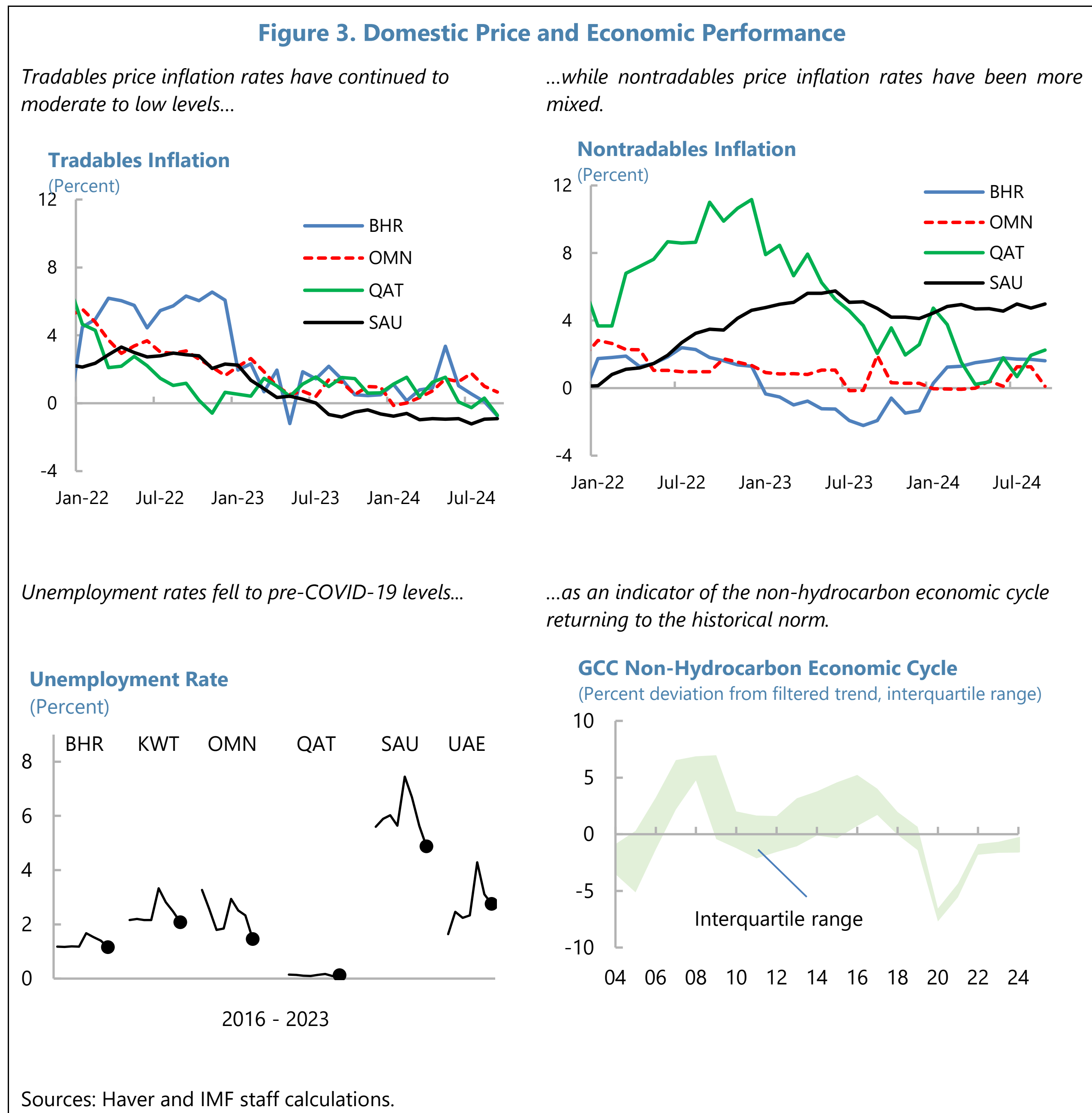
Sources: EPFR, Haver, PortWatch, and IMF staff calculations.

1/ The decline in international flight arrivals in Oman is related to the shift in regional tourism inflows towards land transportation after Covid-19 against the backdrop of the development of roads connecting it with GCC neighbors.

6. **Inflation has been contained, helped by the appropriate tightening of monetary conditions and a broadly neutral output gap** (Figure 3). Headline inflation rates nearly halved to somewhat below 2 percent in 2023 and is expected to remain at similar levels in the medium term. Tradable goods (including food) inflation fell as subsidies and caps on certain prices were maintained, the currency pegs to the strong US dollar contained imported inflation, and as GCC central banks broadly followed U.S. monetary policy tightening. Nontradables inflation has showed more variation across countries. In Qatar, it moderated from the World Cup-related high level as the boost from the Asian Cup in early-2024 was relatively modest. In Saudi Arabia, nontradables inflation remained

elevated, driven mostly by rental prices, against the backdrop of positive non-hydrocarbon output gap. Consistent with moderate levels of unemployment, the aggregate non-hydrocarbon output gap in the GCC remained broadly neutral, helping contain nontradables inflation.

Figure 3. Domestic Price and Economic Performance



Tradables price inflation rates have continued to moderate to low levels...

...while nontradables price inflation rates have been more mixed.

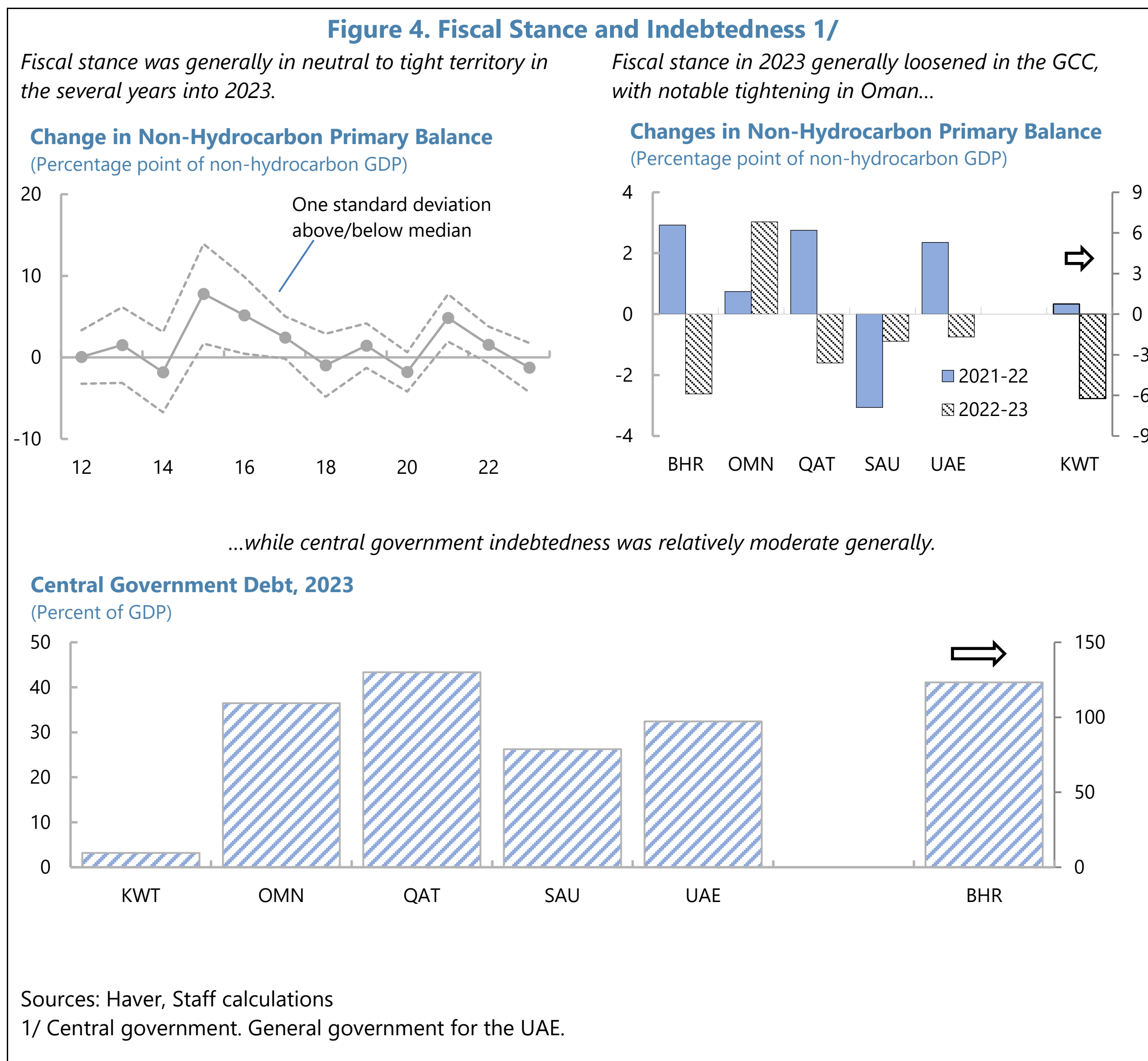
Unemployment rates fell to pre-COVID-19 levels...

...as an indicator of the non-hydrocarbon economic cycle returning to the historical norm.

Sources: Haver and IMF staff calculations.

7. Favorable hydrocarbon prices and sustained reform efforts continued to support fiscal accounts in the region (Figure 4). The overall fiscal balance fell by 4 percentage points to somewhat below 6 percent of GDP in 2023. As indicated by the change in the non-hydrocarbon primary balance to non-hydrocarbon GDP ratio, the fiscal stance of the median GCC country loosened in 2023, with cross-country variations. Oman continued fiscal consolidation in 2023, worth a nonhydrocarbon primary adjustment of 3 percentage points of non-hydrocarbon GDP. The fiscal stance loosened by

¾–1 percentage point in the UAE and Saudi Arabia (in the latter amid strong investment-related spending) and 1½ percentage points in Qatar.[3] In Bahrain, the momentum for fiscal consolidation slipped in 2023, following significant reductions in the non-hydrocarbon primary deficit since the 2018 adoption of the Fiscal Balance Program (by 9 percentage points to 18 percent of non-hydrocarbon GDP in 2022).[4] The fiscal stance loosened by around 6 percentage points in Kuwait due to the public sector wage bill and subsidies. Central government debt as a share of GDP was broadly unchanged in 2023 in the region.



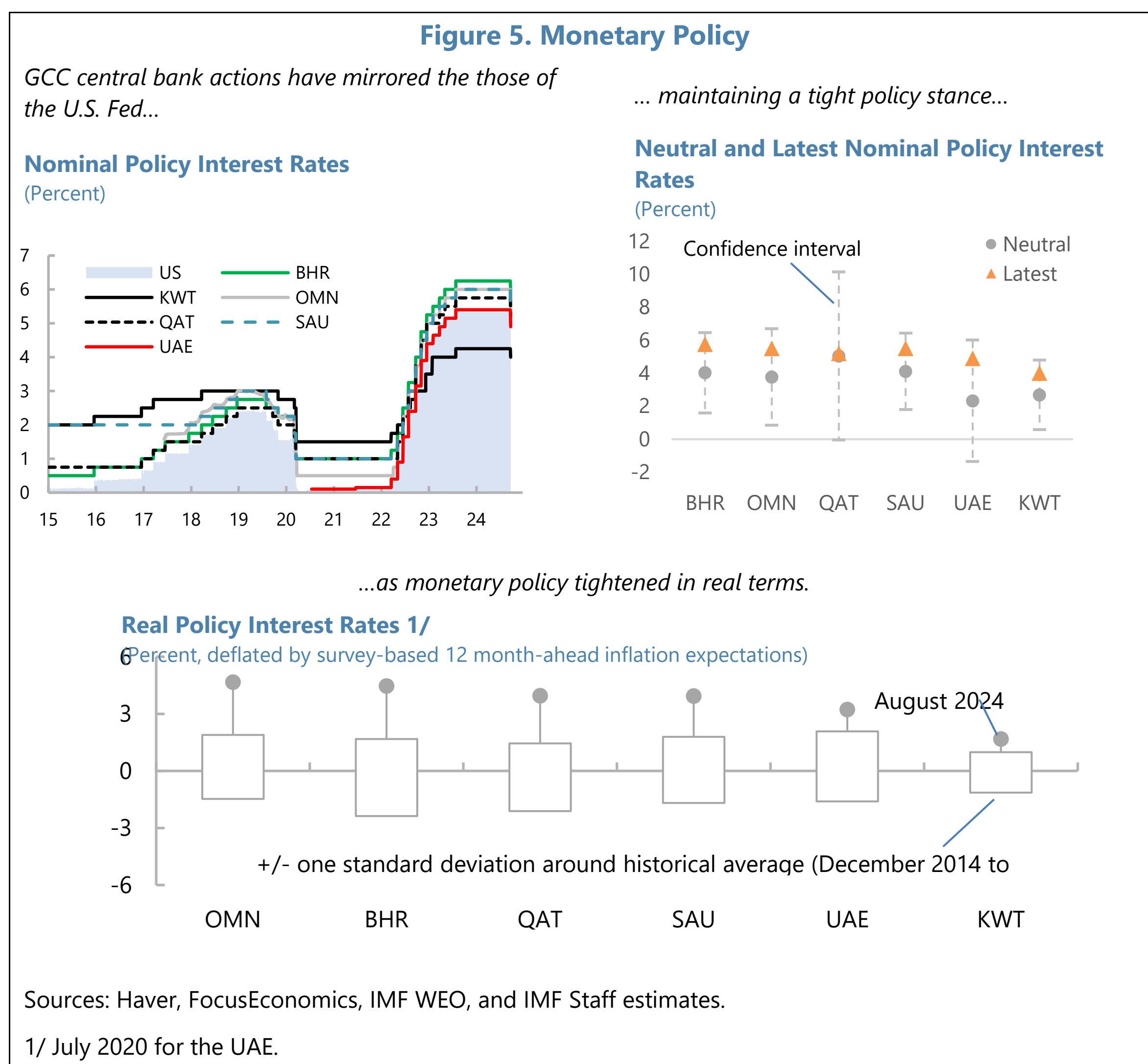
[3] Its medium-term budget will be updated to finance reform initiatives in the Third National Development Strategy released in January 2024.

[4] See the footnote to Table 5.

Monetary Policy and Financial Sector Developments

With GCC monetary policy mirroring that of the U.S. Federal Reserve, an appropriate policy stance has been maintained. Amid high interest rates, credit growth decelerated, while the banking system has remained resilient. GCC financial markets have demonstrated strong performance.

8. Mirroring the U.S. Federal Reserve's monetary policy to support the peg, the GCC central banks started the easing cycle in September 2024 (Figure 5). Following the sharp tightening cycle between early-2022 and mid-2023, GCC central banks have started cutting the policy rate in September 2024, mirroring the actions of the U.S Federal Reserve, which is consistent with their pegs to the US dollar.[5] Notwithstanding the uncertainty around the estimates of the neutral rate, the



[5] In Kuwait, where the dinar is pegged to an undisclosed basket of currencies, the tightening cycle halted in July 2023. Also, cumulative rate hikes between early-2022 and mid-2023 of 275 basis points were below the 525 basis points in the U.S. Federal funds rate.

monetary policy stance is assessed to be tight as of mid-2024 in the GCC countries. In addition, financial conditions have also tightened appropriately, as monetary aggregates have been kept under control, benefiting from improved liquidity management frameworks across the GCC. For instance, the ongoing implementation of the Dirham Monetary Framework in the UAE aims to steer the overnight interbank rate towards the policy rate through the use of standing facilities, open market operations, and reserve requirements. In Saudi Arabia, the introduction of an auction mechanism for the placement of public deposits with commercial banks, with the central bank acting as a fiscal agent, strengthened the use of market-based instruments for liquidity management. In Oman, ongoing efforts to reinforce liquidity management include establishing an interest rate corridor, initiating open market operations, and enhancing capacity at the Central Bank of Oman as part of the Monetary Policy Enhancement project. Finally, Qatar has enhanced liquidity management through the more effective use of T-bill issuances to absorb excess liquidity.

9. Amid decelerating private sector credit, asset quality is strong and banking sectors in the GCC remain well capitalized and liquid (Figure 6). Capital adequacy ratios remain well above regulatory requirements. Profitability has rebounded from the pandemic low, with return on equity in the range of 5-15 percent, supported by an increase in net interest margins on the back of the lower pass-through of tighter financial conditions to deposit rates (partly as some deposits are unremunerated). As higher policy rates passed through to lending rates, credit growth has decelerated in most GCC countries, with cross-country differences reflecting idiosyncratic factors. In Saudi Arabia, for example, credit growth moderated but remained double digit owing to corporate loan growth and mortgage lending supported by the Saudi Housing Program. In the UAE, the quarterly *Credit Sentiment Survey* suggests that credit demand has remained strong despite banks' underwriting standards having been tightened. Asset quality remains high, and non-performing loan (NPL) ratios moderate across the GCC. In the UAE, the gross NPL ratio peaked at close to 8 percent and has decreased to close to 5 percent in 2023. Provisioning against credit losses is prudent, especially in Kuwait and Saudi Arabia where it exceeds the stock of NPLs. Funding continues to be dominated by deposits, with the loan-to-deposit ratio below or around 100 percent in four countries.

10. The strong performance of GCC financial markets has been supported by external conditions, robust economic activity, and policies aimed at mobilizing financing for the implementation of Vision programs (Figure 7):

- **Equities:[6]** The number of listed companies continued to increase in the first three quarters of 2024, with more than 30 **initial public offerings** (IPOs) in a total amount exceeding US$5 billion, led by Saudi Arabia's Tadawul stock exchange in terms of the number of IPOs, the Dubai Financial Market, the Abu Dhabi Securities Exchange, and Oman's Muscat Stock Exchange in terms of the value of IPOs.[7] In addition, market capitalization was boosted by Saudi Aramco's secondary

[6] For cross-country comparability, MSCI stock indices are used, the performance of which sometimes differs from that of major domestic stock price indices.

[7] The largest IPO in the GCC was recorded in the Muscat Stock Exchange when OQ Exploration and Production, part of the state-owned energy company OQ, raised US$2 billion.

offering (US$12 billion). Strong investor appetite is demonstrated by heavily oversubscribed IPOs.[8] In general, IPO activity was led by companies in energy, health care, consumer goods and services, and industry.

- Against the backdrop of an outflow of close to $400 million from equity funds, **GCC stock markets** underperformed the benchmark for EMs (MSCI EM Index, +7 percent) in 2023. The stock index declined in Kuwait (-10.1 percent), Oman (-1.3 percent), Qatar (-0.4 percent), and the UAE (-3.0 percent). The major exception was Saudi Arabia where performance continued to be robust (+8.7 percent), and the Bahrain stock exchange also showed gains (+3.4 percent). In 2024, GCC stock markets continued to show divergent performance as of mid-October, with gains in Bahrain (+13 percent) being comparable to EM performance (+13 percent). Gains were relatively modest in Kuwait (+3 percent), Oman (+1 percent), and the UAE (+1 percent), while stock indices declined in Qatar (-3 percent) and Saudi Arabia (-3 percent).
- **Debt securities:** In line with general trends in EMs, net bond outflows from the GCC reached US$2.5 billion in 2023 and US$1.4 billion during January-August 2024. Nonetheless, sovereign spreads have remained broadly stable since early-2023, except for some declines in Bahrain and Oman (close to 50 and 90 basis points, respectively). As part of their strategy to diversify funding sources and finance reform implementation, GCC countries also tapped international bond markets in 2024, including bond issuances of US$17 billion by the sovereign in Saudi Arabia (exceeding issuances by any other EM), US$9.6 billion by Saudi Arabia's Public Investment Fund, US$9 billion by Saudi Aramco, US$2 billion by Bahrain, US$5 billion by Abu Dhabi, US$2.5 billion by the Abu Dhabi Development Holding Company, and US$2.5 billion of first-ever green bonds by Qatar.

External Sector Developments

Current account surpluses have narrowed owing to oil production cuts and strong investment-related imports. External surpluses were invested abroad and accumulated as international reserves, albeit to a different extent across GCC countries.

11. The GCC countries continue to record current account surpluses, albeit to a declining extent due to oil production cuts and strong imports (Figure 8). Following the decline from 17.8 percent of GDP in 2022 to 11.8 percent of GDP in 2023, the GCC current account surplus is expected to further moderate to 9.7 percent of GDP in 2024. On the one hand, external balances are supported by relatively high hydrocarbon prices and robust non-hydrocarbon exports of goods and services, including tourism. In Qatar, for example, peak tourist arrivals during the 2024 Asian Cup exceeded those during the 2022 World Cup, while Saudi Arabia achieved the 2030 goal of 100 million inbound and domestic visitors already in 2023. On the other hand, this is more than offset by strong investment-related imports and the impact of the extension of oil production cuts to be phased out gradually between the fall of 2024 and late-2025.

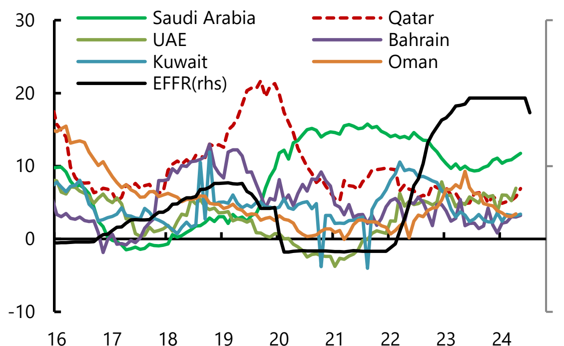
[8] The IPO of Dr. Soliman Abdul Kader Fakeeh Hospital, for example, was 119 times oversubscribed, with orders reaching US$91 billion.

Figure 6. Banking Systems

Credit growth has decelerated...

GCC Credit Growth and Federal Funds Rate

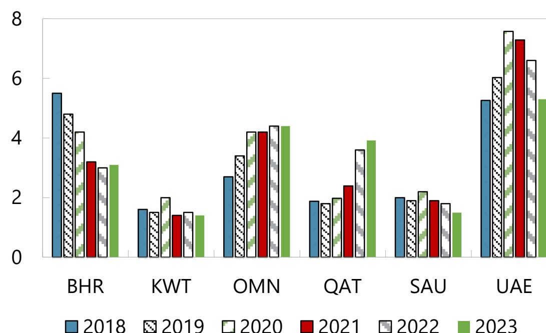
(Percentage, YoY)



...while asset quality has remained high, with low NPLs....

Gross Non-Performing Loans to Total Loans

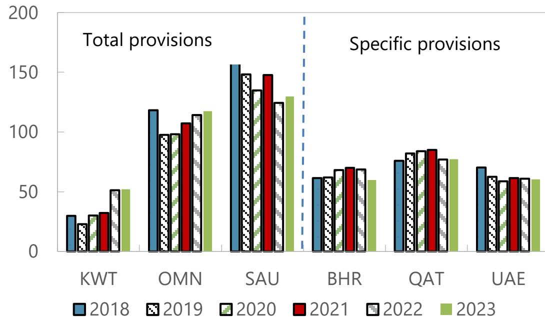
(Percentage)



...and high provisioning against credit losses.

Provisions to Gross NPLs

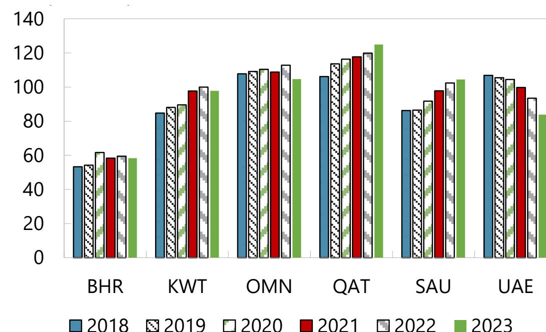
(Percentage)



Funding continues to be dominated by deposits.

Loans-to-Deposit Ratio 1/

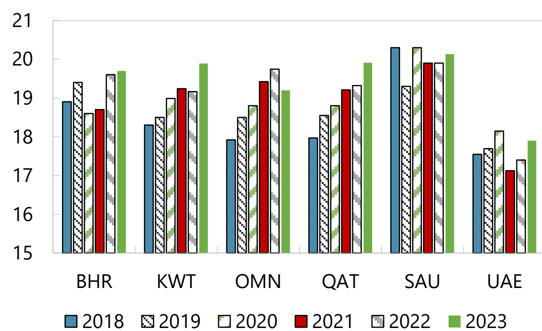
(Percentage)



Capital adequacy ratios exceed regulatory requirements by a comfortable margin...

Capital Adequacy Ratio

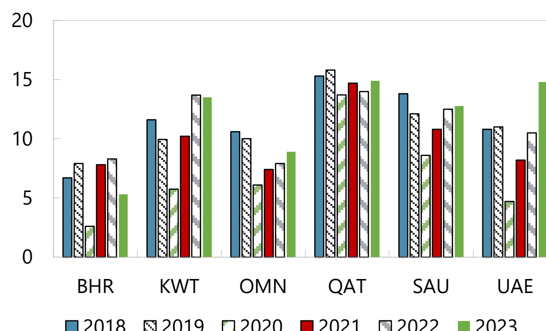
(Percentage)



... while profitability has rebounded on the back of rising net interest margin.

Return on Equity

(Percentage)



Sources: Haver, Staff calculations

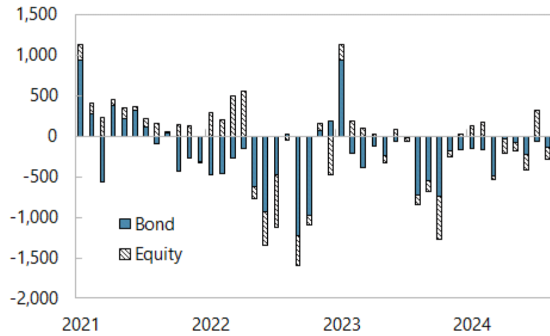
1/ Authors' calculations.

Figure 7. Financial Market Performance

As net bond and equity fund flows to the GCC have generally been negative since early-2023…

Net Bond and Equity Flows to GCC

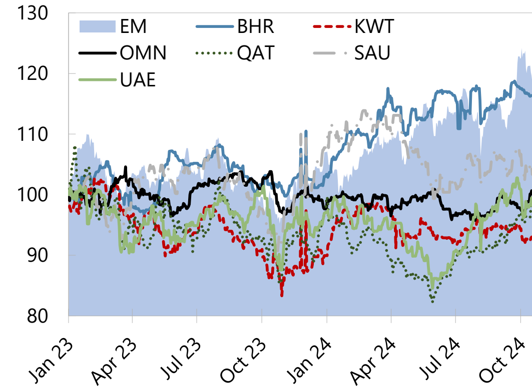
(Millions of US$)



… most GCC domestic equities have underperformed EMs, except for Bahrain and Saudi Arabia…

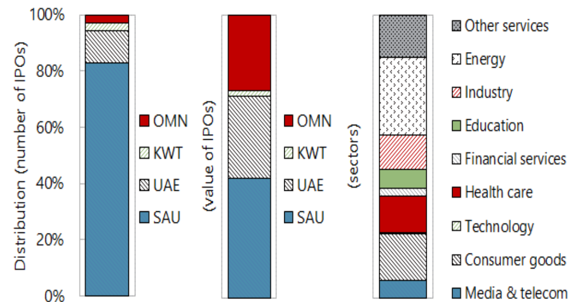
MSCI Stock Market Indices

(Jan 2023=100)



… supported by a large number of IPOs in Saudi Arabia…

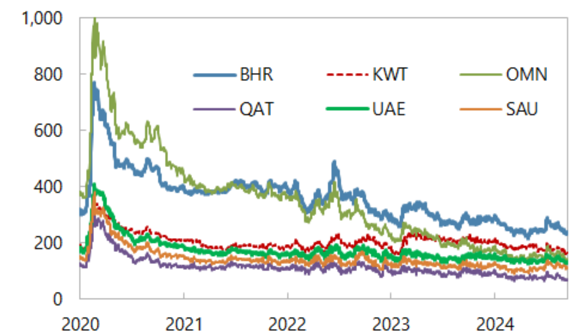
Initial Public Offerings, Jan-mid-Oct, 2024



…while sovereign bond spreads have been stable.

Sovereign Bond Spreads

(Basis points)



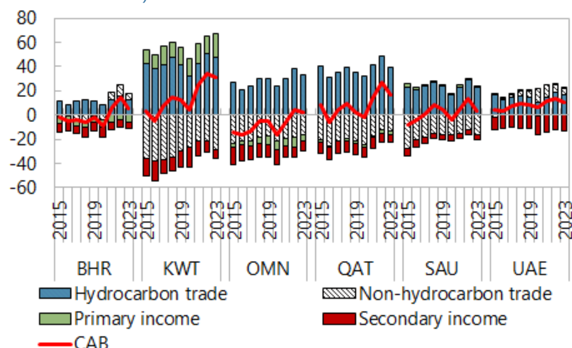
Note: Bond and equity flows are institutional and retail investor flows, thereby not encompassing total portfolio flows.
Sources: EPFR, Bloomberg, Tadawul stock exchange, Dubai Financial Market, Abu Dhabi Securities Exchange, Boursa Kuwait, Staff calculations.

Figure 8. Current Account Balance

Current account surpluses narrowed…

Current Account Balance

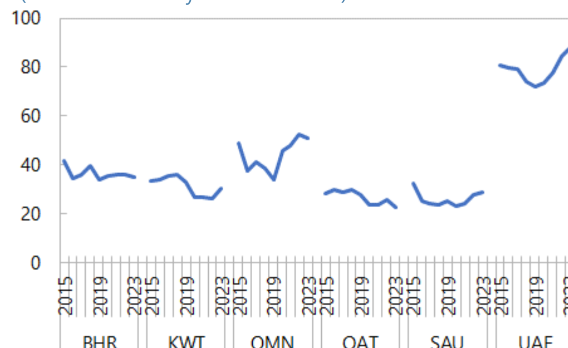
(Percent of GDP)



….on the back of strong investment-related imports…

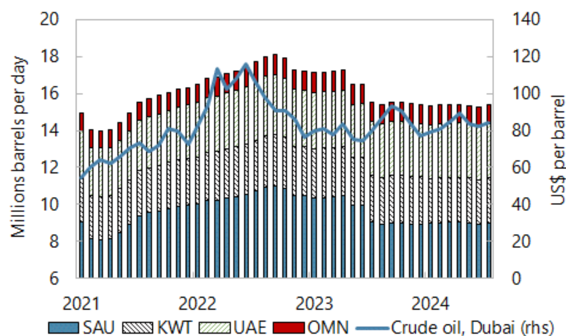
Non-Hydrocarbon Imports

(Percent of non-hydrocarbon GDP)



…and oil production cuts, while elevated hydrocarbon prices continued to support the current account balance….

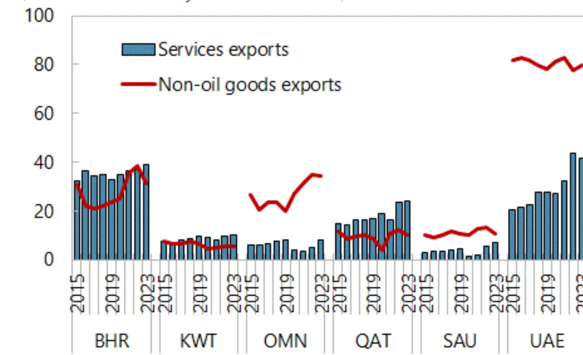
Oil Production and Oil Prices



…along with robust non-hydrocarbon goods and services exports, albeit to a different extent across GCC countries.

Non-Hydrocarbon Goods and Services Exports

(Percent of non-hydrocarbon GDP)

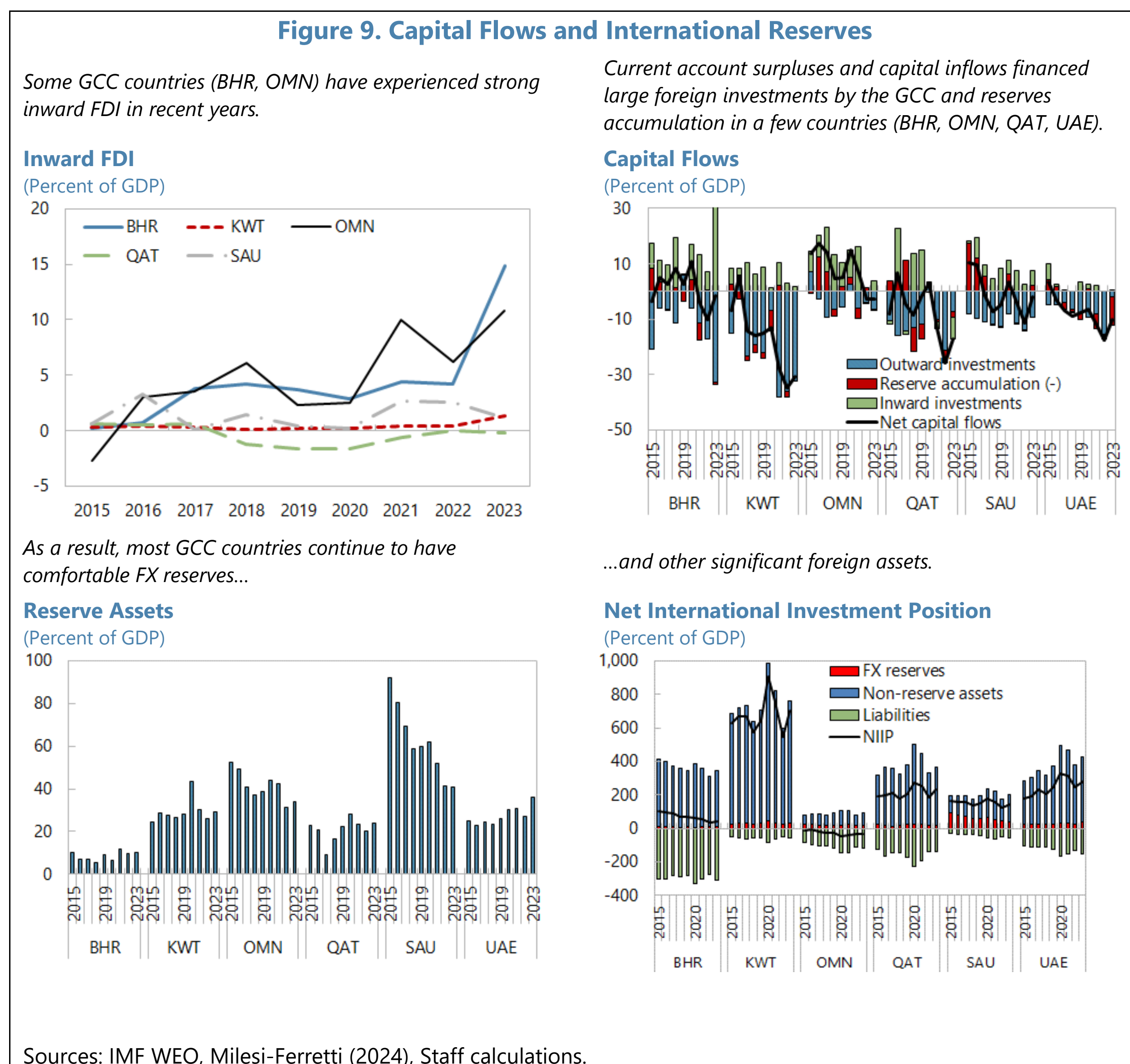


Sources: IMF WEO, OPEC Monthly Oil Market Reports, World Bank "Pink Sheet" Data, Staff calculations.

12. **Against the backdrop of current account surpluses and private capital inflows, the GCC countries have increased foreign investments, extended financial support to the region, and accumulated FX reserves** (Figure 9 and Annex III). Supported by policies aimed at economic diversification, inward foreign direct investment (FDI) have accelerated in recent years in some GCC countries (Bahrain, Oman, Saudi Arabia, the UAE).[9] In addition, portfolio inflows have been boosted by the issuance of international bonds by sovereigns and SWFs, the large number of IPOs, and the increasing weight of the GCC in emerging market bond and equity indices (partly related to the exclusion of Russia). Against the backdrop of current account surpluses and capital inflows, the GCC countries made sizeable investments abroad, including (i) *acquisition of foreign assets*, including by SWFs and national oil companies (e.g., acquisition of a stake in Lenovo and Heathrow Airport by PIF,

[9] In Bahrain, the authorities have made efforts to attract FDI, including into financial services, manufacturing, ICT, and tourism through initiatives such as the Golden License. The 2023 uptick in FDI for Bahrain was largely driven by a foreign financial institution's bank acquisition. In Oman, FDI was mostly into hydrocarbon up and downstream sectors. The understanding of the evolution of FDI, however, continues to be constrained by data deficiencies.

Truist Insurance Holdings by Mubadala, and NextDecade Corporation by ADNOC); (ii) *financial support to foreign sovereigns*, including announced investments of US$35 billion by the UAE in Egypt, and US$5 billion by Saudi Arabia in Pakistan; and (iii) *reserve accumulation*, especially in the UAE.



Sources: IMF WEO, Milesi-Ferretti (2024), Staff calculations.

13. The GCC external balance sheets remain strong. Official reserves remain generally adequate according to standard IMF metrics and GCC countries separately hold large financial assets through SWFs. Based on the latest assessment, the external position is broadly in line with the level implied by medium-term fundamentals and desirable policies in Oman and the UAE, and stronger in Qatar. Although it is weaker than the level consistent with medium-term fundamentals in Kuwait and Saudi Arabia, the external position is strong given large external buffers.

14. The nominal effective exchange rates appreciated between early-2023 and mid-2024, while real rates were broadly stable (Figure 10)**.** The nominal effective exchange rate (NEER)

appreciated across the GCC since early-2023, notwithstanding some corrections at the end of the year, reflecting movements in the U.S. dollar. As inflation in the GCC was below that of trading partners, real effective exchange rates (REER) were broadly stable. In 2024, the NEER appreciated further across the GCC, while the REER has showed some divergence. In Bahrain and Saudi Arabia, it remained broadly stable given the continued negative inflation differential. In Qatar and the UAE, and to a lesser extent in Oman, low inflation even led to a depreciation of the REER. Finally, the combination of the relatively high nominal appreciation and inflation resulted in the appreciation of the REER in Kuwait.

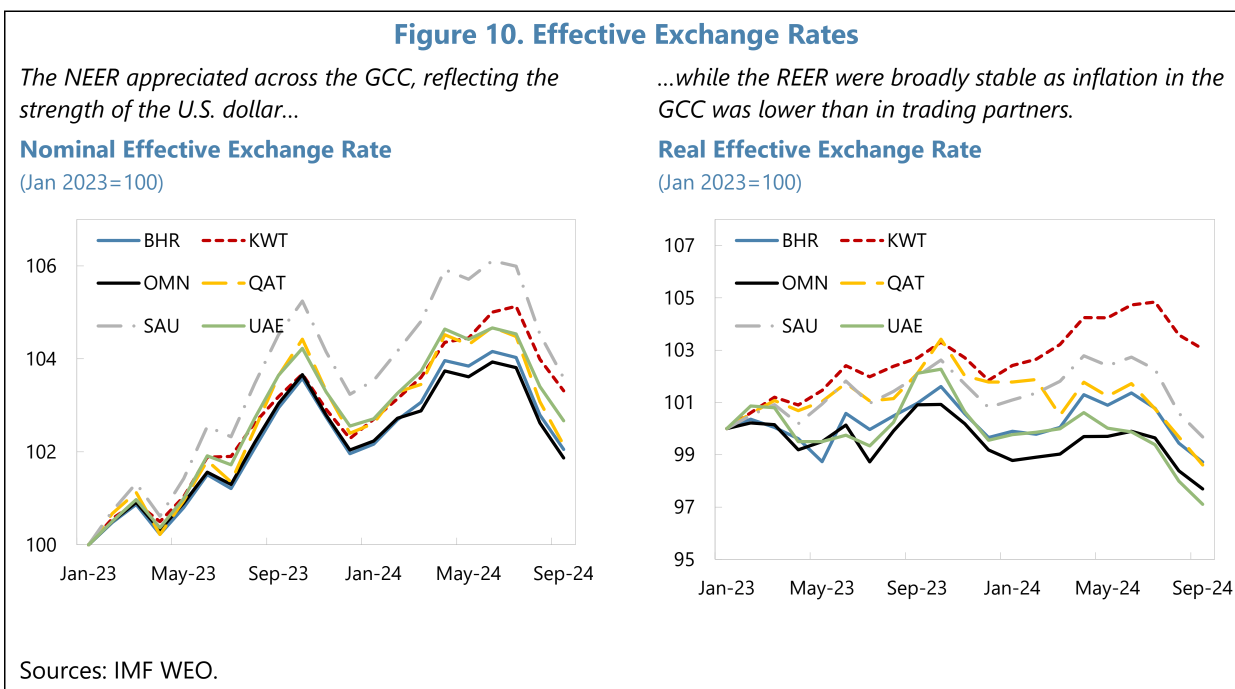


Figure 10. Effective Exchange Rates

The NEER appreciated across the GCC, reflecting the strength of the U.S. dollar…

Nominal Effective Exchange Rate
(Jan 2023=100)

…while the REER were broadly stable as inflation in the GCC was lower than in trading partners.

Real Effective Exchange Rate
(Jan 2023=100)

Sources: IMF WEO.

C. Outlook and Risks

Over the medium term, economic activity will benefit from stronger non-hydrocarbon activity on the back of reform implementation and a robust hydrocarbon sector, while inflation will stabilize at low levels, supported by credible policy frameworks. The external sector will remain strong, with a gradual narrowing of current account surpluses on the back of strong domestic investments. Risks around the mildly favorable outlook are broadly balanced in the near term. More challenging longer-term risks call for taking action on policy priorities discussed later.

15. Going forward, growth is expected to accelerate on the back of a recovery in oil production in 2025, as well as strong non-hydrocarbon and robust hydrocarbon economy over the medium term (Figure 11). GCC overall output growth is projected to rebound to 1½ percent in 2024, though at a pace somewhat slower than previously expected due primarily to extended oil production cuts. It will strengthen further to 3½ percent in 2025 as production cuts are gradually unwound. Over the medium term, non-hydrocarbon output growth is set to remain strong, projected at 3½ percent, following rapid project implementation, a construction boom, and accelerated reform

efforts to diversify the economy. Nonetheless, medium-term non-hydrocarbon growth will differ across GCC countries, ranging from 2-3 percent in Kuwait and Qatar to 3.5-4.5 percent in Bahrain, Oman, Saudi Arabia, and the UAE. In addition, economic activity will be supported by a recovery in the hydrocarbon sector.

16. The hydrocarbon sector will continue to play an important role over the medium term. Notwithstanding the objective of the GCC countries to diversify the economy, the hydrocarbon sector will continue to play an important role in both domestic economy and global energy supply supported by several factors (Figure 12). First, Oman, Qatar, Saudi Arabia, and the UAE have announced the expansion of their natural gas production capacities (Box 2). Second, oil and natural gas production in the GCC is less carbon-intensive compared with other producers. Kuwait, Saudi Arabia, and the UAE in the top four least carbon-intensive oil producers, while Oman, Qatar, Saudi Arabia, and the UAE are in the top six countries with the lowest carbon intensity of natural gas production. Moreover, significant decarbonizing operations are being undertaken, including through carbon capture. The GCC countries also have a cost advantage over competitors, allowing them to maintain production throughout the energy transition. Finally, the GCC countries constitute a large share of global spare capacity in oil production and oil reserves.

17. Following some divergence in the near term, inflation will stabilize at around 2 percent over the medium term (Figure 11). In 2024-25, headline inflation is expected to be above 2 percent in Kuwait, below in Bahrain, Oman, and Qatar, and broadly 2 percent in Saudi Arabia and the UAE. Over the medium term, headline inflation will stabilize broadly at 2 percent, consistent with medium-term inflation in the US, supported by the exchange rate pegs, policy discipline, and the elastic supply of expatriate workers.

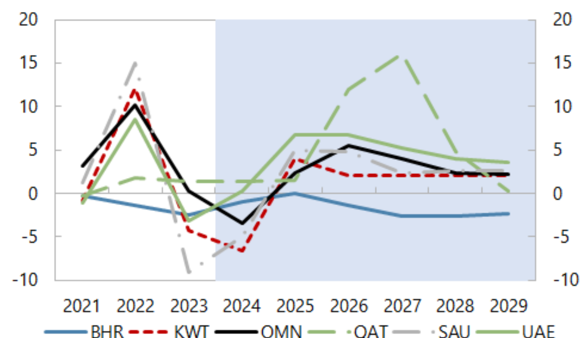
18. External balances are expected to remain strong, with cross-country differences partly reflecting the pace and size of investments as part of the broad reform agenda (Figure 11)**.** In Kuwait and Qatar, the current account balance is expected to record double-digit surplus over the medium term, notwithstanding a narrowing as hydrocarbon exports decline. In Saudi Arabia, large investments are expected to result in a modest current account surplus in 2024 and a gradual widening of a deficit over the medium term. In the rest of the GCC, the current account balance will remain either stable or slightly decline to single-digit surpluses.

Figure 11. Macroeconomic Outlook

Hydrocarbon growth will be supported by the unwinding of production cuts and the expansion of natural gas production capacities…

Real Hydrocarbon Growth

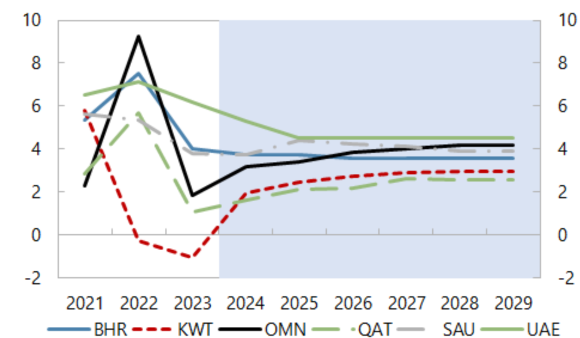
(Percent, y/y)



…while non-hydrocarbon activity will remain robust on the back of strong reform implementation, albeit to a different extent across countries.

Real Non-Hydrocarbon Growth

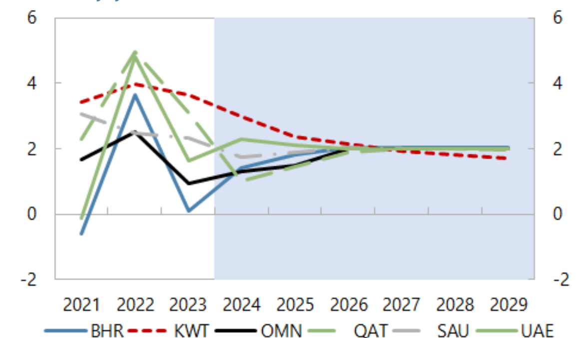
(Percent, y/y)



Headline inflation will stabilize at around 2 percent across the GCC.

Headline Inflation

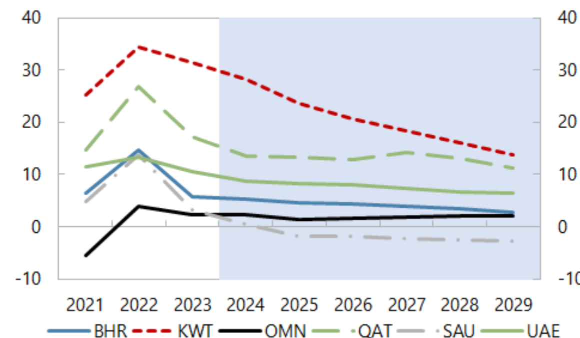
(Percent, y/y)



External balances are expected to remain strong, with cross-country differences partly reflecting the pace and size of investments.

Current Account Balance

(Percent of GDP)



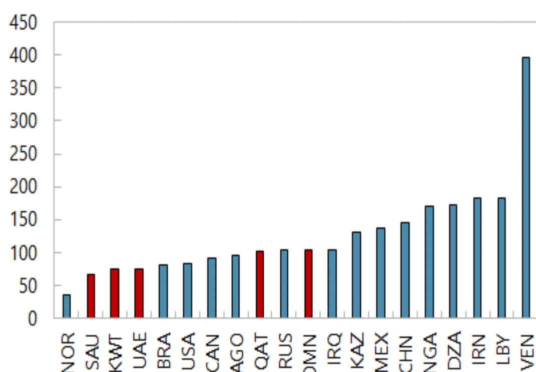
Sources: IMF WEO, Staff calculations.

Figure 12. Carbon Intensity and Costs of Oil Production

Oil production in the GCC countries is less carbon-intensive compared with other producers…

CO_2 Emissions from Oil Production, 2022

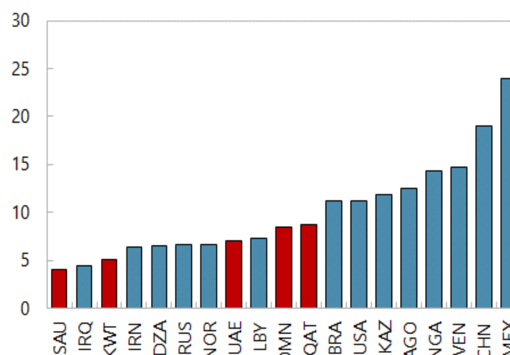
(In kilograms of carbon dioxide equivalent per barrel of oil equivalent)



…and has a major cost advantage.

Oil Production Costs

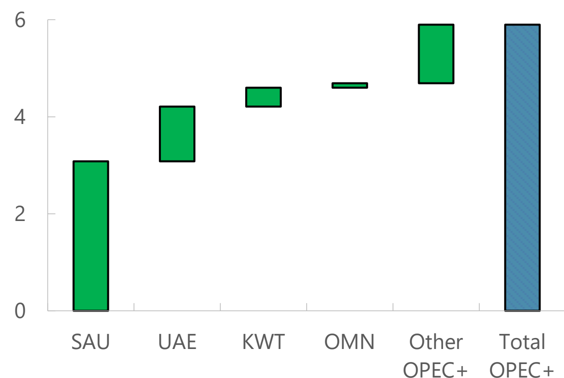
(US$ per barrel)



The GCC countries represent a large part of global spare capacity…

Effective Spare Capacity, April 2024

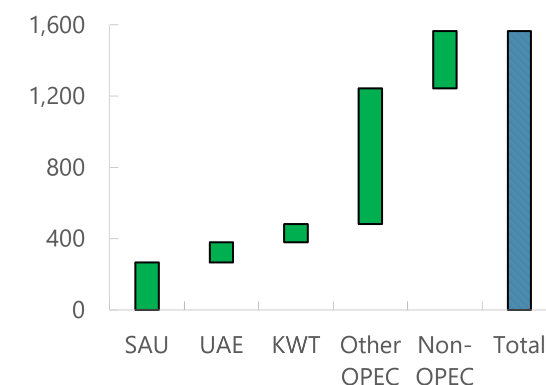
(Million barrels per day)



…and oil reserves.

Proven Crude Oil Reserves

(Billion barrels)



Note: Production costs include operational expenditures (production, transportation, SG&A, tax, abandonment costs) as estimated by Rystad Energy.

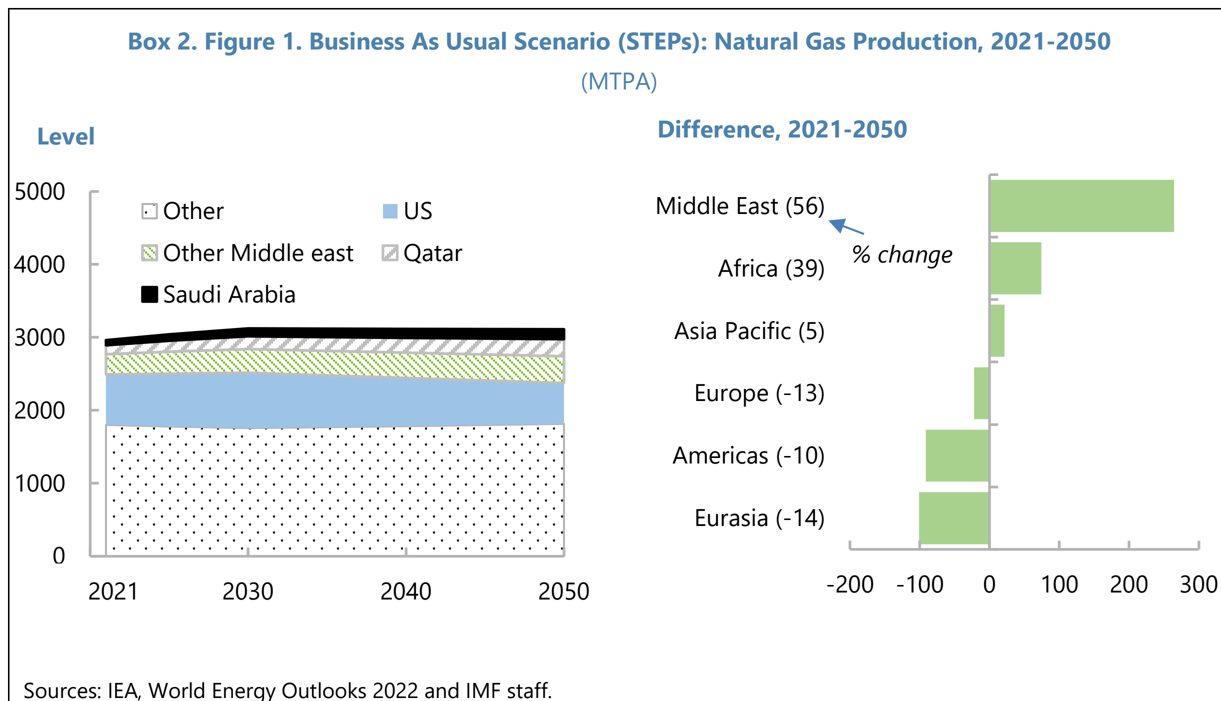
Sources: statista.com, Rystad Energy, IEA Oil Market Report - May 2024, OPEC, Staff calculations

Box 2. Natural Gas Production Expansion in the GCC

Oman, Qatar, Saudi Arabia, and the UAE have announced their plans to expand natural gas production through 2030. Oman unveiled plans to build a new train with a capacity of 3.8 mtpa and increase LNG production capacity to 15.2 mtpa by 2029. Qatar currently produces 77 mtpa of LNG and has upgraded the planned increase from 48 mtpa to 65 mtpa, lifting the total to 142 mtpa by 2030 (mostly exported). The production of other gas products is likely to expand, in which case the overall natural gas production may increase by around 50 percent. During the same period, Saudi Arabia is set to expand natural gas production by 60 percent. The UAE will expand its LNG export capacity from 6 mtpa to 15 mtpa.

These plans are broadly consistent with the IEA's "business as usual" scenario, or STEPs, up to 2050. Under STEPs, countries are assumed to continue partially implementing announced policies. According to the IEA (2022), Qatar and Saudi Arabia are set to expand natural gas production by around 90 percent each by 2050, while other countries in the Middle East by 30 percent. The Middle East is the only region that is projected to expand natural gas production substantially, by more than 250 mtpa (or more than 50 percent) by 2050.

Box 2. Figure 1. Business As Usual Scenario (STEPs): Natural Gas Production, 2021-2050
(MTPA)



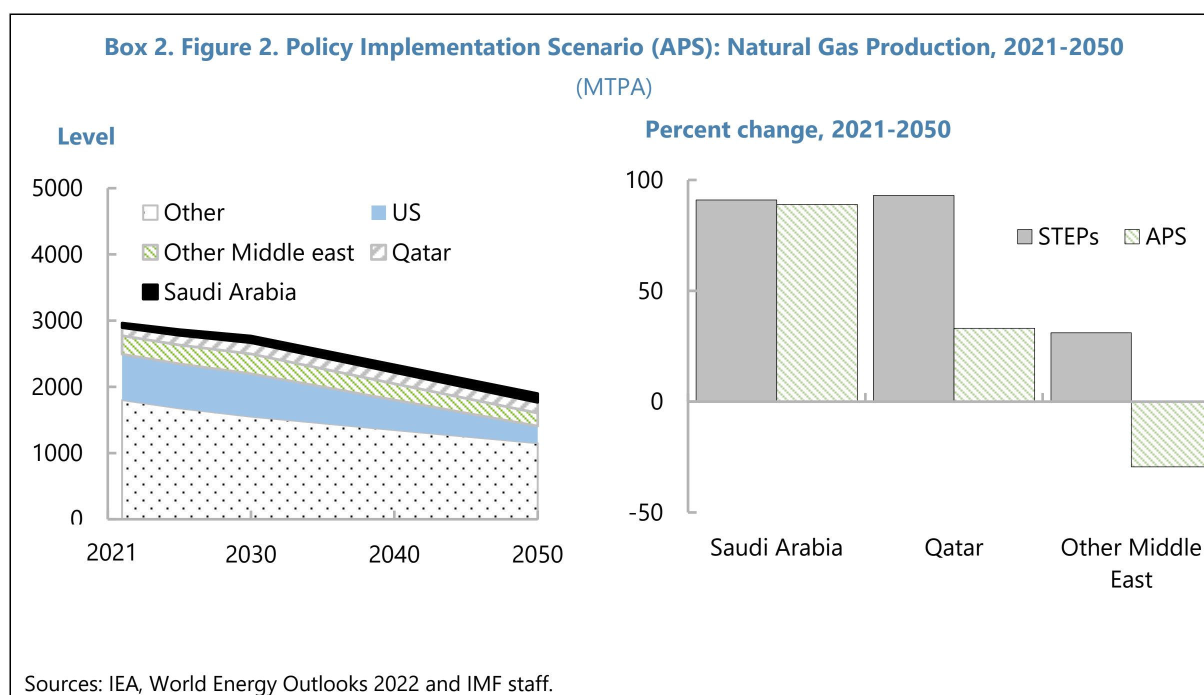
Sources: IEA, World Energy Outlooks 2022 and IMF staff.

The planned expansions may "over supply" natural gas under other more stringent energy transition scenarios. The path of global energy transition is highly uncertain. Under the IEA's different scenarios where announced policies are implemented, or APS, the overall supply of natural gas is set to decline. Natural gas production is projected to remain little changed for the Middle East as a whole (as opposed to a large increase under STEPs) with notable cross-country differences. For Saudi Arabia, production is projected to grow at a pace similar to one under STEPs, potentially reflecting rotation away from crude oil domestically. For Qatar, by contrast, production is projected to grow less than under STEPs, warning that the planned production expansion could represent an "over supply". Production for the rest of the Middle East is projected to contract (as opposed to expand by 30 percent under STEPs), potentially warning that boosts to production in other regional economies could also represent an "over supply".

Box 2. Natural Gas Production Expansion in the GCC (concluded)

Such assessments are sensitive to the underlying assumptions. For instance, views differ on the trajectory of demand for natural gas, including demand from emerging and developing countries, especially Asia, and from AI and data centers. Supply could be enhanced by a strong boost to natural gas production and liquified natural gas export terminals in the US. In addition, the global energy transition could progress in a disorderly manner. For instance, due to demand-supply imbalances (potentially triggered by under-investment in energy production), energy prices could surge and boost producing countries' revenue at the cost of importing countries' welfare. The substitutability of natural gas with coal and oil would also depend on price action. For instance, as the lowest-cost (and lowest-emission) producer of LNG, Qatar may be able to export LNG at lower prices, facilitating greater rotation away from coal and crude oil while managing to export at or near capacity.

Box 2. Figure 2. Policy Implementation Scenario (APS): Natural Gas Production, 2021-2050
(MTPA)



Sources: IEA, World Energy Outlooks 2022 and IMF staff.

19. In the near term, risks to the outlook are broadly balanced. *Upside* risks include higher-than-expected oil production on the back of faster reversal of OPEC+ and voluntary cuts, higher natural gas production/expansion, higher commodity prices, accelerated implementation of investment projects and structural reforms, and faster monetary policy easing in advanced economies. On the *downside*, both hydrocarbon and non-hydrocarbon exports would be negatively impacted by a global economic slowdown, especially in China, while higher-for-longer interest rates would constrain growth and potentially affect public finances and financial stability. Overheating in the context of large projects could lead to the resurgence of inflation. Finally, the conflict in Gaza and Israel, and the Red Sea tension, if protracted or broadened, could affect the region through more volatile hydrocarbon prices, reduced exports, lower tourism and investment, and more costly external funding.

20. GCC countries are an important source of spillovers to rest of the MENA region and beyond. Sizeable and stable private and public foreign exchange flows to neighboring countries have mitigated the impact of negative shocks. Expatriate workers in the GCC have steadily repatriated a

significant portion of their earnings to their home countries. US$110 billion worth of remittances are estimated to have flown out of the GCC in 2023 (World Bank, 2024). The GCC countries have been providing extensive support to regional countries including through financing for both budgetary and balance of payment needs (about US$56 billion disbursed from 2020 to 2024Q3 while US$24 billion or so of new funds are committed, including longer-term project loans and investment mainly from the UAE to Egypt). An adverse shock to the GCC countries would reduce financial buffers for the neighboring countries.

21. Key medium-term risks stem from geoeconomic fragmentation, energy transition, and productivity improvements. Russia's war in Ukraine (and related sanctions), the conflict in Gaza and Israel, and an increasing use of trade restrictions[10], have raised the specter of geoeconomic fragmentation. The GCC's continued multilateralism would mitigate potential negative effects. If fragmentation deepens, the GCC may benefit from an increase in energy prices and trade diversion given the low level of tariffs in the GCC compared with other regions, while they would be negatively affected by global economic output losses.[11] The GCC countries also face a large degree of uncertainty around the pace of global energy transition. Depending on the relative balance of supply (e.g., underinvestment in hydrocarbon production) and demand (e.g., shift to low-carbon consumption), hydrocarbon prices could increase or decrease, with important implications for external and fiscal balances, financial stability, and economic growth. In either case, the GCC countries have an advantage over their competitors due to the relatively low carbon-intensity and cost of hydrocarbon production. Finally, productivity improvements, in the context of reform implementation and the emergence of AI, could boost growth. At the same time, AI-led growth could also result in uneven outcomes across the segments of the population, and the emergence or intensification of risks (e.g., cybersecurity).

POLICIES FOR DIGITAL, GREEN, AND SUSTAINABLE GROWTH

Policy priorities include (i) ensuring fiscal sustainability while creating space for public investments supporting the broad reform agenda; (ii) enhancing monetary policy transmission in the near to medium term; (iii) safeguarding financial stability; and (iv) implementing structural reforms aimed at supporting strong, sustainable, and inclusive growth.

A. Fiscal Policy to Achieve Stability and Sustainability while Enhancing Growth[12]

Fiscal policy should continue to work towards an appropriate balancing act between achieving stability and sustainability while supporting economic diversification. Medium-term fiscal consolidation, with a

[10] IMF, 2023, The High Cost of Global Economic Fragmentation, IMF Blog, August 28, 2023

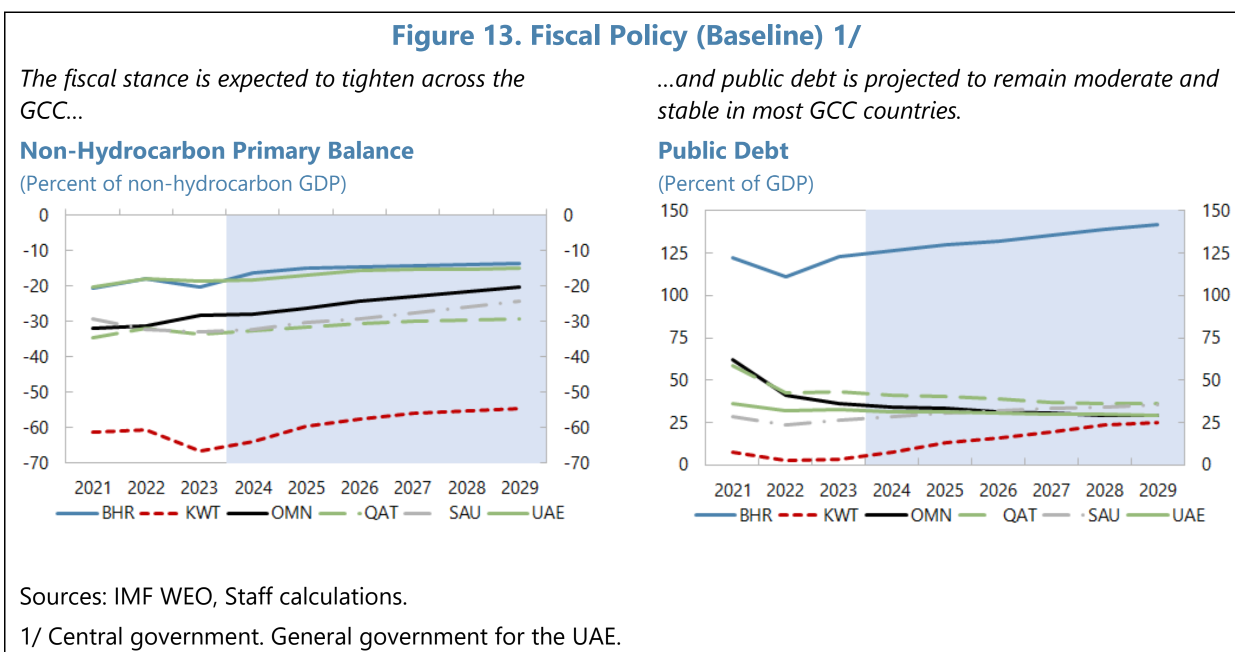
[11] IMF, 2024, Trade Patterns amid Shocks and a Changing Geoeconomic Landscape, Chapter 3 in IMF, 2024, Regional Economic Outlook – Middle East and Central Asia – An Uneven Recovery amid High Uncertainty, April 2024.

[12] Also see Korniyenko, Y., and J. Vacher, forthcoming, Medium-term Fiscal Frameworks: A Blueprint for GCC Resilience.

focus on non-hydrocarbon revenue mobilization, would help ensure stability and sustainability while increasing resources available for growth-enhancing investments. Improving fiscal policy would involve the adoption of appropriate fiscal rules, credible medium-term fiscal frameworks, enhanced monitoring of risks, and consolidated sovereign asset-liability management frameworks.

22. The fiscal stance is expected to tighten over the medium term under the IMF staff's baseline projections for all GCC countries (Figure 13). The magnitude of projected fiscal consolidation, measured by the projected increase in the non-hydrocarbon primary balance relative to non-hydrocarbon GDP between 2023 and 2029, varies from a total of around 3½–4 percentage points of non-hydrocarbon GDP in Qatar and the UAE, to around 7–8½ percentage points in Bahrain, Oman, and Saudi Arabia, and as much as around 12 percentage points in Kuwait (Table 1, first column). Most of the projected consolidation is expenditure-driven, including through public investment reduction (Bahrain, Qatar), spending efficiency measures (Saudi Arabia), wage bill containment (Kuwait, Oman, Saudi Arabia), and subsidy rationalization (Kuwait, Oman). Some revenue-raising measures are also planned (Bahrain's introduction of the global minimum corporate tax in January 2025). Against this backdrop, public debt is expected to remain moderate and stable in most GCC countries.

Figure 13. Fiscal Policy (Baseline) 1/



Sources: IMF WEO, Staff calculations.

1/ Central government. General government for the UAE.

23. However, additional fiscal consolidation is needed in most GCC countries to achieve intergenerational equity and other considerations. Latest staff assessment based mainly on the country-specific PIH anchors is that GCC countries, except for Qatar, need to consolidate their fiscal positions over and above the fiscal path embedded in the baseline projections (Table 1, middle column).[13] Bahrain and Kuwait need to consolidate substantially, and Oman, Saudi Arabia, and the UAE by 1½–5 percentage points of non-hydrocarbon GDP. Even if no meaningful adjustment is called for, maintaining sufficient fiscal buffers against external shocks would be advisable particularly as

[13] Given the modest debt level across the GCC, except for Bahrain, the pace and size of fiscal consolidation is determined primarily on the basis of intergenerational equity.

hydrocarbon prices and the magnitude of fiscal space could be highly uncertain amid geopolitical turbulence and the global energy transition (Mirzoev and Zhu, 2019).

Table 1. Projected Fiscal Consolidation and Additional Consolidation Needs

	Baseline medium-term fiscal consolidation 1/	Additional consolidation needed? 2/	Size and pace 3/
Bahrain	6.8	Y	Substantial, sustained
Kuwait	12.2	Y	Substantial, gradual
Oman	7.9	Y	1.5
Qatar	4.4	N	…
Saudi Arabia	8.6	Y	5, medium term
United Arab Emirates	3.6	Y	3, gradual

Sources: Country reports, WEO, and IMF staff calculations.
1/ Annual non-hydrocarbon primary balance, in percentage points (ppts) of non-hydrocarbon GDP, projected 2023 differential to 2029 in the IMF's October 2024 WEO baseline. A positive value signifies projected fiscal consolidation.
2/ Assessed Yes or No against country specific PIH benchmarks and other considerations, mainly from latest Staff Reports.
3/ ppts of non-hydrocarbon GDP when a number is indicated.

24. With this in mind, and to navigate through elevated uncertainty, GCC countries should adopt fiscal frameworks that deliver both short-term stability and long-term fiscal sustainability.

- **Stability:** In the short term, fiscal policy should dampen the macroeconomic impact of both the business cycle and the volatility in commodity revenue, remain prudent to avoid procyclicality, and rebuild policy buffers especially during good times. Given somewhat negative to neutral non-hydrocarbon output gaps in many GCC countries, fiscal consolidation is recommended to be gradual or implemented over the medium term. Countries with fiscal space could deploy targeted and temporary fiscal measures.

- **Sustainability:** In the long run, fiscal consolidation is needed to stabilize net government financial assets and achieve intergenerational equity while ensuring space for public investments aligned with the broader reform agenda. This would be supported by a credible medium-term fiscal framework (MTFF) based on PIH (see below), as well as enhanced fiscal risk analysis and institutions.

Fiscal Consolidation

25. Fiscal consolidation should continue to focus on non-hydrocarbon revenue mobilization. GCC countries should continue implementing key fiscal reforms to exploit significant gaps relative to the potential to mobilize tax revenue, especially compared with emerging and advanced economies (Figure 14).

- **VAT**. A broad-based VAT should be introduced (Kuwait, Qatar) especially when a favorable medium-term outlook provides opportunities (robust non-hydrocarbon output growth and

moderate inflation). The additional revenue could finance capital expenditure that is efficient and productive. In other GCC countries, the base could be further broadened, including by rationalizing tax expenditures.

- **CIT**. The UAE implemented a general federal corporate income tax (CIT) of 9 percent in June 2023.[14] In other countries, a CIT for domestic firms—with an appropriate threshold—could also be considered (Kuwait, Qatar). Finally, the adoption of the global minimum CIT would help increase non-hydrocarbon revenues further, complemented by a thorough review of existing tax incentives (including in Special Economic Zones) to avoid tax leakages to other jurisdictions (Annex I).

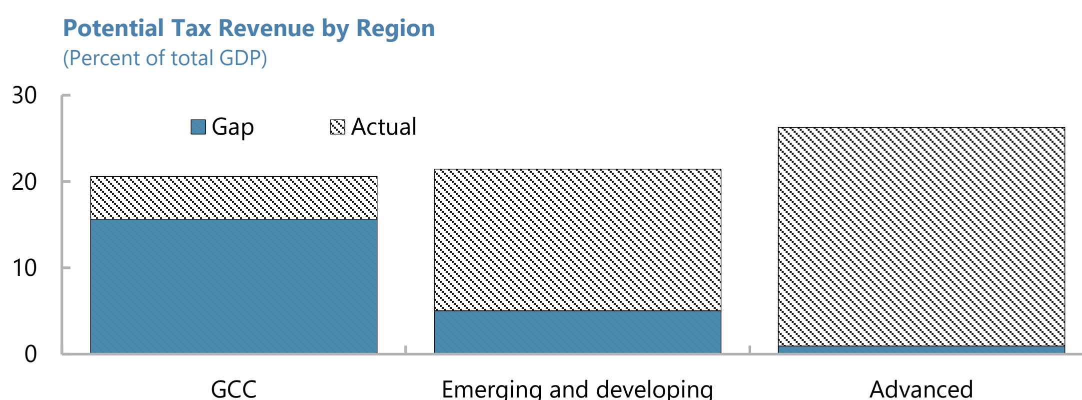
- **Other taxes**. Reducing tax complexity would help boost tax collection, while exploring options such as property taxes, luxury taxes, or environmental levies would further support revenue mobilization as the economy diversifies.

- **Tax administration**. Efficiency could be enhanced, in particular where tax revenue lags non-hydrocarbon output growth. Ongoing reforms include the adoption of electronic invoicing (Oman, Saudi Arabia), the expansion of taxpayer registry (Oman), the enhancement of the capacity of the tax authority (the UAE), as well as digitalization and the realignment of customs procedures with international best practices (Saudi Arabia). Also, the VAT introduction would lay the foundation for greater revenue diversification by facilitating the introduction and administration of other taxes (Qatar).

Figure 14. Potential Tax Revenue by Region

(Percentage of total GDP)

GCC countries have large gaps relative to the potential for mobilizing tax revenue.



Sources: IMF (2022) and authors.
Note: Stochastic Frontier Analysis was applied to a panel of 146 countries for 2000–19. Macroeconomic determinants of tax potential include economic performance, trade openness, capital mobility, economic diversification, and institutions. As an important caveat, the efficient amount of tax revenue to GDP a country can raise could differ from that suggested by the frontier.

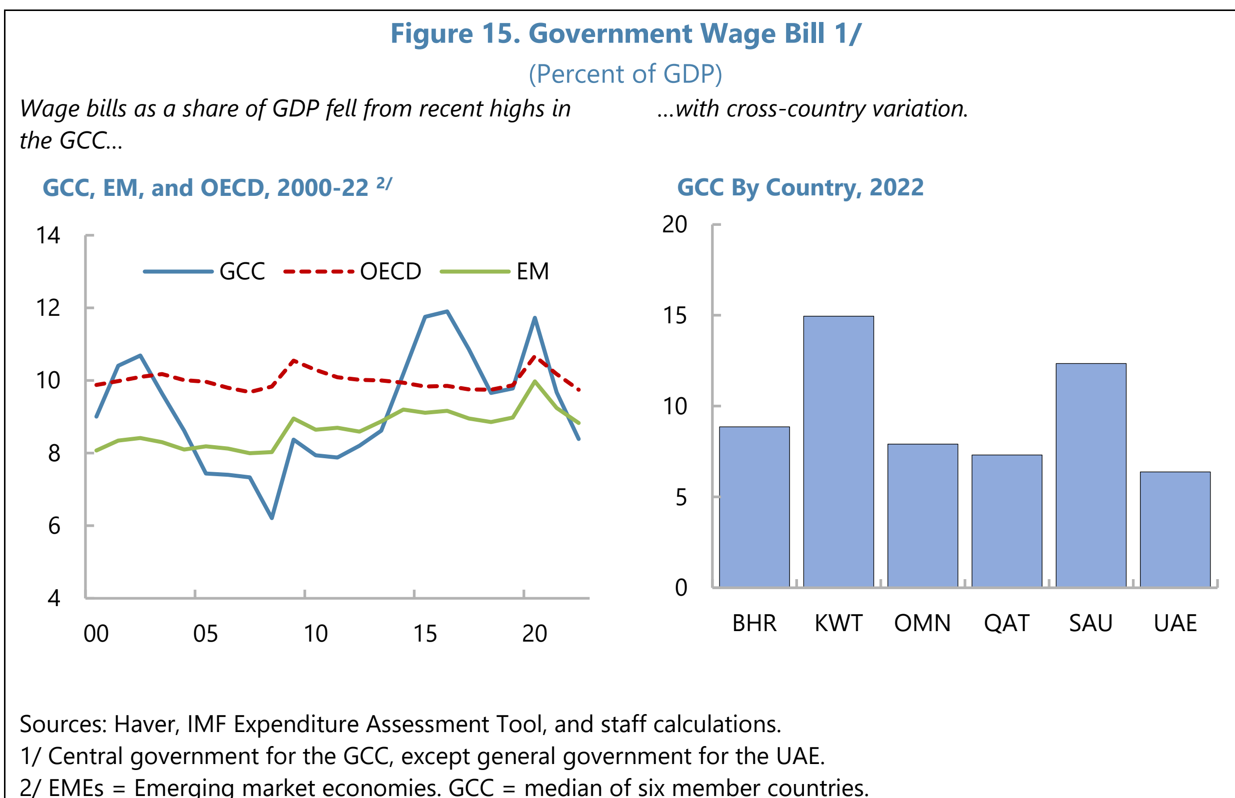
[14] On June 1, 2023, the UAE introduced a general CIT on businesses for financial years starting on or after June 2023.

26. Fiscal consolidation should also be supported by improving the efficiency of and rationalizing public expenditure. In the GCC, median wage was somewhat below EM and OECD levels as a share of GDP (around 8 percent of GDP in 2022), even though more volatile due partly to greater variation in GDP (Figure 15). Efficient public investment is key for elevating growth potential amid a ramp-up in spending on large-scale projects in some countries. Subsidies were relatively high, about 6 percent of GDP in 2023 (Figure 16).

- **Rationalizing public wage bill and boosting investment efficiency**. Fiscal consolidation efforts rely on enhancing public wage bill efficiency, including through the efficient provision of new public services (Qatar), and civil service reform and natural attrition (Saudi Arabia). Public sector wages should be gradually aligned with those in the private sector to reduce public-private wage premia (Bahrain, Kuwait, Oman, Saudi Arabia). Strengthening the public investment management framework would reinforce cost controls and maximize the growth return on priority projects. The IMF's Public Investment Management Assessment (PIMA) would help the authorities design an action plan to bolster infrastructure governance and enhance public investment effectiveness.

Figure 15. Government Wage Bill 1/

(Percent of GDP)



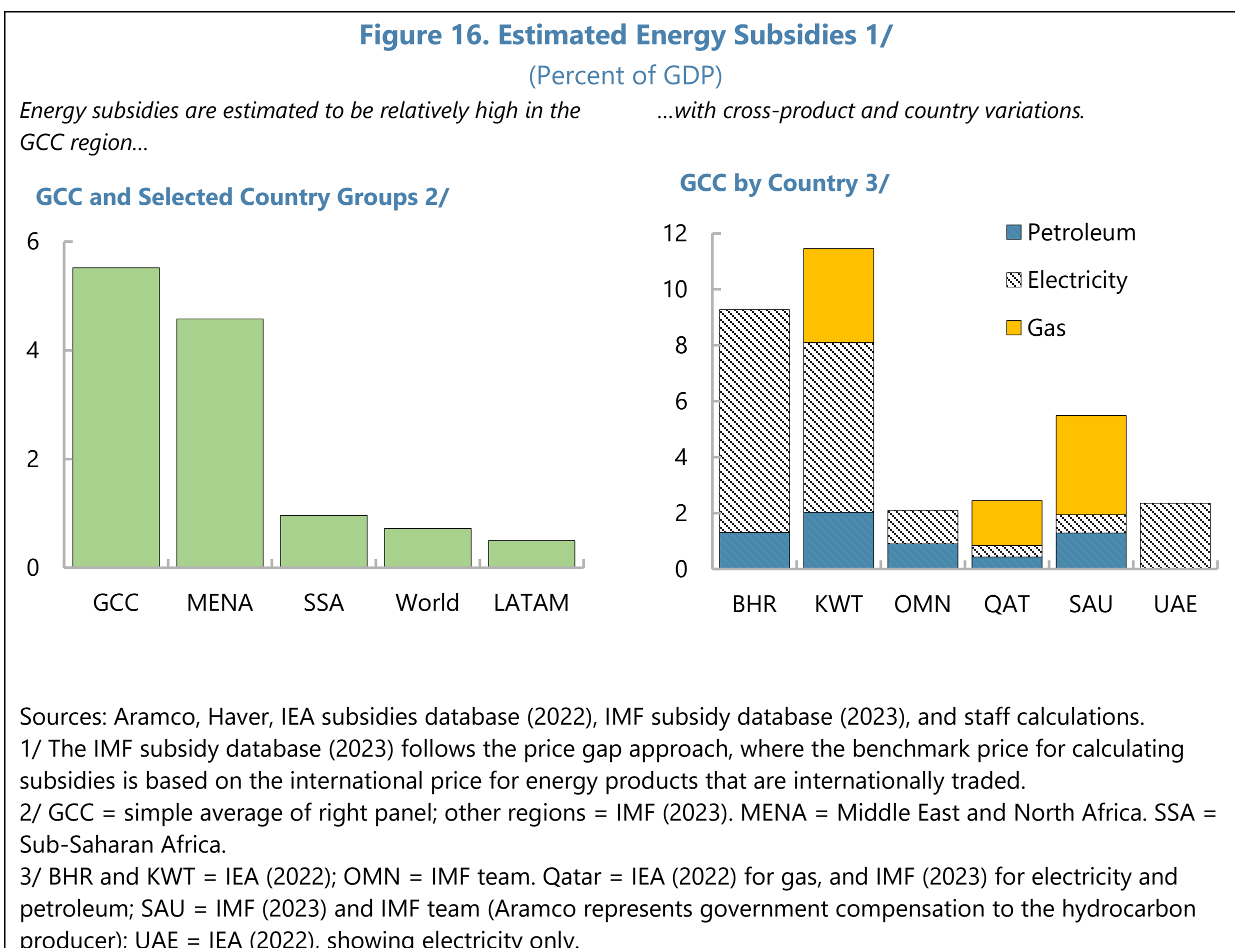
Sources: Haver, IMF Expenditure Assessment Tool, and staff calculations.
1/ Central government for the GCC, except general government for the UAE.
2/ EMEs = Emerging market economies. GCC = median of six member countries.

- **Continuing subsidy reforms.** The rationalization of subsidies will generate fiscal savings, promote efficient energy and water consumption, and support climate ambitions. More efficient energy consumption domestically would also allow higher hydrocarbon exports and revenues. Raising public awareness about the budgetary costs and distributional impact of subsidies would help build consensus for reforms. In Qatar, energy subsidies have fallen after previous reforms, but more can be done, including to lift the remaining caps on gasoline and diesel prices, gradually align domestic natural gas prices with global prices, and progressively phase out remaining

subsidies for electricity and water, with targeted support to the vulnerable. Similarly, recent steps (e.g., increase in diesel prices) reduced subsidies in Saudi Arabia, but further progress is needed, including by removing the cap on gasoline prices. The latter should also be a policy priority in Oman. The UAE liberalized fuel prices in 2015 and provides targeted support to those in need, which could be a useful model for other GCC countries.

Figure 16. Estimated Energy Subsidies 1/

(Percent of GDP)



Sources: Aramco, Haver, IEA subsidies database (2022), IMF subsidy database (2023), and staff calculations.
1/ The IMF subsidy database (2023) follows the price gap approach, where the benchmark price for calculating subsidies is based on the international price for energy products that are internationally traded.
2/ GCC = simple average of right panel; other regions = IMF (2023). MENA = Middle East and North Africa. SSA = Sub-Saharan Africa.
3/ BHR and KWT = IEA (2022); OMN = IMF team. Qatar = IEA (2022) for gas, and IMF (2023) for electricity and petroleum; SAU = IMF (2023) and IMF team (Aramco represents government compensation to the hydrocarbon producer); UAE = IEA (2022), showing electricity only.

Fiscal Rules and Institutions

27. The GCC countries should formally establish a fiscal anchor and operational rules (see Box 3 for more detail). A long-term ***fiscal anchor*** helps provide medium-term direction to fiscal policy (consistent with fiscal sustainability and intergenerational equity), and quantify any adjustment needs, while ***operational fiscal rules*** translate the assessment to the annual budget. As such, a long-term fiscal anchor, based on the Permanent Income Hypothesis (PIH), would guide the trajectory of fiscal consolidation. A number of key considerations inform the choice of an effective fiscal rule. So far, both implicit and explicit fiscal rules have been used by GCC countries. However, the uncertain global backdrop and other requirements call for the strengthening of fiscal rules.

28. Implementing a credible fiscal rule would also require:

- **Developing a credible and operational medium-term fiscal framework (MTFF)**. Some GCC countries have already implemented multi-year budget frameworks (e.g., Qatar's and Saudi Arabia's 3-year budget frameworks; Oman's medium-term fiscal plan) with binding spending envelopes for government entities to help de-link spending from hydrocarbon price volatility. The next step is to develop a full-fledged MTFF with longer horizons, informed by credible macroeconomic projections and with clear medium-term fiscal anchors to ensure intergenerational equity and priority spending. The MTFF should guide and be integrated into the annual budget process, complemented by a fiscal risk statement. In the case of Bahrain, a pre-committed medium-term adjustment path would enhance policy credibility.

- **Credible monitoring and design mechanisms.** For instance, independent fiscal institutions including fiscal councils can assess fiscal plans and performance, evaluate macroeconomic and budgetary forecasts, monitor the implementation, and foster compliance with fiscal rules. They also help foster transparency and promote fiscal stability. In the GCC, efforts are underway for greater institutional capacity, coordination and efficiency. For example, the UAE set up the Government Financial Policy Coordination Council in 2008 to coordinate and integrate government policies to enhance the UAE's competitiveness, expenditure efficiency and achieve economic development. The Council's mandate has been expanded since then to ensure coordination of fiscal policy across emirates and could be further leveraged to improve coordination across the public sector, including to help consolidate the UAE's overall fiscal policy stance. Strong institutional capacity, proficiency, experience, operational independence, and access to timely information are crucial elements to fulfill the functions of an independent fiscal institution.

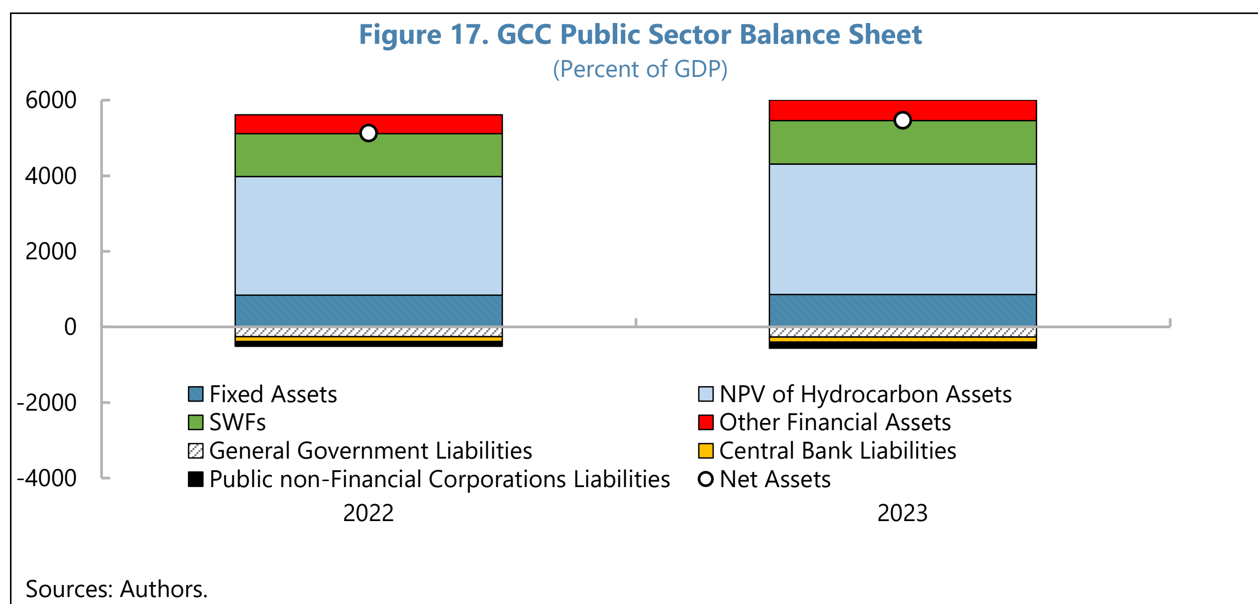
- **Enhanced fiscal transparency**. Saudi Arabia has made significant progress in fiscal transparency through the expanded Budget Statement and higher frequency reports publication. Further important efforts have been made through the publication of the PIF financial statements and by improved transparency in public procurement. Regular publication of MTFFs, general government budgets and their reconciliation with budgeted outcomes (with sufficient details on government spending), sectoral fiscal statistics, the hydrocarbon revenue management strategy, and public sector balance sheet would enhance fiscal transparency and accountability. Bringing extrabudgetary spending above the line can further improve fiscal transparency and reduce reform implementation risks (e.g., Bahrain).

29. Incorporating a fiscal risk statement accounting for a range of shocks would significantly strengthen fiscal frameworks. Many of the factors that led to the historical deviations in GCC fiscal outturns are likely to remain going forward, including elevated hydrocarbon dependence, high hydrocarbon price volatility, spending surprises, and sometimes unrealized forecasts. In addition, contingent liabilities from government-related entities could be sizeable. Climate-related physical and transition risks are significant. Against this backdrop, preparing a fiscal risk statement along with the budget similar to some regional (Oman, Saudi Arabia) or emerging economies (Indonesia, South Africa) would help inform mitigation measures, including provisioning for potential fiscal costs.

30. Developing frameworks for sovereign asset-liability management (SALM) would enhance fiscal policy efficiency, debt management, and investment strategies (Figure 17). Regional SWFs have boosted international bond issuance and investments abroad, while also upping their involvement in the domestic economy (Oman, Saudi Arabia, the UAE). The higher exposure of SWFs to the domestic economy could reduce their ability to safeguard in the long run their financial wealth, important buffers against adverse shocks and for intergenerational equity, and create new transmission channels of shocks. Therefore, assessing sustainability and vulnerability of broader public finances to shocks (e.g., commodity prices) would require information on public sector balance sheets. To this end, Oman, Saudi Arabia, and the UAE are taking initial steps by compiling data on public sector financial assets and liabilities. Furthering such efforts are important given the increasing role of SWFs and SOEs in GCC countries' capital expenditures.

Figure 17. GCC Public Sector Balance Sheet

(Percent of GDP)



Sources: Authors.

Box 3. Fiscal Anchor and Operational Fiscal Rules for the GCC Countries

This box discusses staff recommendations on the fiscal anchor and operational fiscal rules.

Fiscal Anchor

A long-term fiscal anchor could be based on the Permanent Income Hypothesis (PIH). The anchor in resource-rich countries (RRC) is commonly defined as the non-hydrocarbon primary balance consistent with the sustainable flow of income from net wealth, including net financial wealth and resource wealth (the present value of future hydrocarbon revenue). Net wealth would be constant with a changing composition over time—lower revenue from hydrocarbon extraction, as reserves fall and/or energy transition reduces the value of reserves, should be offset by higher net financial wealth saved and invested. This also safeguards a fair distribution of resource wealth across generations, or intergenerational equity.[1]

[1]This assessment of fiscal sustainability differs from one for a non-resource rich country, where government financial asset position tends to be small, often based on the sustainability of gross public debt.

Box 3. Fiscal Anchor and Operational Fiscal Rules for the GCC Countries (concluded)

Operational Fiscal Rules

Both implicit and explicit fiscal rules have been used by GCC countries. Bahrain extended its original Fiscal Balance Program, targeting a balanced state budget by 2024. Oman's MTFF has been modified to focus on fiscal sustainability instead of solely targeting a fiscal balance. Saudi Arabia's fiscal sustainability program now includes ongoing work and experimentation with a structural fiscal rule—which aims at avoiding procyclicality and is based on a multi-year smoothing of oil prices in real terms. The UAE uses multiple fiscal rules at central and local governments' level. The adoption of fiscal rules has become increasingly common in RRCs more broadly—by 2021, 30 out of 57 RRCs have adopted one of the fiscal rules (Apeti et al. 2023).

Several considerations guide the choice of an effective fiscal rule. Fiscal rules should primarily help constrain excessive deficits, preventing unsustainable debt dynamics, while allowing enough discretion to pursue changing policy priorities and respond swiftly to shocks. Fiscal rules have different advantages and disadvantages, and their effectiveness depends on the design, legal status, enforceability, and the strength of fiscal institutions (Korniyenko and Vacher, forthcoming, Annex III). For instance, the design should be consistent with the long-term fiscal anchor chosen, the size of fiscal buffers, and accompanied by escape clauses (IMF 2012, 2015, Basdevant et al. 2021). One view is that for hydrocarbon exporting countries, the structural revenue rule best dampens fiscal procyclicality, while the expenditure, balanced budget, and debt rules are effective in improving primary balances.[2] However, these results should be taken with caution, given the small country sample, in particular for the expenditure rule adopted by these countries, and the relatively short period.

The uncertain global backdrop and emerging and other requirements call for strengthening of fiscal rules. More robust operational rules would strengthen credibility and effectiveness and help the GCC support their developmental strategies, including National Visions and long-term challenges, such as climate change.[3] To this end, fiscal rules in the GCC should be formalized to clearly delink spending decisions from hydrocarbon prices to, for instance, resist calls for more spending under the favorable hydrocarbon revenue outlook, and/or when these prices surge. A formal rule should be guided by and consistent with a long-term fiscal anchor. Rules should be enshrined in legislation, signaling the importance attached by governments to reinforcing fiscal sustainability, and detail the circumstances under which the rules can be amended to ensure their flexibility.

[2]Focusing on the oil exporting countries, Apeti et al. (2023) show that the revenue rule matters for smoothing procyclicality of fiscal policy, while expenditure rules do not have a significant effect. Nevertheless, considering the scarcity of expenditures rules in the sample of oil exporting countries, this result should be taken with caution.

[3]Key characteristics of well-designed fiscal rules include simplicity, flexibility, and enforceability (IMF, 2018).

B. Monetary and Exchange Rate Policies: Enhance Monetary Policy Transmission

With exchange rate pegs continuing to serve the GCC economies well, the enhancement of liquidity management frameworks and the deepening of domestic financial markets would strengthen monetary policy transmission.

31. While currency pegs remain appropriate, monetary policy transmission could be enhanced through policies aimed at improving liquidity management frameworks. Exchange rate pegs have continued to deliver relatively low and stable inflation and remain appropriate nominal anchors given the GCC countries' economic structures. The external position, benefiting from fiscal consolidation, where needed, and competitiveness-enhancing reforms over the medium term, will continue to support the ability of GCC central banks to maintain currency pegs. While monetary policy

has been mirroring that of the U.S. Federal Reserve, domestic interest rate and liquidity conditions have been affected by factors such as hydrocarbon prices, non-hydrocarbon revenue mobilization, or rapid credit growth on the back of policy initiatives (see, for example, episodes of liquidity squeeze in Saudi Arabia in 2022)[15]. As U.S. monetary policy eases, GCC countries should follow and continue improving management of domestic monetary conditions. In particular, efforts should focus on the continuous improvement in liquidity management frameworks, including via appropriate standing facilities, market-based approaches for liquidity management accompanied by effective liquidity forecasting methods, and transparency on the monetary policy operations.[16]

32. Deeper domestic financial markets would enhance monetary policy transmission. Continued issuance of local currency sovereign debt will support capital market and yield curve development. Domestic corporate bond markets could be deepened through further development of green bond and sukuk markets. Finally, structural challenges (e.g., need for longer maturities, collateral, and refinancing) can be addressed by the relevant authorities.

C. Financial Sector Policies to Maintain Financial Stability

Financial sector policies should focus on adapting to and mitigating 'old' (e.g., rapid credit growth, the concentration of exposures, sovereign-bank nexus, NPLs in certain segments, activities of subsidiaries abroad) and 'new' risks (e.g., digitalization).

33. Notwithstanding systemic stability, some vulnerabilities have emerged in certain segments of the banking sector. Specifically, the banking sector's exposure has become more concentrated in some GCC countries in terms of both assets (e.g., real estate sector in Saudi Arabia and the UAE, claims on the government in Qatar) and liabilities (e.g., government deposits in Oman and Saudi Arabia).[17] The strengthening of the sovereign-bank nexus on the liability side could amplify systemic shocks, including from oil price volatility (Figure 18). Also, while the aggregate NPL has moderated in the UAE, it remains high in the construction sector. Moreover, there are signs of significant price growth in some segments of the real estate sector. Finally, a few banks in the GCC have sizeable exposure to Egypt and Türkiye, ranging from 3 to 20 percent of their total assets and from 1 to 15 percent of their net income[18], through their subsidiaries, highlighting the potential for cross-border spillovers.

[15] SAMA took timely and resolute action to address the liquidity pressure. See Annex IV of the 2023 Saudi Arabia Staff Report.

[16] A case in point is the ongoing implementation of the Dirham Monetary Framework (IMF, 2022, United Arab Emirates: Technical Assistance Report – Liquidity Management and Forecasting, Vol 2022, Issue 236, July 22, 2022) and the accompanying enhancement to transparency, including through the publication of *Daily Liquidity Indicators* and information on associated monetary operations on the UAE's central bank's website.

[17] Results from banking sector solvency stress tests and sensitivity analysis for Saudi Arabia indicate resilience to a severe adverse economic scenario, and to additional shocks to real estate prices and sectoral loan portfolio default rates. See the IMF's 2024 Saudi Arabia Financial System Stability Assessment.

[18] Fitch Ratings, 2024, GCC Banks Show Strong Appetite for International Expansion, July 23, 2024.

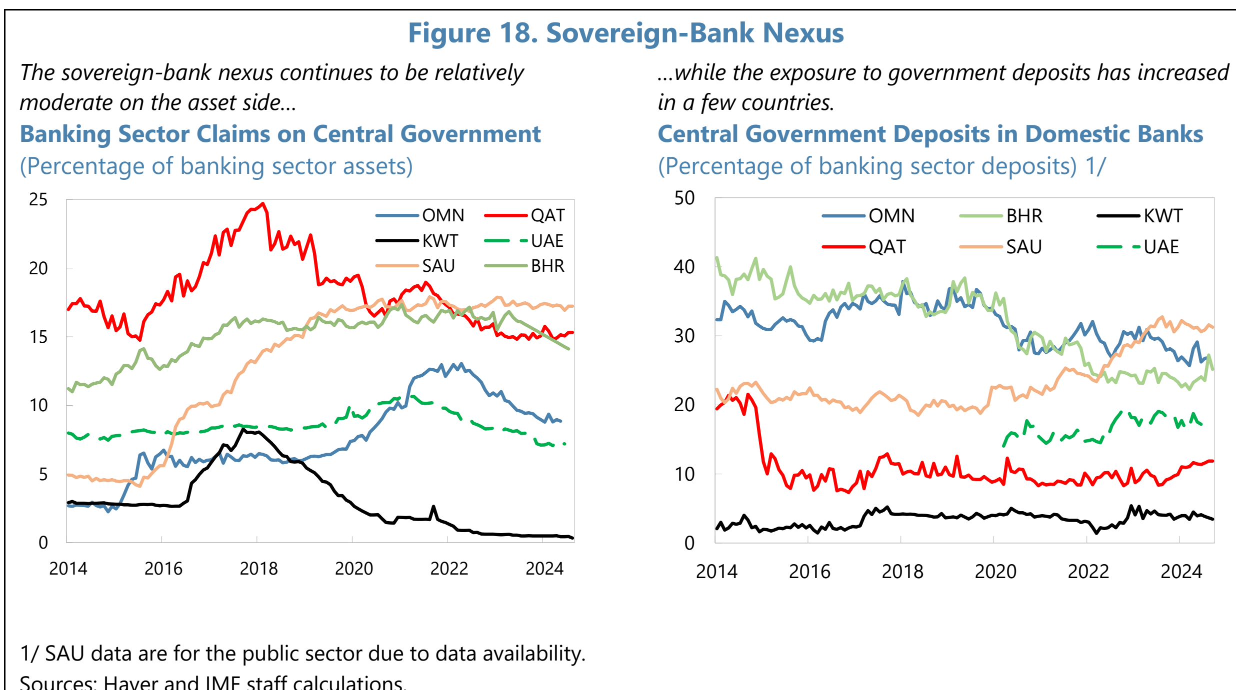


Figure 18. Sovereign-Bank Nexus

The sovereign-bank nexus continues to be relatively moderate on the asset side…

…while the exposure to government deposits has increased in a few countries.

1/ SAU data are for the public sector due to data availability.
Sources: Haver and IMF staff calculations.

34. Financial sector policies should continue to respond to emerging risks. GCC banks are strong generally, but financial sector regulators should continue to closely monitor banks' capital, liquidity, and asset quality, as well as conduct regular stress tests, including related to emerging risks from the changing interest rate environment (e.g., the impact of US monetary policy easing), rapid credit growth, the concentration of exposures (e.g., real estate), the sovereign-bank nexus, or the increasing activities of subsidiaries abroad[19]. Where appropriate, a positive neutral counter cyclical capital buffer, zero at present, could be considered (Oman, Saudi Arabia, the UAE). If significant risks are identified, appropriate actions should be taken, including the recalibration of macroprudential policies that have been actively used in the GCC (Table 2). Finally, the monitoring of risks would benefit from a reduction in data gaps (e.g., development of real estate price indices).

35. Notwithstanding the potential benefits from advancing digitalization, the careful assessment and management of risks remain crucial. The fintech sector continues to grow rapidly with the support of the authorities, including by establishing regulatory sandboxes (across the GCC), licensing digital banks (Saudi Arabia and the UAE), and creating a FinTech Hub (Bahrain, Qatar, and Saudi Arabia), the Innovation Hub "Wolooj" in Kuwait, and DIFC FinTech Hive (the UAE). The GCC countries are also actively exploring CBDCs, with Bahrain, Oman, Saudi Arabia, and the UAE leading in this area.[20] While CBDCs can enhance monetary policy transmission, they might pose risks to the

[19] In Saudi Arabia, for example, macroprudential tools should be used to forestall possible risks of a lending boom amid large infrastructure projects and measures to increase the homeownership rate (IMF – Saudi Arabia 2024 Article IV Consultation Staff Report, Country Report No. 2024/280).

[20] In Saudi Arabia, SAMA has conducted a cost-benefit analysis of CBDCs, with a focus on wholesale transactions aimed at supporting Vision 2030 agenda in terms of financial innovation and economic digitalization. In the UAE, the active exploration of retail and wholesale CBDC is part of the comprehensive Financial Infrastructure Transformation (FIT) Program, launched by the CBUAE in February 2023. The FIT also includes the soft launch of an Instant Payment Platform

(continued)

financial sector, including by drawing deposits away from banks. A cautious approach thus continues to be warranted, including through a careful cost-benefit analysis and the exploration of risks related to financial stability. Also important is the strengthening of cybersecurity protocols through national and GCC-wide strategies, the formulation of minimum standards, periodic stress tests, and the proper assessment and mitigation of risks emanating from third-party service providers. Finally, the authorities should continue to apply a mix of activity- and entity-based regulation proportionate to the size, complexity, and risk profile of fintech firms.

36. Continuing to adapt to international standards also remains important. Specifically, it remains key to formalize emergency liquidity assistance (ELA), establish deposit insurance schemes, operate a comprehensive bank resolution framework, and enhance AML/CFT regimes in line with the FATF standards as needed, particularly with regards to risk-based supervision of virtual assets and virtual asset service providers (VASPs). For example, the removal of the UAE from the FATF "grey list" in February 2024 in light of major efforts to enhance the AML/CFT regime is a welcome development. Moreover, the modernization of the regulatory and supervisory frameworks should continue, including by fully implementing the Basel III final reforms and adopting IFRS9 reporting requirements where still needed, as well as by shifting supervision towards a more risk-based approach.

D. Structural Policies to Support the Transition to the New Growth Model

The GCC countries have made remarkable progress on economic diversification and toward the sustainable development goals. Nonetheless, the reliance on the hydrocarbon sector remains high, albeit to a different extent across countries, and the non-hydrocarbon growth outlook faces major challenges: (i) total factor productivity (TFP) growth has been weak in the GCC; (ii) further capital deepening is constrained by the moderate level of inward FDI and the presence of capability and market failures in the traditionally hydrocarbon-dependent economy; and (iii) the ability of the labor force to adapt to the new growth model is impaired by the mismatch of skills, and the segmentation of the labor market. Policies should focus on addressing these obstacles, while also increasing the GCC countries' resilience to geoeconomic fragmentation (Aiyar and Ohnsorge, 2024).

37. The GCC countries had made major progress on economic diversification and toward the sustainable development goals (SDGs), supported by the continuous improvement in the business climate (Figure 19). Against the backdrop of significant policy efforts, there has been remarkable progress on:

- **Economic diversification**, with both output and trade becoming more diversified, albeit to a different extent across GCC countries. The share of the non-hydrocarbon economy, for example, ranges from 60-65 percent in Kuwait, Oman, and Qatar, to about 75 percent in the UAE and around 85 percent in Bahrain.[21]

(Aani) in October 2023 and other initiatives such as a Domestic Card Scheme, and innovation in OpenFinance and SupTech.

[21] The cross-country comparison is complicated by methodological differences. Bahrain and the UAE, for example, do not include downstream hydrocarbon activity in the hydrocarbon GDP.

Table 2. Key Macroprudential Policy Measures in GCC Countries

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Broad-based tools						
Countercyclical capital buffer framework	Yes	Yes	Yes	Yes	Yes	Yes
Positive countercyclical capital buffer rate	No	No	No	No	No	No
Capital conservation buffer	Yes	Yes	Yes	Yes	Yes	Yes
Limit on leverage ratio	Yes	Yes	Yes	Yes	Yes	Yes
Household sector tools						
Household sector capital requirements	n.a.	Yes	Yes	No	No	No
Cap on credit growth to the household sector	n.a.	No	Yes	No	No	No
Cap on loan-to-value ratio	No	Yes	Yes	Yes	Yes	Yes
Cap on loan-to-income ratio	n.a.	Yes	No	Yes	No	Yes
Cap on debt-service-to-income ratio	Yes	Yes	Yes	Yes	Yes	Yes
Limit on amortization periods	n.a.	Yes	Yes	No	No	Yes
Corporate sector tools						
Cap on credit growth to the corporate sector	n.a.	No	No	No	No	No
Caps on loan-to-value ratio or debt-service coverage ratio for commercial real estate credit	n.a.	No	No	Yes	No	No
Exposure caps on corporate credit	n.a.	Yes	No	Yes	Yes	No
Liquidity tools (banking sector)						
Liquidity buffer requirements	Yes	Yes	Yes	Yes	Yes	Yes
Liquidity Coverage Ratio	Yes	Yes	Yes	Yes	Yes	Yes
Liquidity Coverage Ratio by currency	n.a.	No	No	Yes	No	Yes
Stable funding requirements	Yes	Yes	Yes	Yes	Yes	Yes
Net Stable Funding Ratio	Yes	Yes	Yes	Yes	Yes	Yes
Loan-to-deposit ratio	Yes	Yes	Yes	Yes	Yes	Yes
Limits on maturity mismatches	n.a.	Yes	Yes	Yes	No	No
Reserve requirements for macroprudential purposes	Yes	No	No	Yes	No	Yes
Limits on foreign exchange positions	n.a.	Yes	Yes	Yes	No	No
Net foreign exchange positions	n.a.	Yes	Yes	Yes	No	No
Tools for systemic liquidity risk and nonbank sector						
Asset management industry	Yes	No	No	n.a.	Yes	No
Insurance companies	n.a.	No	No	n.a.	Yes	Yes
Central counterparty clearing	Yes	No	No	n.a.	Yes	No
Securities lending market	Yes	No	No	n.a.	Yes	No
Tools for Systemically Important Institutions (SIIs) and interconnectedness						
Capital surcharges for SIIs	Yes	Yes	Yes	Yes	Yes	Yes
Liquidity surcharges for SIIs	Yes	No	No	No	No	No
Limits on the size of exposures between financial institutions	n.a.	No	No	Yes	Yes	Yes

Legend: No | Yes | n.a.

Source: IMF Macroprudential Policy Database.

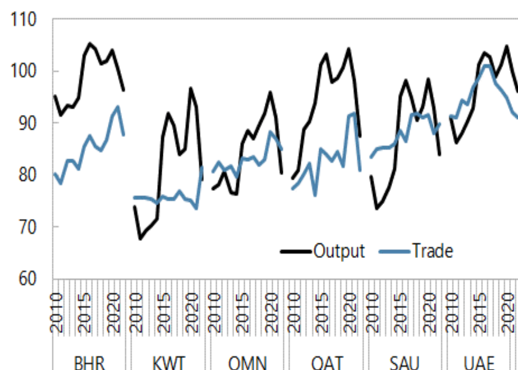
- **SDGs.** The GCC countries have also made progress toward the SDGs, albeit at a decelerating pace since the pandemic. For example, the SDGs on eliminating poverty and reducing inequality have

already been achieved, and the GCC countries are close to the targets on 'good health and well-being', and 'quality education' thanks to their favorable initial position. Notwithstanding the relatively large remaining distance to the target, the region has also advanced in terms of 'gender equality'.

Figure 19. Economic Diversification, SDGs, and Competitiveness

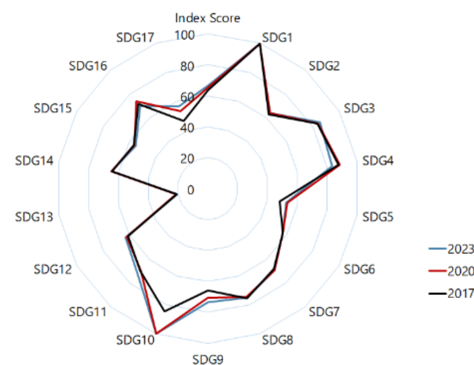
The GCC countries have become more diversified, albeit to a different extent across countries…

Economic Diversification Index, 2010-22 1/



…and have also made progress towards the sustainable development goals…

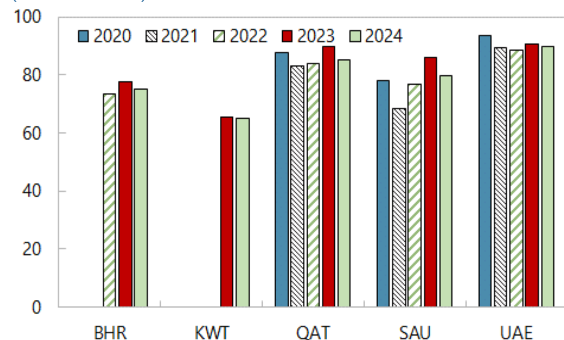
Sustainable Development Goals 2/



…supported by improved competitiveness, with four GCC countries ranked in the top 30 countries…

IMD World Competitiveness

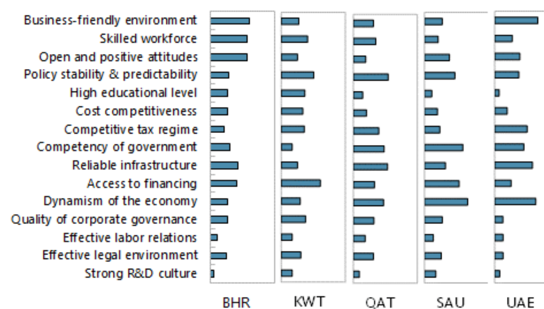
(Overall Score)



…although the key attractiveness indicators differ across countries.

IMD Key Attractiveness Indicators 3/

(Percentage of Responses, 0-100)



1/ For a description of the EDI, see the note on the methodology.

2/ SDG1, No poverty; SDG2, Zero Hunger; SDG3, Good Health and Well-Being; SDG4, Quality Education; SDG5, Gender Equality, SGD6, Clean Water and Sanitations; SDG7, Clean and Affordable Energy; SDG8, Decent Work and Economic Growth; SDG9, Industry, Innovation and Infrastructure; SDG10, Reduced Inequalities, SDG11, Sustainable Cities and Communities; SDG12, Sustainable Consumption; SDG13, Climate Action; SDG14, Life below Water; SDG15, Life on Land; SDG16, Peace Justice and Strong Institutions; SDG17, Partnerships for the Goals.

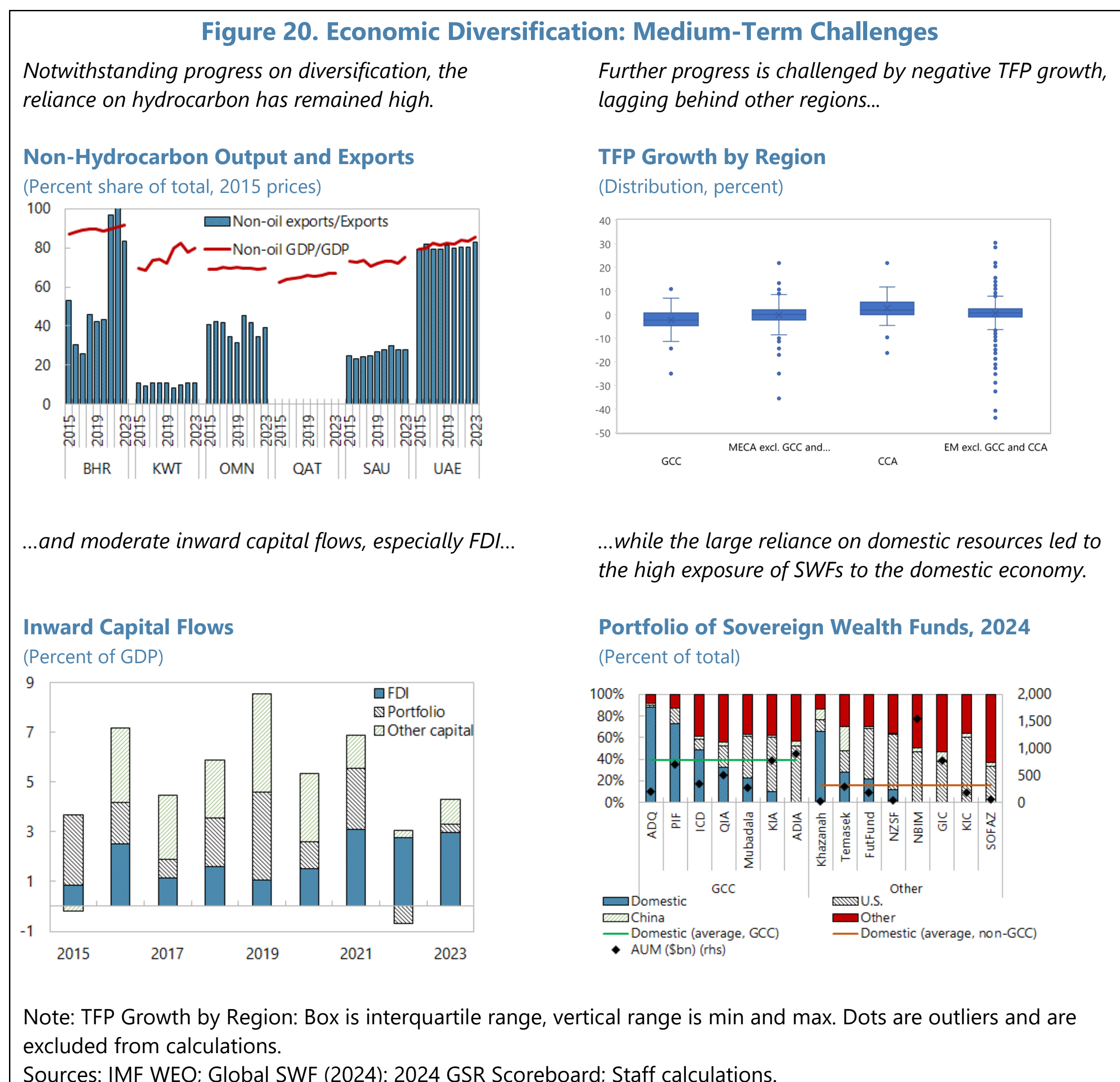
3/ The key attractiveness indicators are the result of IMD's Executive Opinion Survey that asked participants to select five indicators from a list of 15 that are perceived as the key attractiveness of the given economy.

Sources: Prasad A., Refass S., Saidi N., Salem F., Shepherd B., Global Economic Diversification Index 2023. Dubai: Mohammed bin Rashid School of Government., World Bank, and IMF staff calculations.

38. Business climate. Progress on diversification and SDGs has been supported by the continuous improvement in the business climate. Four out of six GCC countries (Bahrain, Qatar, Saudi Arabia, and UAE) are among the top 30 most competitive economies, with Saudi Arabia having climbed 8 notches in the IMD's World Competitiveness ranking in two years (IMD, 2024). Although the main attractiveness factors differ across countries, the GCC economies, in general, benefit from business-friendly environment, policy stability and predictability, reliable infrastructure, and economic dynamism.

39. Despite advances in diversification, the reliance on hydrocarbon remains high and non-hydrocarbon growth is constrained by several factors (Figure 20). For instance, hydrocarbon exports are at around 90 percent of total exports in Kuwait and Qatar. Low TFP growth, moderate foreign capital inflows, and segmented labor markets continue to hold back growth potential in the non-hydrocarbon economy.

Figure 20. Economic Diversification: Medium-Term Challenges



Note: TFP Growth by Region: Box is interquartile range, vertical range is min and max. Dots are outliers and are excluded from calculations.
Sources: IMF WEO; Global SWF (2024): 2024 GSR Scoreboard; Staff calculations.

- **Stagnant TFP**. In line with global trends, the GCC countries experienced a long-term decline in TFP growth, which lags behind that of other emerging economies.[22] Nonetheless, the implementation of Vision reforms is estimated to have had a significant positive impact on labor productivity in recent years, underscoring the importance of continued progress (Box 4). Efforts to facilitate digitalization and AI could also play a key role in kickstarting TFP growth.

- **Modest capital inflows**. Notwithstanding the substantial financing needs of Vision reforms, inward capital flows, especially FDI, remain modest. In addition to the unlocking of financing, attracting more foreign capital would also support growth and diversification via know-how and technology transfer, thereby potentially boosting exports in sophisticated sectors with a higher impact on growth (Box 5). Moreover, higher access to foreign capital would reduce the need to tap into SWFs, whose estimated exposure to the domestic economy reached around 40 percent of their assets under management in 2024, well above the average of 16 percent in other regions. Notwithstanding their contributions to development objectives, the high exposure of SWFs to the domestic economy could reduce their long-term ability to protect the country's financial wealth against shocks to the economy and could also create competition for the banking sector in financing economic diversification.

- **Segmented labor market**. Many GCC countries embarked on major reforms to reduce the segmentation of the labor market and made significant improvement, but further progress is needed. FLFP is still low, and the labor markets is characterized by the dominance of nationals in the public and expatriate workers in the private sector (Figure 21).

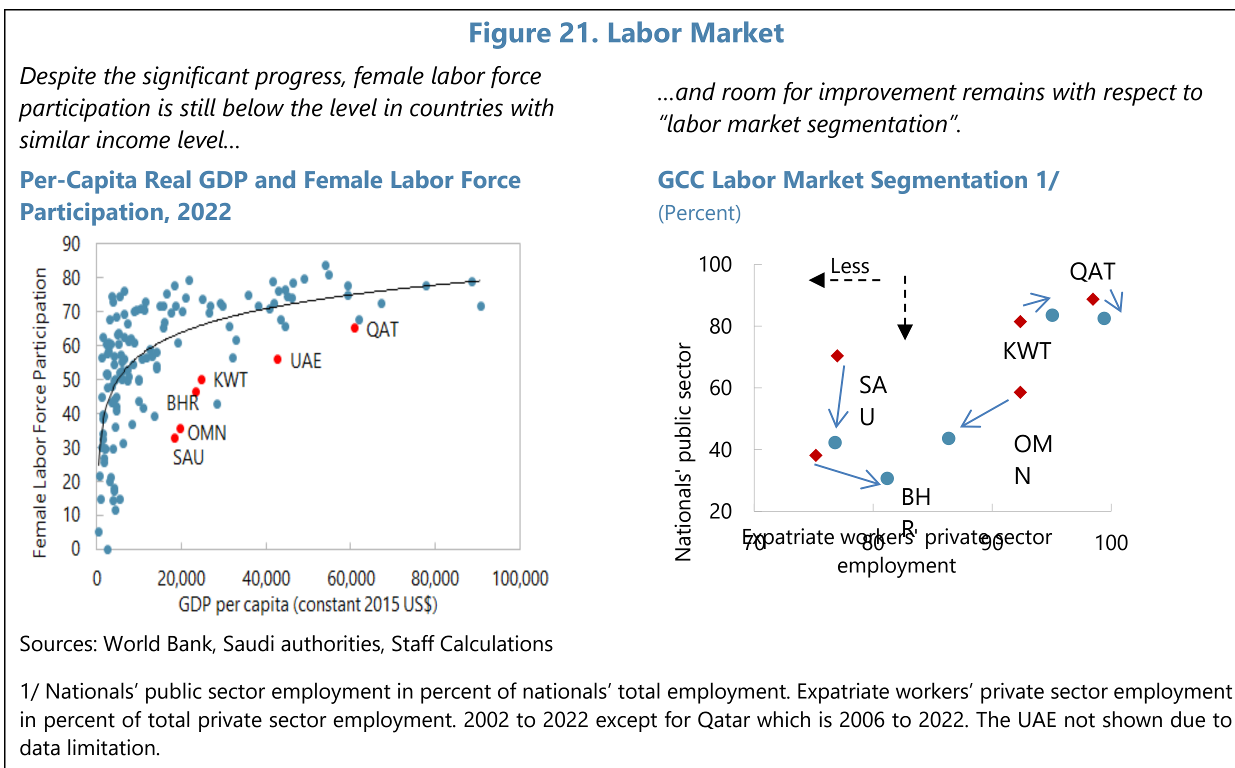


Figure 21. Labor Market

Despite the significant progress, female labor force participation is still below the level in countries with similar income level…

Per-Capita Real GDP and Female Labor Force Participation, 2022

…and room for improvement remains with respect to "labor market segmentation".

GCC Labor Market Segmentation 1/
(Percent)

Sources: World Bank, Saudi authorities, Staff Calculations

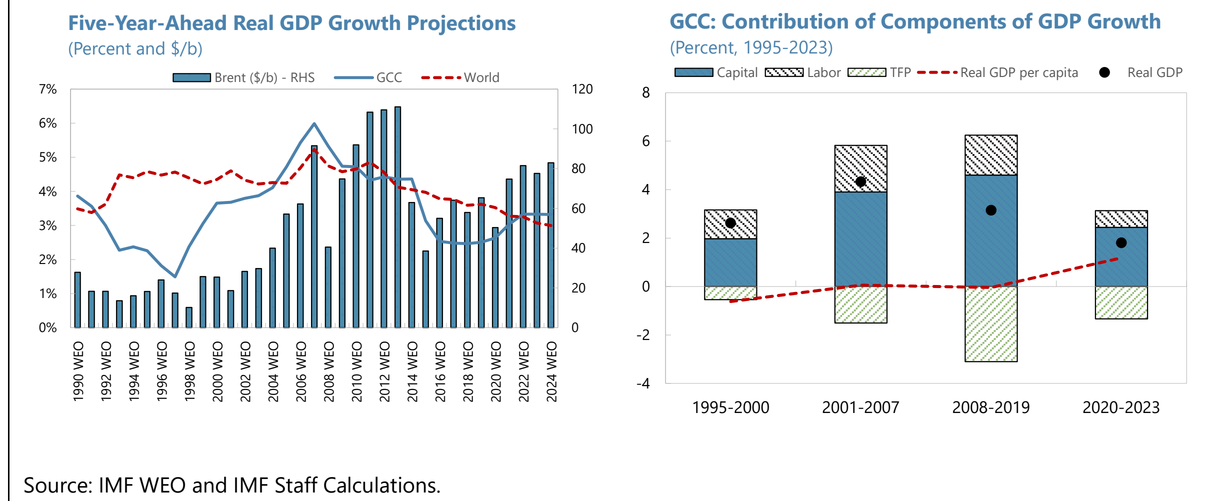
1/ Nationals' public sector employment in percent of nationals' total employment. Expatriate workers' private sector employment in percent of total private sector employment. 2002 to 2022 except for Qatar which is 2006 to 2022. The UAE not shown due to data limitation.

[22] IMF, 2024, Saudi Arabia's Productivity Growth: Drivers and Strategies, Selected Issues Paper.

Box 4. What Drives Productivity Growth in the GCC amid Economic Diversification?

Boosting TFP growth is key for rekindling medium-term growth in the GCC. Medium-term global growth projections have generally been revised downward in the past two decades (Box Figure 1, left panel). In addition, these projections for the GCC economies have been highly volatile, partly due to large oil price swings. Despite major transformational programs, the contribution of TFP to growth has been negative in the GCC in the past three decades, albeit to a declining extent in the past few years (right panel). As such, boosting TFP growth remains key to support growth over the medium term.

Box 4. Figure 1. Output and Productivity Growth



Source: IMF WEO and IMF Staff Calculations.

Policies to support innovation and private-sector participation would boost TFP growth in the GCC. Our empirical analysis suggests that policies to safeguard macroeconomic stability and facilitate digitalization had the largest contributions to the GCC's TFP growth over the past two decades (Box Figure 2).[1] Those that support capital account openness, institutional quality, and exports of products with higher value added and greater "complexity" also made important contributions, albeit to a smaller extent. The impact of state footprint on TFP growth is negative in the GCC, and more so than in the broader Middle East and Central Asia, highlighting the substantial upside to TFP growth from enhancing public sector efficiency and gradually increasing private sector participation.

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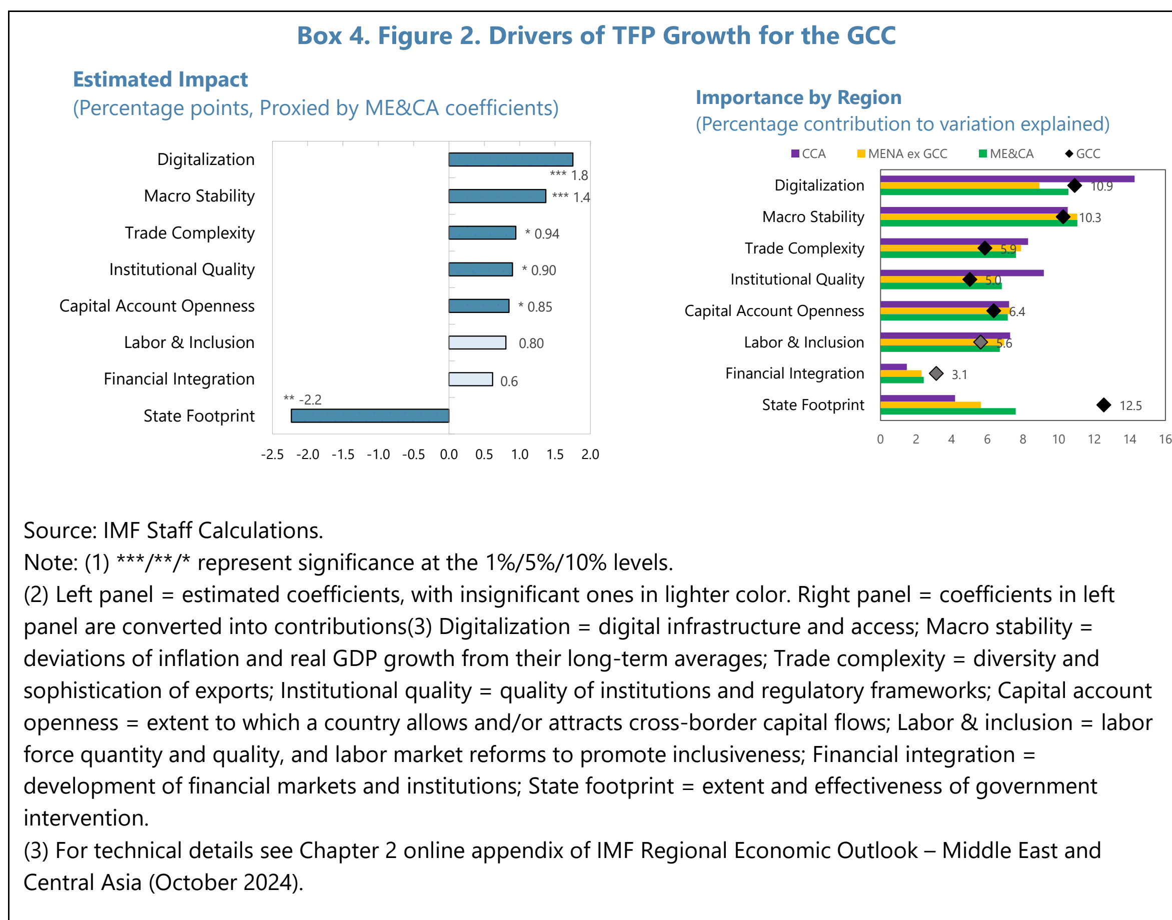
[1]To guide policies to boost TFP growth in the GCC, its determinants have been estimated, using a dataset of a large panel of countries in the Middle East and Central Asia spanning 2000–23. The impact of policy variables on TFP growth is isolated by using fixed effects models that control for unobserved heterogeneity across sub-regions and years. Explanatory variables are selected guided by the literature, data availability, cross-country distribution, and economic interpretation. Key policy variables are grouped into eight categories (Box Figure 2). The first principal component of each category is used for the baseline regression.

Box 4. What Drives Productivity Growth in the GCC amid Economic Diversification? (concluded)

Box 4. Figure 2. Drivers of TFP Growth for the GCC



Source: IMF Staff Calculations.
Note: (1) ***/**/* represent significance at the 1%/5%/10% levels.
(2) Left panel = estimated coefficients, with insignificant ones in lighter color. Right panel = coefficients in left panel are converted into contributions(3) Digitalization = digital infrastructure and access; Macro stability = deviations of inflation and real GDP growth from their long-term averages; Trade complexity = diversity and sophistication of exports; Institutional quality = quality of institutions and regulatory frameworks; Capital account openness = extent to which a country allows and/or attracts cross-border capital flows; Labor & inclusion = labor force quantity and quality, and labor market reforms to promote inclusiveness; Financial integration = development of financial markets and institutions; State footprint = extent and effectiveness of government intervention.
(3) For technical details see Chapter 2 online appendix of IMF Regional Economic Outlook – Middle East and Central Asia (October 2024).

Box 5. Export Diversification: Where do GCC Countries Stand?

GCC countries have made important progress in diversifying their exports over the past decades but there is room to increase the share of non-hydrocarbon exports. Paying close attention to policies that foster export diversification would be key to enhance growth prospects and mitigate the impact of the global energy transition.

Economic diversification has progressed across the GCC (Box Figure 1, upper left panel). In the tradables sector, the export concentration index indicates a very high level of concentration of exports in oil and gas in Kuwait, Oman, Qatar, and Saudi Arabia about two decades ago (upper right panel). Since then, the index has declined sharply for most GCC countries, suggesting that the region's exports have become more diversified into non-hydrocarbon and non-mineral goods (NHM exports, hereafter). Indeed, per-capita NHM exports have risen in the GCC.

Increases in services exports in terms of volume and composition have been uneven in the GCC (Box Figure 1, lower left panel). Per-capita services exports in Bahrain, Qatar, and the UAE are well above those of other GCC countries and some other resource-rich comparators. Transport and tourism tend to dominate

Box 5. Export Diversification: Where do GCC Countries Stand? (continued)

services exports in most GCC countries, while the share of information and communication technology exports remains relatively small notwithstanding progress made in recent years.

Export diversification has important growth payoffs, especially when focused on sophisticated sectors. Greater exports of products with high complexity are associated with higher medium-term per-capita output growth (Box Figure 1, lower right panel).[1] This is consistent with regression-based results. Specifically, a 10 percent rise in real per-capita exports of products with high complexity is associated with a 0.4 percentage point increase in real per-capita GDP growth. The regression analysis also highlights a positive and significant relationship between per-capita services exports and medium-term output growth.

Against this backdrop, additional efforts are needed to boost export diversification in the GCC. First, despite recent progress, export concentration of some GCC countries (Kuwait, Oman, Qatar, and Saudi Arabia) is higher than in comparator countries-at around 0.5-suggesting that more efforts are needed to expand non-hydrocarbon exports. Export concentration of Bahrain and the UAE is, however, broadly comparable to that of non-GCC resource-rich countries, such as Australia, Malaysia, and Norway. Second, per-capita NHM exports of GCC countries remain subdued relative to more diversified hydrocarbon-rich economies, such as Australia, Chile, Malaysia, Mexico, and Norway.

Such efforts should focus on products with higher complexity. Apart from the UAE, GCC countries continue to lag other resource-rich countries, such as Australia, Malaysia, Mexico, and Norway, in terms of per-capita manufacturing exports that tend to create higher value added and jobs. Similarly, exports of products with higher complexity are comparable to those of comparators such as Malaysia, Norway, and Mexico only in Bahrain and the UAE.[2]

Further boosting human capital and R&D would facilitate export diversification. Remarkable progress made so far in enhancing infrastructure, education, and governance should continue. Research & development expenditures, which remain low relative to countries with similar income levels, should be scaled up to support the upgrading of export products. Greater export diversification would increase regional economies' resilience to navigate the global energy transition.

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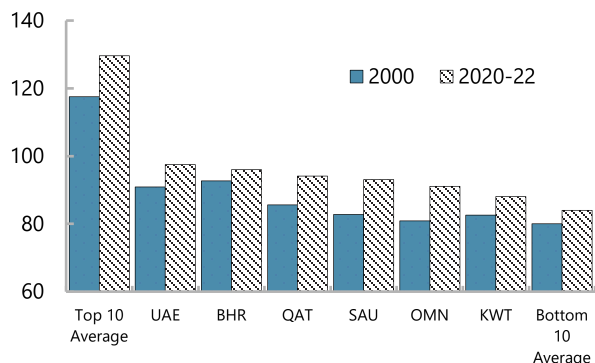
[1]Similar results are obtained when plotting the log of per capita manufacturing exports against the 5-year ahead real GDP per capita growth.

[2]Complex products are defined as products with a "Product Complexity Index" (PCI) above zero. Products with a high PCI are typically those that require advanced manufacturing techniques, specialized skills and more sophisticated knowledge, and complex supply chains. Examples include electronics, precision instruments, and advanced machinery (Hidalgo and Hausmann, 2009).

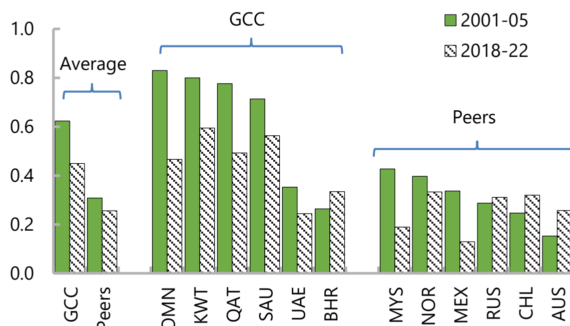
Box 5. Export Diversification: Where do GCC Countries Stand? (concluded)

Box 5. Figure 1. Indicators of Economic Diversification and Growth Impact

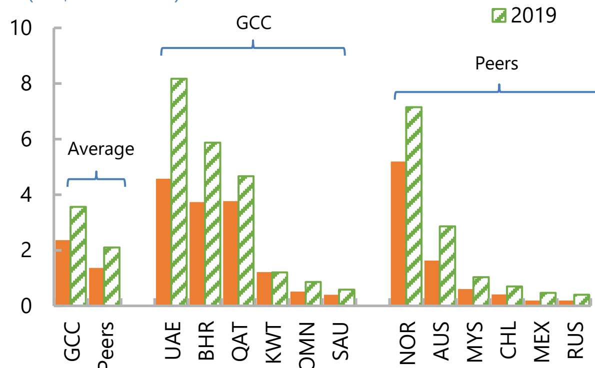
GCC countries have made progress in economic diversification…



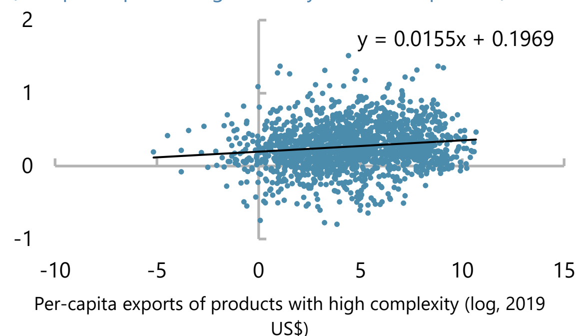
…and in reducing export concentration even though room remains for more progress…



…so is in per-capita services exports.



Exports of goods with high complexity facilitate per-capita output growth in the medium term.



Sources: Global Economic Diversification Index 2024, OECD-WTO Balanced Trade in Services (BaTIS), and IMF staff calculations

40. Against this backdrop, economic diversification is supported by a comprehensive reform agenda. The GCC countries have deployed industrial policies, as well as reforms to improve the business climate, enhance human capital (labor market, education), and foster digitalization. Specifically, policies have focused on the following main areas:

- **Industrial policies (IP)** (Figure 22). The majority of IP measures deployed by GCC countries has targeted the manufacturing sector(Table 3). While IP could play an important role in developing the non-hydrocarbon economy, it remains critical to target market and capability failures, minimize risks/distortions, and ensure compliance with the World Trade Organization (WTO) rules. As such, the design and deployment of industrial policies should include rigorous calibration and monitoring, cost-benefit analysis, clear exit criteria, sunset clauses, and integration into the broader reform agenda. Plans should also avoid discriminatory provisions, such as local content requirements in government contracts, as these could lead to allocation distortions and provoke retaliations from trade partners. Finally, to maximize the benefits associated with IP, policies should focus on export diversification, especially exports of sophisticated sectors (Box 5).[23]

Table 3. Selected Industrial Policy Measures in the GCC

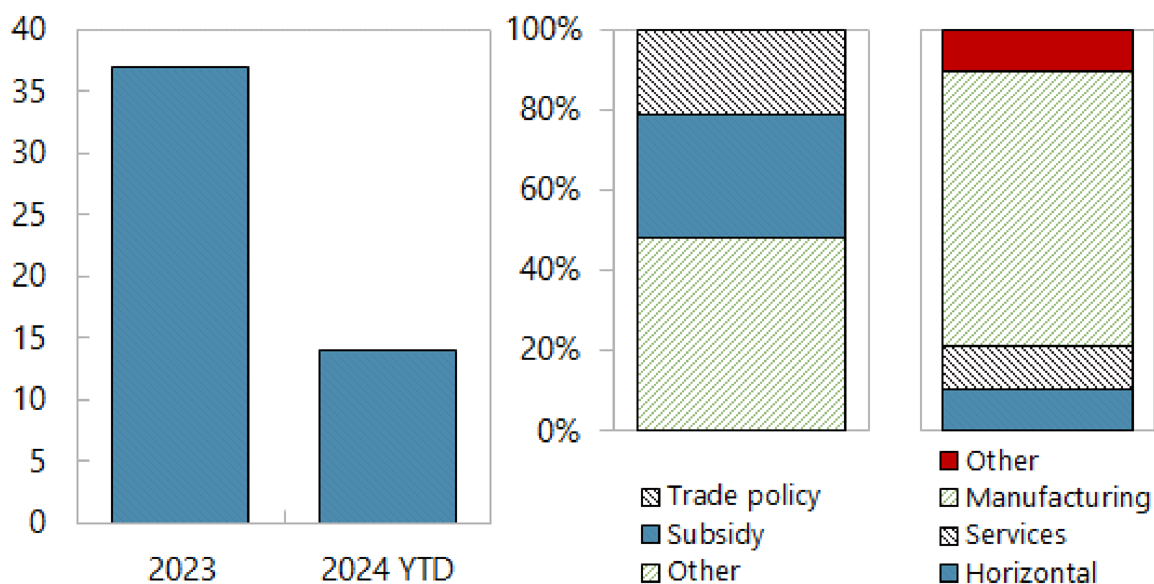
Oman	Plans to develop 5 business clusters to integrate SMEs into both domestic and international value chains.
Qatar	Numerous special economic and free zones, industrial parks, and the Qatar Financial Center, combined with financial and sector specific incentives, aim at boosting FDI and trade.
Saudi Arabia	Four special economic zones were established in 2023 to attract FDI in manufacturing and emerging technologies through tax incentives and the option for full foreign ownership.
	PIF, Aramco, and Baosteel agreed to establish an integrated steel plate manufacturing complex.
	Saudi Eximbank agreed to provide financing to ACWA Power.
	Modon agreed to provide funds for establishing Vaccine Industrial Company.
UAE	In more than 40 free economic zones, companies may be able to qualify for a 0% rate on qualifying income, conditional on meeting all the relevant conditions to be considered as a Qualifying Free Zone Person. Companies may also benefit from customs or VAT reliefs in designated free zones.
GCC	Definitive antidumping duty on imports of super absorbent polymer from Belgium, China, France, Korea and Singapore.
	Initiation of antidumping investigation on imports of certain electrical connectors, switches, sockets and plugs from China.

Source: Authors based on NIPO database.

[23] Cherif, R., F. Hasanov, and M. Sarsanbayev, 2024, Call of Duty – Industrial Policy for the Post-Oil Era, IMF Working Paper 24/74.

Figure 22. Industrial Policies, 2023–24
(Number of measures, and composition of measures in percent)

More than 50 IP measures have been documented in the GCC over the past two years, predominantly in the form of subsidies and trade policy measures, with a focus on the manufacturing sector.



Note: Trade policy includes export and import policy, trade defense, and export incentives.

Sources: NIPO Database, Evenett, Simon, et al. (2024) and staff calculations.

- **Business climate.** With the aim of further enhancing the business climate, there are numerous ongoing policy initiatives, including the newly enacted law on civil transactions, new investment code, the forthcoming adoption of the commercial transactions law, the development of a national governance framework to streamline fees and levies (Saudi Arabia), the strengthening of intellectual property laws (UAE), and significant privatization efforts (e.g., divestment of nine SOEs in 2023 and plans to divest more than 30 state-owned assets during 2024-28 in Oman). Reforms to improve the business environment should intensify, including in the areas of bureaucracy and access to financial services and credit, including by upgrading credit scoring methods.

- **Labor market and human capital**. Reform measures have already been implemented and such efforts need to be intensified (Box 6). Policies should continue to focus on containing public sector employment, facilitating employment of nationals in the private sector, lifting nationals' skills through aligning educational systems with labor market needs, improving labor market flexibility, and enhancing women's role at work and in the society more broadly.

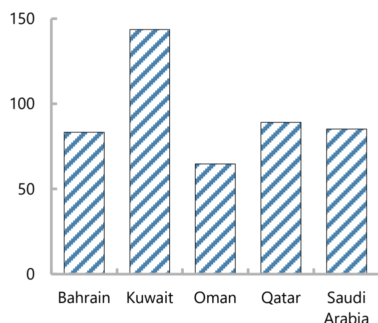
Box 6. Labor Market Reforms in the GCC

Amid increasing working-age national population and efforts to reduce dependency on hydrocarbon revenues, the GCC countries have adopted measures to help integrate nationals more effectively into the private sector, traditionally dominated by expatriate workers while maintaining labor market flexibility.

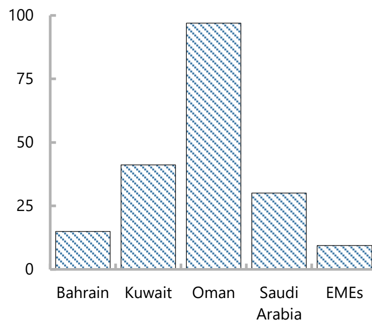
Creating private sector jobs for nationals has become increasingly important. Job creation over the past two decades in the non-hydrocarbon sector was primarily driven by industries with lower-skill and wage employment (trade, construction, services) supported by the flexible supply of expatriate workers (Box Figure 1, panel 1). The latter has worked as an adjustment mechanism to terms-of-trade shocks under the currency pegs. It has capped private sector wages, rendering public sector jobs more desirable to nationals, particularly those with lower skills (panel 2). For the governments, absorbing the increasing national graduates into the public sector creates challenges for achieving necessary fiscal discipline. Recognizing the challenge, GCC authorities have implemented a series of policy interventions to facilitate nationals to take private sector jobs (panel 3).

Box 6. Figure 1. Indicators of Labor Market Performance in the GCC

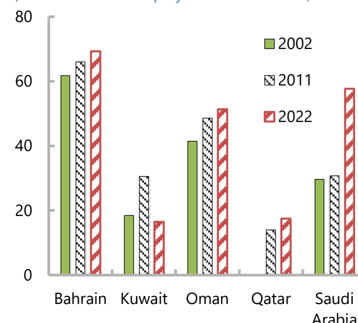
New private sector jobs have largely been taken by foreign workers



Public sector wages tend to be above their private sector counterpart.



More nationals have taken private sector employment.



Sources: Authorities, IMF FAD Expenditure Assessment Tool, NCSI, and IMF staff.
1/ Aggregate net job creation includes the job reduction of nationals in the public sector in Saudi Arabia and expatriates in the public sector in Kuwait and Saudi Arabia. Public sector data for Oman have a structural change due to the expansion of the survey to include other public sector workers.
2/ Wage premia for GCC economies for nationals only.

Key interventions undertaken include:

- **Containing public sector employment** through revising salaries and benefits while improving efficiency with greater digitalization (Saudi Arabia), facilitating voluntary retirement (Bahrain), aligning working conditions of public sector with private sector (UAE), and scholarships for citizens to relocate from a public to a private sector job (Qatar).
- **Facilitating employment of nationals in the private sector** through quotas to employ nationals in the private sector (many GCC countries); a program to bridge the public-private sector wage differences for nationals (Kuwait, Qatar, Saudi Arabia, and the UAE) and between nationals and expatriates in the private sector (Bahrain, Oman); incentives for hiring nationals (Oman, Saudi Arabia, and the UAE); and additional benefits to the firms exceeding their Saudization targets, including more exemptions (Saudi Arabia).
- **Lifting nationals' skills** through aligning educational systems with labor market needs (Qatar and Saudi Arabia), including international partnerships for higher education; an apprenticeship program for nationals in collaboration with academic and vocational training institutes (Bahrain and the UAE); various vocational training programs that combine academic knowledge with practical skills (Kuwait); the large-scale Human Capability Development program aimed at promoting training for 1.7 million participants, and the mandating of employers to design a policy for training and upskilling employees (Saudi Arabia); on-the-job

Box 6. Labor Market Reforms in the GCC (concluded)

training initiatives (Bahrain and the UAE); trainings for oil and gas workers on technologies in the hydrogen sector (the UAE); a strategy to develop future-ready skills, particularly in areas such as information technology, cybersecurity, and the use of AI in teaching methods (Qatar, the UAE).

- **Improving labor market flexibility** through allowing greater flexibility for expatriates in changing their jobs and transferring employment without requiring employer consent (most GCC countries); investor visa programs that offer residency opportunities for expatriates with real estate investments (Bahrain, Oman, Qatar, and Saudi Arabia); extending golden visas to entrepreneurs, professionals, and job seekers with the right academic credentials (the UAE); pensions system reform to improve social security and end-of-service benefits for expatriates to attract high-skilled labor (Oman).
- **Enhancing women's role** through prohibiting employment and wage discriminations based on gender and opening previously male-only jobs for women (Bahrain, Qatar, Saudi Arabia, and the UAE); subsidizing childcare for working mothers (Bahrain, Saudi Arabia); extending maternity leave and provision for nursing hours (Kuwait, Oman, and Saudi Arabia); providing transportation to working mothers (Saudi Arabia); flexible work arrangements such as part-time and remote work options (Kuwait, Oman, Qatar, Saudi Arabia, and the UAE); female leadership programs, including quotas for female representation in government advisory bodies and councils, and guidance for private sector entities to promote women in leadership positions (Saudi Arabia and the UAE).

41. Digitalization and AI could play a key role in the economic diversification strategy. AI, for example, could enhance productivity by increasing output production efficiency and accelerating innovation. The use of AI technologies could boost GDP by around 35 percent by 2030 in the UAE,[24] while AI could constitute more than 12 percent of GDP by 2030 in Saudi Arabia.[25] At the same time, there are also potential major challenges, especially the exposure of almost 40 percent of global employment to AI.[26] As such, it remains crucial to upgrade skills in the labor market (Box 6), as well as to conduct careful risk assessment to ensure ethical and responsible AI practices and to regularly evaluate the effectiveness of implementation strategies. Against this backdrop, the GCC countries have several ongoing AI initiatives, with the high level of digitalization providing them with a solid basis:

- **Digitalization:** The GCC countries have made sizeable progress on digitalization in key sectors (government, financial, corporate) (Figure 23). The Enhanced Digital Access Index (EDAI), which measures digital connectivity, reveals a significant acceleration in digitalization across GCC over the past few years, with Qatar, Saudi Arabia, and the UAE on par with AEs. In terms of digital adoption in the public sector, Saudi Arabia and the UAE ranked third and fourth, respectively, globally in 2022 based on the GovTech Maturity Index (GTMI).
- **AI initiatives**. The UAE, for example, is well-positioned to become a hub for AI and digital innovation supported by the AI and Digital Economy Strategies, the National Program for AI, and the establishment of both the Ministry of AI, the first in the GCC, and the UAE AI Council. The UAE have also been seeking foreign capital and know-how to exploit the potential in new technologies

[24] IMF, 2024, Unlocking Potential: The UAE's Artificial Intelligence Playbook, Selected Issues Paper.

[25] https://www.pwc.com/m1/en/publications/potential-impact-artificial-intelligence-middle-east.html.

[26] IMF, 2024, Gen-AI: Artificial Intelligence and the Future of Work, Staff Discussion Note 2024/001.

(see, for example, the investment by Microsoft in AI company G42 of Abu Dhabi). Similarly, Saudi Arabia is undertaking major efforts, with its national AI strategy aiming to attract US$20 billion in investment, train 20,000 data and AI experts, establish 300 active AI startups, and become a global AI and data leader by 2030.

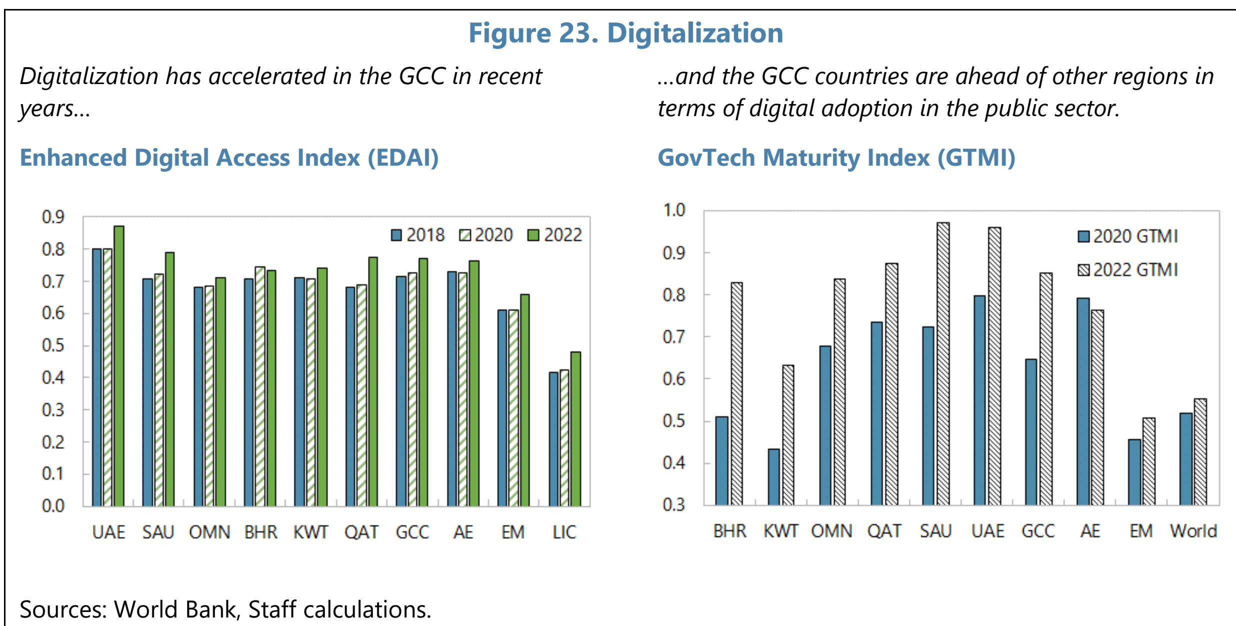


Figure 23. Digitalization

Digitalization has accelerated in the GCC in recent years…

…and the GCC countries are ahead of other regions in terms of digital adoption in the public sector.

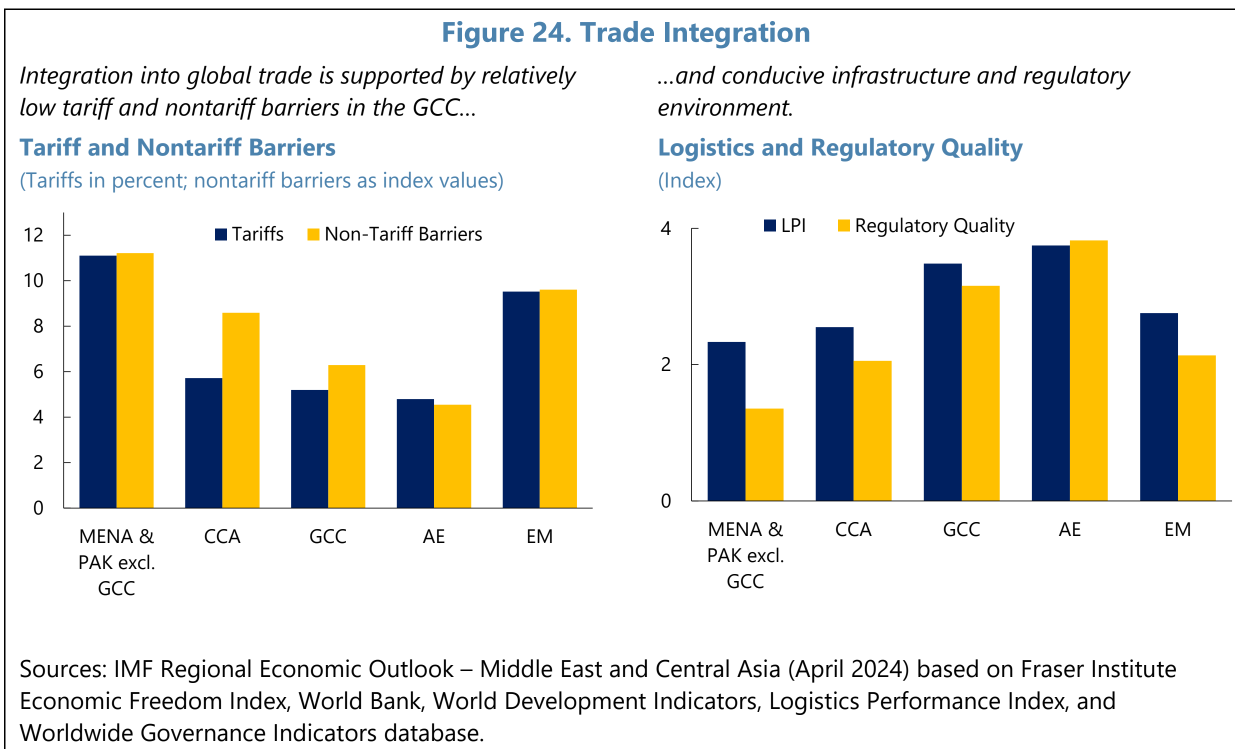
Sources: World Bank, Staff calculations.

42. With the aim of supporting sustainable non-hydrocarbon growth and diversifying financing sources, the GCC countries have also made significant efforts to enhance trade and financial integration. The establishment of the GCC Common Market and the integration of financial markets have been at the center of GCC policy priorities. Given the limited size of domestic markets, export orientation is a critical feature of policies aimed at economic diversification. Moreover, diversification efforts are also supported by increased financial integration through higher and more diversified financing sources, as well as improved access to technology and know-how. Against this backdrop, the GCC countries have launched several initiatives:

- **Trade integration** (Annex II). The GCC countries have relatively low tariffs and nontariff barriers as indicated by perception-based indicators, and high-quality infrastructure and regulatory environment (Figure 24). Moreover, the potential for trade growth is enhanced by several policy initiatives. For example, the GCC countries made major efforts to boost tourism (e.g., Saudi Arabia's memorandum of understanding with Bahrain and Oman; GCC plans for a unified visa for tourists and businesspeople that would allow entry to all GCC countries). To support within-GCC trade and value chain integration, GCC countries excluded each other from local content requirements. Moreover, with the aim of boosting trade and participation in global value chains, the GCC countries have also negotiated several free trade agreements (FTA) and Comprehensive Economic Partnership Agreements (CEPA). For example, an FTA between Oman and India is being negotiated, and FTAs with East African countries are also under consideration. To improve supply chains, Bahrain, the UAE, Egypt, and Jordan entered into an agreement on joint EV production, which will also be produced for local markets. Other initiatives include the accession of the UAE to

the BRICS and commitments to the development of the India-Middle East Europe Economic Corridor (IMEEC).[27]

Figure 24. Trade Integration



Sources: IMF Regional Economic Outlook – Middle East and Central Asia (April 2024) based on Fraser Institute Economic Freedom Index, World Bank, World Development Indicators, Logistics Performance Index, and Worldwide Governance Indicators database.

- **Financial integration** (Annex III). Given the importance of FDI for economic diversification, the GCC authorities have launched several initiatives to increase the attractiveness of the region for foreign investors. While these initiatives have already started bearing fruit (e.g., a sharp increase in the number of foreign investment licenses in Saudi Arabia), inward capital flows, especially FDI, have remained modest in most GCC countries as highlighted in Annex III. To this end, greater financial depth, higher human capital, quality institution, and labor market flexibility are among key factors that attract FDI (Yu and Walsh, 2010). In addition to the potential growth benefits, greater reliance on more stable foreign funding would also allow SWFs to reorient their investments to best safeguard buffers for macroeconomic and financial stability and intergenerational equity. Finally, greater financial integration within the GCC would benefit the region by widening the range of financing options for businesses and governments. This could be supported by further reforms in the banking systems and capital markets.[28]

43. The GCC countries have put in place several initiatives aimed at supporting climate transition, including major efforts to develop renewable energy. At COP28, hosted by the UAE in 2023, the GCC countries reiterated their commitment to global climate transition efforts. Bahrain,

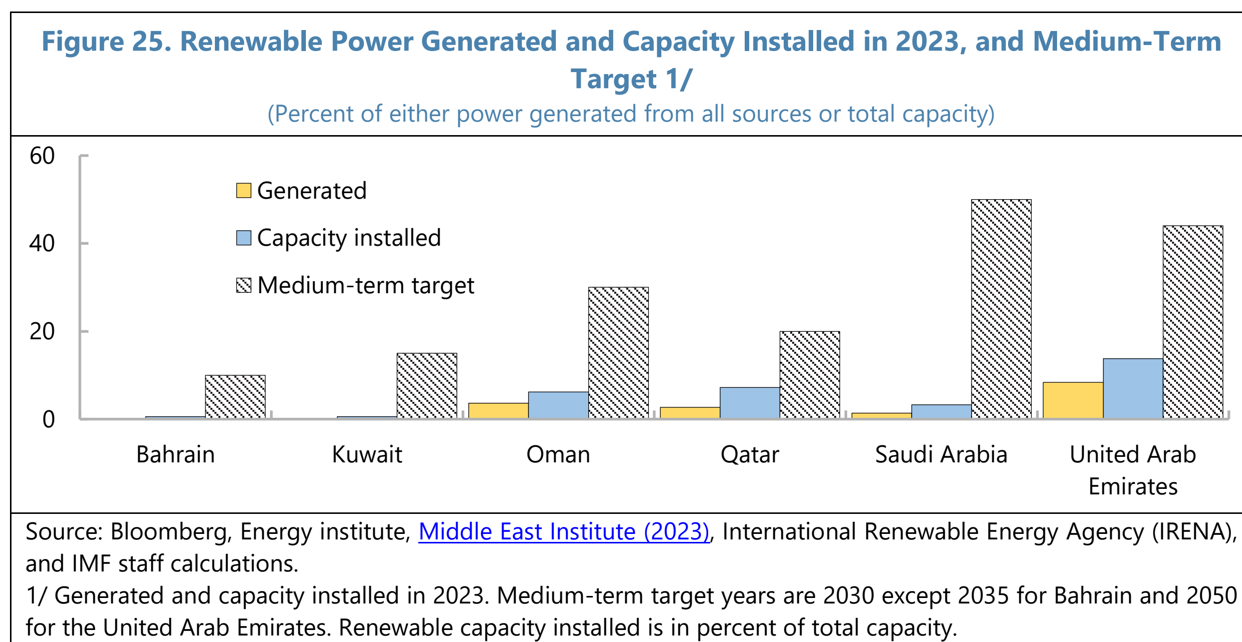
[27] Saudi Arabia was invited but has not officially joined the BRICS.

[28] Specific measures would include streamlining bank regulations, loosening bank licensing restrictions, facilitating the establishment of branches in other GCC countries, creating a pan-GCC stock exchange, cross-listing companies, and harmonizing listing requirements, disclosure standards, and trading rules. Investments in modern trading platforms, clearing and settlement systems, and robust data dissemination would be also beneficial.

Kuwait, Saudi Arabia, and the UAE had previously announced net zero emission targets by 2050 or 2060, and all GCC countries have pledged to reduce emissions considerably over the next decades. Saudi Arabia is also spearheading the Middle East Green Initiative (MGI), a regional effort to mitigate the impact of climate change on the region. The GCC countries have continued to build renewable energy generation capacity and there are several ongoing initiatives on renewable energy, energy efficiency, clean hydrogen, and carbon capture (Figure 25). For example, they have made sizeable investments in solar (across the GCC) and wind power capabilities (e.g., Kuwait's Shagaya Wind Power Plant (10 MW), Oman's Harweel Wind Power Plant (50 MW) and Saudi Arabia's Dumat Al Jandal (400 MW)), as well as hydrogen (e.g., eight green hydrogen projects in Oman; blue hydrogen plans in Saudi Arabia). In addition, green bond issuances have increased and diversified resources available for climate policies. Nonetheless, further progress is needed. For example, the rationalization of energy subsidies would help achieve goals by incentivizing energy conservation and improving returns on investment in renewable energies. Also, green finance could be supported by government initiatives, while investments in green technologies could be incentivized by integrating green finance into investment decisions and enforcing green investment disclosure standards.

Figure 25. Renewable Power Generated and Capacity Installed in 2023, and Medium-Term Target 1/

(Percent of either power generated from all sources or total capacity)



Source: Bloomberg, Energy institute, Middle East Institute (2023), International Renewable Energy Agency (IRENA), and IMF staff calculations.
1/ Generated and capacity installed in 2023. Medium-term target years are 2030 except 2035 for Bahrain and 2050 for the United Arab Emirates. Renewable capacity installed is in percent of total capacity.

CONCLUDING REMARKS

44. The economic outlook for the GCC remains positive. In the near term, economic activity will be supported by the gradual phasing out of oil production cuts. Over the medium term, domestic economic activity will benefit from the strengthening non-hydrocarbon activity on the back of reform implementation and the robust hydrocarbon sector, while inflation will stabilize at a low level, supported by credible policy frameworks. The external sector will remain strong, with a gradual narrowing of current account surpluses on the back of strong investments. Risks around the mildly favorable outlook are broadly balanced in the near term. More challenging medium-term risks call for taking action on policy priorities.

45. The GCC should continue to ensure stability and sustainability, and intensify reform implementation to continue economic diversification and boost growth prospects.

- In the *short term*, fiscal policy should remain prudent to avoid procyclicality; monetary policy should be consistent with the currency pegs while enhancing the effectiveness of its transmission; and financial sector policies should monitor and respond to emerging risks.

- In the *medium term*, fiscal consolidation, with a focus on non-hydrocarbon revenue mobilization (especially in the context of global corporate taxation initiatives), is needed to ensure stability and sustainability and to boost space for growth-enhancing investments. This should be supported by the adoption of appropriate fiscal rules, and credible medium-term fiscal frameworks, enhanced risk monitoring, and consolidated sovereign asset-liability management frameworks. Finally, ambitious reform agendas should be fully implemented, and the increase in trade and financial integration should remain a common policy priority to fully reap reform dividends, enhance resilience to the risk of geoeconomic fragmentation, and benefit from potential trade diversion.

46. Finally, stronger IMF-GCC collaboration would complement the member states' effort to bolster macroeconomic stability and resilience. IMF country teams and experts, including in the context of the establishment of the new Regional Office in Riyadh and active engagement of the Center for Economics and Finance (CEF) in Kuwait, stand ready to support the GCC member states' reforms, through surveillance, analytical work, and capacity development. For the broader MENA region, the GCC member states have played an important role in supporting regional macroeconomic stability, complementing a range of work by the IMF. Amid multiple global headwinds and rising vulnerabilities in the region, enhancing cooperation between the IMF and the GCC countries is critical to reinforce the region's macroeconomic stability.

Table 4. Annual Indicators of Real Sector

	2021	2022	2023	2024	2025	2026	2027	2028	2029
				Projections					
Real GDP growth (% yoy)									
Bahrain	4.4	6.0	3.0	3.0	3.2	2.9	2.8	2.8	2.9
Kuwait	2.3	5.9	-3.6	-2.7	3.3	2.5	2.6	2.6	2.6
Oman	2.6	9.6	1.3	1.0	3.1	4.4	4.0	3.6	3.6
Qatar	1.6	4.2	1.2	1.5	1.9	5.8	7.9	3.5	1.6
Saudi Arabia	5.1	7.5	-0.8	1.5	4.6	4.4	3.6	3.5	3.5
United Arab Emirates	4.4	7.5	3.6	4.0	5.1	5.1	4.7	4.4	4.3
GCC average	*3.4*	*6.8*	*0.8*	*1.4*	*3.5*	*4.2*	*4.2*	*3.4*	*3.1*
Hydrocarbon real GDP growth (% yoy)									
Bahrain	-0.3	-1.4	-2.5	-1.0	0.0	-1.4	-2.6	-2.7	-2.3
Kuwait	-0.9	12.1	-4.3	-6.6	4.0	2.0	2.0	2.0	2.0
Oman	3.2	10.2	0.3	-3.4	2.4	5.4	3.9	2.3	2.2
Qatar	-0.3	1.7	1.4	1.4	1.5	12.0	16.1	4.8	0.2
Saudi Arabia	1.2	15.0	-9.0	-5.0	5.0	4.8	2.4	2.6	2.6
United Arab Emirates	-1.1	8.5	-3.1	0.3	6.7	6.7	5.2	4.0	3.5
GCC average	*0.3*	*7.7*	*-2.9*	*-2.4*	*3.3*	*4.9*	*4.5*	*2.2*	*1.4*
Non-Hydrocarbon real GDP growth (% yoy)									
Bahrain	5.4	7.5	4.0	3.7	3.7	3.6	3.6	3.6	3.6
Kuwait	5.8	-0.3	-1.0	2.0	2.4	2.7	2.9	2.9	3.0
Oman	2.3	9.3	1.8	3.2	3.4	3.9	4.0	4.2	4.2
Qatar	2.8	5.7	1.1	1.6	2.1	2.2	2.6	2.6	2.6
Saudi Arabia	5.6	5.3	3.8	3.7	4.4	4.3	4.1	3.9	3.9
United Arab Emirates	6.5	7.1	6.2	5.3	4.5	4.5	4.5	4.5	4.5
GCC average	*4.7*	*5.8*	*2.6*	*3.3*	*3.4*	*3.5*	*3.6*	*3.6*	*3.6*
Inflation (% yoy)									
Bahrain	-0.6	3.6	0.1	1.4	1.8	2.0	2.0	2.0	2.0
Kuwait	3.4	4.0	3.6	3.0	2.4	2.1	1.9	1.8	1.7
Oman	1.7	2.5	0.9	1.3	1.5	2.0	2.0	2.0	2.0
Qatar	2.3	5.0	3.1	1.0	1.4	1.9	2.0	2.0	2.0
Saudi Arabia	3.1	2.5	2.3	1.7	1.9	2.0	2.0	2.0	2.0
United Arab Emirates	-0.1	4.8	1.6	2.3	2.1	2.0	2.0	2.0	2.0
GCC average	*1.6*	*3.7*	*2.0*	*1.8*	*1.9*	*2.0*	*2.0*	*2.0*	*2.0*
Population growth (%)									
Bahrain	2.2	1.6	3.2	2.5	2.5	2.5	2.5	2.5	2.5
Kuwait	-2.7	13.7	2.5	2.0	2.0	2.0	2.0	2.0	2.0
Oman	1.0	9.9	4.7	3.2	3.2	3.2	3.2	3.2	3.2
Qatar	-3.0	6.7	4.5	1.0	0.5	0.5	0.5	0.5	0.5
Saudi Arabia	-2.4	4.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0
United Arab Emirates	3.0	7.6	3.9	3.0	0.8	0.7	0.7	0.7	0.7
GCC average	*-0.3*	*7.3*	*3.4*	*2.3*	*1.8*	*1.8*	*1.8*	*1.8*	*1.8*

Sources: Haver, WEO, and IMF staff.

Table 5. Annual Indicators of Fiscal and External Sectors 1/

	2021	2022	2023	2024	2025	2026	2027	2028	2029
				Projections					
	Overall fiscal balance (% GDP)								
Bahrain	-10.6	-5.1	-10.6	-7.7	-7.3	-7.7	-8.6	-9.2	-9.6
Kuwait	8.5	30.4	29.9	25.6	25.3	24.9	24.3	23.6	22.9
Oman	-3.2	10.3	6.7	5.0	2.5	3.3	3.4	3.5	3.5
Qatar	0.2	10.4	5.6	2.0	2.1	4.0	3.6	3.3	3.5
Saudi Arabia	-2.2	2.5	-2.0	-3.0	-3.4	-3.2	-3.1	-3.0	-2.8
United Arab Emirates	4.0	10.0	5.0	4.8	4.4	4.2	4.2	4.1	4.1
GCC average	*-0.5*	*9.7*	*5.8*	*4.4*	*3.9*	*4.2*	*4.0*	*3.7*	*3.6*
	Non-hydrocarbon primary balance (% non-hydrocarbon GDP)								
Bahrain	-20.7	-17.8	-20.4	-16.4	-15.0	-14.7	-14.3	-13.8	-13.6
Kuwait	-61.1	-60.4	-66.6	-64.0	-59.7	-57.4	-56.0	-55.1	-54.4
Oman	-31.8	-31.1	-28.1	-28.0	-26.3	-24.4	-23.0	-21.5	-20.2
Qatar	-34.6	-31.9	-33.5	-32.6	-31.6	-30.5	-30.0	-29.5	-29.1
Saudi Arabia	-29.1	-32.2	-33.0	-32.3	-30.1	-29.1	-27.5	-25.9	-24.4
United Arab Emirates	-20.3	-17.9	-18.7	-18.4	-16.9	-15.7	-15.2	-15.2	-15.1
GCC average	*-32.9*	*-31.9*	*-33.4*	*-31.9*	*-29.9*	*-28.6*	*-27.7*	*-26.8*	*-26.1*
	Public debt (% of GDP)								
Bahrain	122	111	123	127	130	132	135	139	142
Kuwait	7	3	3	7	13	16	20	24	25
Oman	62	41	36	34	34	32	30	29	29
Qatar	58	43	43	41	40	39	37	36	36
Saudi Arabia	29	24	26	28	31	32	33	34	35
United Arab Emirates	36	32	32	31	31	31	30	30	29
GCC average	*52.4*	*42.3*	*44.2*	*44.8*	*46.4*	*46.9*	*47.6*	*48.7*	*49.5*
	Current account balance (% GDP)								
Bahrain	6.4	14.6	5.9	5.3	4.5	4.3	3.9	3.4	2.9
Kuwait	25.2	34.3	31.4	28.2	23.7	20.8	18.3	16.0	13.9
Oman	-5.5	3.9	2.4	2.3	1.4	1.5	1.9	2.0	2.0
Qatar	14.6	26.8	17.1	13.4	13.3	12.9	14.2	13.2	11.3
Saudi Arabia	4.8	13.7	3.2	0.4	-1.8	-1.9	-2.3	-2.5	-2.7
United Arab Emirates	11.5	13.2	10.7	8.8	8.2	8.0	7.3	6.6	6.4
GCC average	*9.5*	*17.8*	*11.8*	*9.7*	*8.2*	*7.6*	*7.2*	*6.4*	*5.6*
	Central bank reserves (U$ billion)								
Bahrain	4.7	4.5	4.8	5.4	6.2	6.8	7.6	8.4	9.2
Kuwait	45.2	48.2	47.6	50.5	54.4	58.6	63.5	68.8	74.2
Oman	19.7	17.6	17.5	19.0	21.3	22.7	25.1	27.2	29.3
Qatar	42.2	47.4	51.5	56.8	61.5	66.1	69.8	73.9	76.8
Saudi Arabia	455.4	459.9	436.9	429.8	422.4	438.4	459.6	479.0	496.6
United Arab Emirates	127.8	135.3	186.3	211.6	225.5	240.1	255.7	271.8	289.0
GCC average	*115.8*	*118.8*	*124.1*	*128.9*	*131.9*	*138.8*	*146.9*	*154.8*	*162.5*

Sources: Haver, WEO, and IMF staff.

1/ Fiscal data are for central government, except general government for the UAE. For Bahrain, fiscal balance estimates rely on total financing flows (including changes in central bank claims on the government) and tend to be lower than those by subtracting budget expenditures from budget revenues (accordingly, government debt includes central bank claims on government).

Table 6. Quarterly Indicators of Real and External Sectors

	2021		2022				2023			
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Real GDP growth (% yoy)									
Bahrain	4.1	7.9	6.8	8.2	4.2	4.8	2.0	2.0	3.6	4.3
Kuwait	7.0	4.7	9.3	7.1	5.6	2.0	-0.9	-3.5	-5.8	-4.4
Oman	3.2	7.5	-1.8	4.1	6.8	7.0	13.2	6.6	2.2	0.3
Qatar	2.4	2.2	2.1	4.0	4.4	6.1	2.2	1.2	1.5	0.0
Saudi Arabia	6.3	8.4	7.5	9.1	8.0	5.6	3.2	1.7	-3.2	-4.3
United Arab Emirates	7.4	9.2	8.9	7.6	8.5	5.1	3.9	3.8	2.5	4.3
GCC average	*5.1*	*6.6*	*5.5*	*6.7*	*6.2*	*5.1*	*3.9*	*1.9*	*0.1*	*0.0*
	Hydrocarbon real GDP growth (% yoy)									
Bahrain	-4.1	4.8	-4.6	-2.0	0.8	-0.3	-5.6	2.2	-6.0	1.5
Kuwait	9.0	10.2	12.2	14.4	14.4	7.7	2.5	-3.9	-9.0	-6.4
Oman	8.6	6.5	0.7	4.7	16.6	8.9	12.2	4.7	-0.9	-1.8
Qatar	-0.7	1.3	-1.6	1.2	2.7	4.8	4.1	2.3	2.3	-3.1
Saudi Arabia	9.8	11.9	20.1	22.5	14.0	5.3	0.8	-3.7	-16.1	-16.2
United Arab Emirates	5.5	8.7	5.8	11.1	11.3	5.3	1.3	-5.2	-5.7	-2.2
GCC average	*4.7*	*7.2*	*5.4*	*8.6*	*10.0*	*5.3*	*2.6*	*-0.6*	*-5.9*	*-4.7*
	Non-Hydrocarbon real GDP growth (% yoy)									
Bahrain	6.1	8.6	9.3	10.5	5.0	5.9	3.5	1.9	5.6	4.9
Kuwait	5.1	0.1	6.5	0.1	-3.3	-3.3	-4.2	-3.1	-2.0	-2.3
Oman	1.2	6.3	-3.4	4.8	3.7	4.3	13.2	11.1	3.9	1.9
Qatar	4.3	2.7	4.5	5.9	5.5	6.9	1.0	0.5	1.0	1.7
Saudi Arabia	6.5	5.3	4.0	6.0	6.2	6.2	5.3	5.1	3.2	4.2
United Arab Emirates	8.2	9.4	10.0	6.2	7.4	5.0	4.8	7.4	5.8	6.7
GCC average	*5.2*	*5.4*	*5.1*	*5.6*	*4.1*	*4.2*	*3.9*	*3.8*	*2.9*	*2.8*
	Inflation (% yoy)									
Bahrain	-0.2	0.3	3.4	3.4	4.0	3.8	0.6	0.0	-0.1	-0.2
Kuwait	3.4	4.0	4.3	4.5	3.9	3.2	3.4	3.7	3.8	3.7
Oman	2.1	3.3	3.7	2.5	2.1	1.8	1.6	0.8	0.8	0.6
Qatar	2.9	5.5	4.2	5.1	5.3	5.4	4.2	3.7	2.4	1.8
Saudi Arabia	0.4	1.1	1.6	2.3	2.9	3.1	3.0	2.7	2.0	1.6
United Arab Emirates	0.5	1.9	2.6	5.6	6.5	4.6	3.4	0.8	0.5	1.9
GCC average	*1.5*	*2.7*	*3.3*	*3.9*	*4.1*	*3.7*	*2.7*	*2.0*	*1.6*	*1.5*
	Current account balance (% of rolling quarterly GDP)									
Bahrain	12.3	10.4	14.1	16.2	13.8	14.3	5.5	5.1	7.4	5.5
Kuwait	21.4	30.1	28.8	36.6	36.8	34.6	26.0	35.2	32.6	31.9
Oman	…	…	…	…	…	…	…	…	…	…
Qatar	16.1	23.9	19.0	29.1	30.1	28.0	22.5	15.5	17.2	13.1
Saudi Arabia	6.8	8.5	15.7	14.7	16.6	7.5	5.6	5.0	0.6	1.6
United Arab Emirates	…	…	…	…	…	…	…	…	…	…
GCC average	*14.2*	*18.2*	*19.4*	*24.2*	*24.4*	*21.1*	*14.9*	*15.2*	*14.5*	*13.0*

Sources: Haver, WEO, and IMF staff.

Annex I. The Global Minimum Corporate Tax under Pillar Two and the GCC[1]

As part of their non-hydrocarbon revenue mobilization strategy, most GCC countries already have corporate income tax (CIT) in place. Effective rates, however, are much lower in many cases thanks to the myriad tax exemptions and holidays. Against this backdrop, the global minimum corporate tax creates an opportunity for wider CIT reforms.

1. **GCC countries are in the process of broadening their tax base**. The sharp decline in oil prices in the last decade prompted a wave of consumption tax reforms in the GCC. Currently, the value-added tax (VAT) is in place in four GCC countries (Bahrain, Oman, Saudi Arabia, and the UAE) and excises are adopted by all except Kuwait. These policies are consistent with reducing dependency on hydrocarbon revenue and enhancing macroeconomic stability. Considerations for corporate income taxes (CIT) reforms have recently come to the fore in the GCC, prompted by the changing international landscape of taxing multinational enterprises and the revenue diversification process.

2. **As members of the OECD/G20 Inclusive Framework on BEPS, GCC countries are committed—alongside 141 other jurisdictions—to reform the taxation of multinationals**.[2] Pillar One is focused on changing where companies pay taxes and Pillar Two would establish a global minimum tax. More imminent and relevant for the GCC countries is Pillar Two, which subjects profits of relatively large multinationals (with group turnover of at least EUR 750 million, which are called 'in-scope' companies) to a minimum effective tax of 15 percent.[3] This minimum corporate tax is estimated to raise global CIT revenue by 5.7 percent (IMF, 2022), and is governed by a set of rules known as the Global Anti-Base Erosion Rules (GloBE). While Inclusive Framework members are not required to implement the minimum tax themselves, they have to respect implementation by others, which creates opportunities for the GCC to improve the CIT design as discussed below.

3. **At present, most GCC countries have some form of a CIT but preferential tax regimes reduce Pillar Two effective tax rates to below 15 percent** (Annex 1. Figure 1). Standard CIT rates vary between 9 percent (UAE's new general CIT for financial years starting on or after June 2023) and 20 percent (Saudi Arabia).[4] However, tax holidays and exemptions are very common in the GCC, in

[1] Prepared by Shafik Hebous (FAD).

[2] Tax base erosion and profit shifting (BEPS) relates to tax planning strategies by multinational enterprises to shift profits to low-tax jurisdictions to reduce their taxes. The 2015 BEPS initiative and the agreement on the Two Pillar reform aim at mitigating tax avoidance and tax competition. Pillar One allocates ¼ of profits above 10 percent of revenue to market jurisdictions for about 100 multinationals with turnover higher than EUR 20 billion. The advancement of Pillar One is still underway and its outlook is rather uncertain as of now.

[3] This is after carving out a portion of profit known as the 'substance-based income exclusion' (SBIE). The SBIE, after a transition period, will exempt 5 percent of each of payroll and tangible assets from the minimum tax base. Estimates suggest about 19 percent of the global profit of multinationals would be subjected to the top-up tax (IMF, 2022).

[4] The CIT applies only to the share of profits attributed to non-GCC residents. Saudi and GCC residents pay Zakat (generally 2.5 percent on the stock of net wealth), which is explicitly recognized as a tax under the GloBE rules.

some cases effectively implying a very low CIT. As a result, the minimum tax will likely apply to most in-scope multinationals in the region.

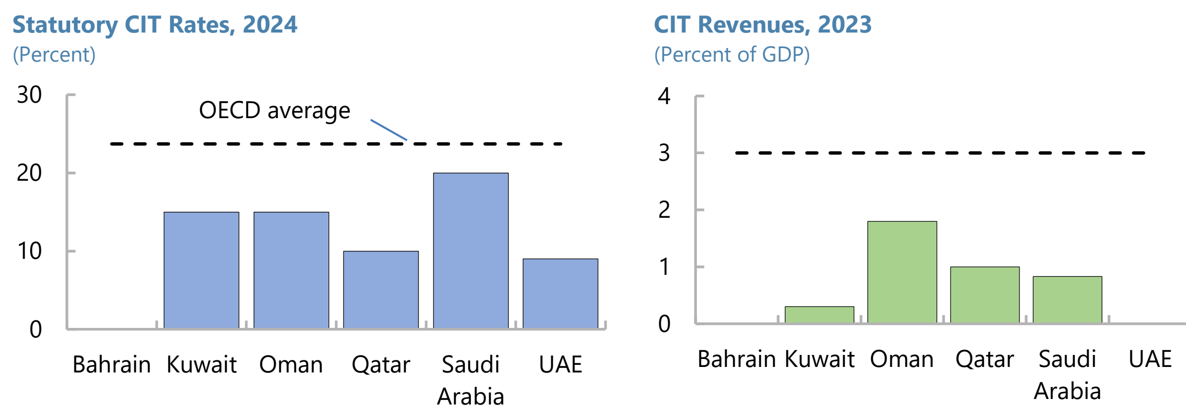
4. Reacting to Pillar Two provides the GCC with an opportunity to implement wider CIT reforms to further boost revenue and enhance efficiency. To this end, Bahrain announced in September 2024 the introduction of a 15 percent Domestic Minimum Top-up Tax for large multinational enterprises effective January 2025. Moreover, regional CIT coordination can further foster those benefits by reducing tax competition and profit shifting within the GCC and facilitate administrative cooperation on tax matters between GCC countries.

5. Exact CIT design options are country-specific, but considerations should generally be given to:

- **Collecting additional revenue without creating disincentive to multinationals.** Adopting the so-called Qualifying Domestic Minimum Top-Up Tax ('QDMTT') allows the hosting GCC country to collect top-up taxes payable on profits of in-scope entities in its jurisdiction, rather than in another jurisdiction. Importantly, the QDMTT per se does not put a country at an investment disadvantage, as in-scope companies will otherwise be taxed at 15 percent effective elsewhere (if its parent or any intermediate holding company is in a jurisdiction that implements Pillar Two). Also, there will be no added compliance costs, as in-scope multinationals need to undertake the minimum tax calculations irrespective of the specific policy of any host country.[5]
- **Addressing CIT distortions.** Ideally, the CIT should not affect the decision whether to undertake the investment at the margin. It should also be neutral with respect to the modality of financing (debt or equity). Such an efficient system, however, is still taxing economic rent (that is, returns above the opportunity cost of investment).[6]
- **Increasing the efficiency and effectiveness of tax incentives.** Tax holidays and profit-based preferential regimes should be replaced with cost-based incentives such as accelerated depreciation and investment tax credits. Under tax holidays, top-up taxes may be collected abroad. Cost-based incentives are more effective as it directly targets investment cost.[7]

[5] There can be a case for adopting further GloBE rules as discussed in Hebous and others (2024).
[6] See Hebous and Mengistu (2024) for options of efficient profit tax designs.
[7] See G20 (2016) for detailed discussions of the designs of tax incentives.

Annex I. Figure 1. GCC and OECD: Statutory CIT Rates and Revenues



Source: OECD, multiple sources, and IMF staff.

Note: Given the UAE CIT regime applies to businesses for fiscal years starting on or after 1 June 2023 and the tax is due 9 months after the tax period, the majority of the UAE's CIT revenue collection will be reflected in the 2025 general government budget data.

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Annex II. Intra-GCC Trade Integration

Intra-GCC trade integration in non-commodity goods and services has progressed, driven largely by the UAE's exports. The GCC Customs Union and the Gulf Common Market may have helped. Intra-regional value chain integration has also strengthened. Yet, there is room to boost intra-regional integration including by further reducing non-tariff measures.

1. Intra-GCC goods and services trade integration has strengthened (Annex II. Figure 1). Views in the literate are mixed as to how the establishment of the GCC Customs Union in 2003 and the Gulf Common Market in 2008 boosted intra-GCC trade by facilitating the movement of goods, reducing trade barriers, and encouraging economic cooperation among member states.

- **Intra-GCC goods exports** rose from $3–5 billion in the 1980–90s to more than $70 billion in 2021 (Annex II. Figure 1, upper panels). As a share of GCC's global goods exports, it rose from 2 percent in the 1980s to 8–9 percent in the recent years. These exports have been mainly driven by non-commodity goods, the share of which was around 85 percent of the total intra-GCC trade in the past decade. Key non-commodity goods rotated from manufactured goods to machinery and transport equipment in recent years. The share of food and beverages has been at around 10 percent of total goods in the past decade after falling from 20 percent earlier.

- **Intra-GCC services exports** almost quadrupled over the past decade and a half, from $4 billion in 2005 to $15 billion in 2021 (Annex II. Figure 1, lower panels). It has been relatively stable when measured relative to the GCC's global services trade, at 10–12 percent. Travel remains the single important category, despite having gradually declined, at a little over 40 percent of total in 2016–20. Transport takes the second place, representing ¼ of total, followed by government services. Importantly, ICT, historically representing around 4 percent of intra-GCC services trade, gained in importance during the COVID-19 pandemic, to near 7 percent in 2020.

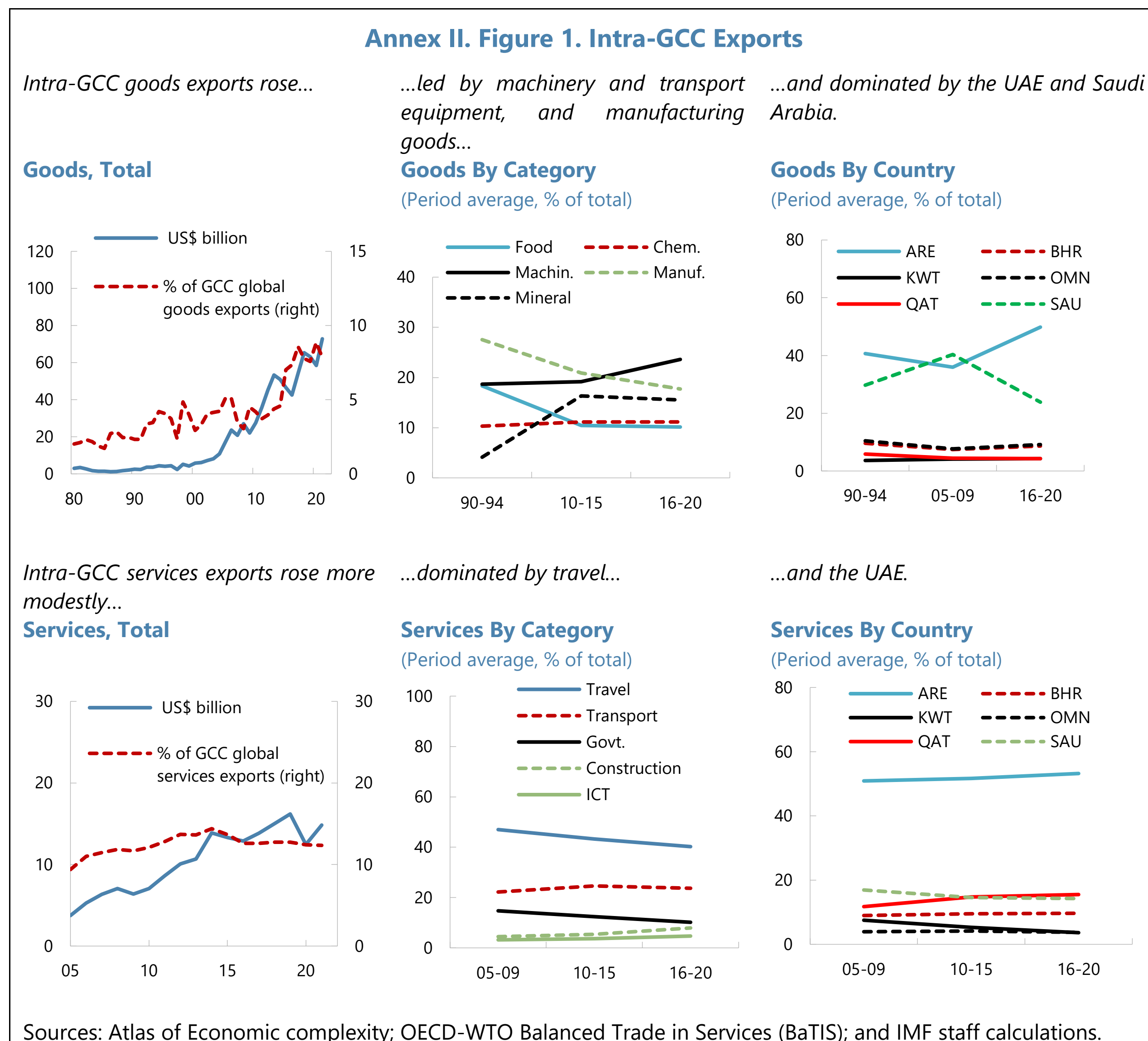
2. Saudi Arabia and the UAE have dominated intra-GCC trade. In goods exports, the role of the UAE rose in the past two decades to ½ of total, as exports products with relatively high complexity rose (e.g., electrical machinery and equipment) while the share of Saudi Arabia's declined to ¼ of total. The UAE maintained the single leading exporter of services within the GCC, accounting for more than ½ of total. Qatar's share gradually increased to 16 percent in 2016–20. The share of Saudi Arabia fell since 2005.

3. Intra-regional trade integration in the GCC lags other major economic areas (Annex II. Figure 2). The GCC's intra-regional trade, around 10 percent of total exports, is significantly below the EU's ½ or more in both goods and services, and NAFTA's nearly ½ for goods. Notably, the GCC's intra-regional trade integration is stronger for services than for goods, in contrast to other regional economic blocks where goods trade is more integrated than services trade.

4. Intra-GCC "value chain integration" has strengthened. Value chain integration refers to the extent to which production processes are distributed and coordinated across the members of the economic area. Intra-GCC trade in value added as a share of intra-GCC gross exports has tripled over

the past decade and a half, from 5 percent in 2005 to 15 percent in 2021. In other words, GCC countries are increasingly trading intermediate products among each other and involved in each other's production processes. The GCC's value chain integration is comparable to NAFTA's, lower than that of ASEAN and the EU (20–27 percent), and is above that of selected areas in the Americas and Africa.

Annex II. Figure 1. Intra-GCC Exports



Sources: Atlas of Economic complexity; OECD-WTO Balanced Trade in Services (BaTIS); and IMF staff calculations.

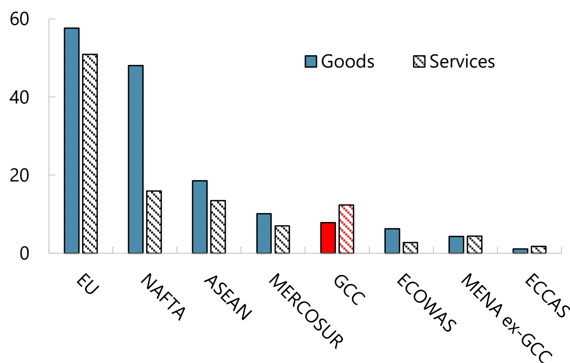
5. Within the GCC, import tariffs are nil but there are some non-tariff measures (NTMs). According to data that capture actual import tariffs, intra-GCC import tariffs are zero, similarly to other key economic areas. The GCC's import tariffs as a region against rest of the world are more frequent but remain low relative other economic regions. Import tariffs imposed by rest of the world are the highest vis-à-vis the GCC countries. Perception-based indicators suggest that the GCC's overall tariffs and non-tariff measures (NTMs) are relatively low. NTMs include, for instance, sanitary and phytosanitary measures, technical barriers to trade, and pre-shipment inspection.

Annex II. Figure 2. Intra-GCC Exports

The GCC's intra-regional trade in goods and services is relatively low...

Intra-Regional Gross Exports, 2021

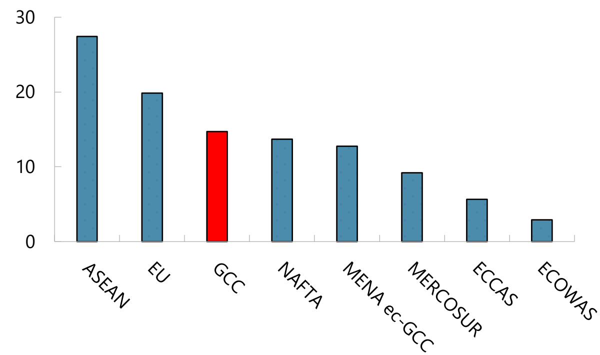
(Percent of global goods or services exports)



...while its intra-regional value chain integration is relatively strong given the level of trade integration.

Intra-Regional Trade in Value-Added, 2021

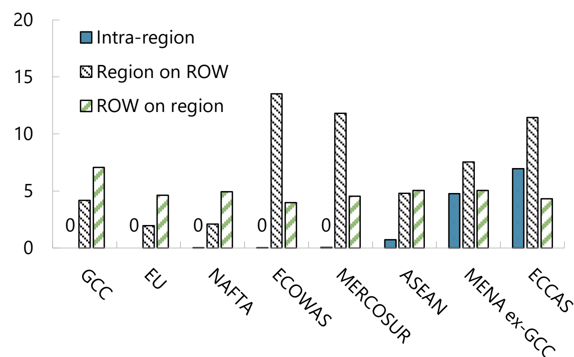
(Percent of intra-regional exports)



Intra-GCC import tariffs are zero, similar to other key economic areas...

Weighted Import Tariffs, 2020

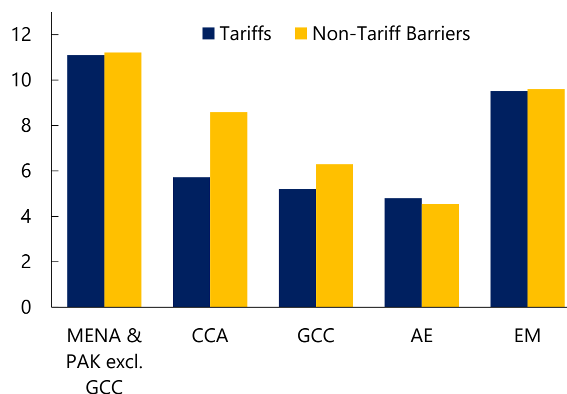
(Percent)



...while non-tariff measures generally are more prevalent than tariffs but relatively low compared with other regions.

Tariff and Nontariff Barriers

(Tariffs in percent; nontariff barriers as index values)



Sources: Atlas of Economic complexity; OECD-WTO Balanced Trade in Services (BaTIS); UNCTAD-Eora Global Value Chain Database; UNCTAD TRAINS; IMF Regional Economic Outlook – Middle East and Central Asia (April 2024) based on Fraser Institute Economic Freedom Index, World Bank, World Development Indicators, Logistics Performance Index, and Worldwide Governance Indicators database; and IMF staff calculations.

Annex III. Financial Integration in the GCC

By enhancing international and regional financial integration, the GCC countries aim to support their growth and economic diversification. This is accomplished by unlocking and scaling up financing for critical investments, including climate, as well as financing advance technology and human capital development, especially if investments are targeting high-growth and high-value added sectors. Against the backdrop of strong policy efforts in recent years, capital inflows to GCC have increased, although to a different extent across different types of capital and countries. More can be done to further enhance GCC financial integration.

Background

1. **Regional financial integration has been a long-standing objective in the GCC.** The GCC's economic progress has been marked by major steps towards greater integration, including the 1981 Unified Economic Agreement, the 2001 revised Economic Agreement, the 2003 Customs Union Agreement, the 2008 common market, and the 2009 establishment of the Monetary Council. These steps have set the stage for a single market, a possible monetary union, and highly integrated financial markets. Although the common currency remains a long-term objective, the initiative has encouraged member states to work together on monetary policies and regulations, leading to some degree of harmonization in this area.

2. **Increasing financial integration is also a cornerstone of the GCC's Vision reforms.** The Vision programs place a large emphasis on enhancing financial integration and becoming more attractive to foreign investors. Some countries also have quantitative targets regarding foreign investments. Saudi Arabia's Vision 2030, for example, aims to increase the contribution of FDI to GDP from 3.8 to 5.7 percent by 2030, while the Oman Vision 2040 targets net FDI inflow of 7 and 10 percent of GDP by 2030 and 2040, respectively.

3. **The GCC countries have launched several initiatives aimed at attracting foreign investment.** Policy efforts to enhance financial integration have accelerated in recent years:

- **Foreign investment laws** have been amended in several countries (Bahrain, Kuwait, Qatar, Saudi Arabia, the UAE), with Saudi Arabia allowing full ownership in some sectors in 2018, and the UAE increasing foreign ownership limits in a few sectors in 2018 and further raising it to 100 percent in most onshore sectors in 2021.
- **Government incentives** have also played an important role, including tax incentives (Kuwait), and special financial and economic zones such as the UAE's Abu Dhabi Global Market (ADGM) and Dubai International Financial Centre (DIFC), and several special economic zones in Bahrain, Oman, Qatar, and Saudi Arabia.
- **Dedicated agencies**, such as the UAE's Ministry of Investment or the Kuwait Direct Investment Promotion Authority, have been designated to attract FDI.

- **Business environment.** The attractiveness of the region was also enhanced by an improvement in the business environment, including through streamlined procedures and regulations.

4. Moreover, several initiatives aim to promote regional **financial integration,** including:

- **Harmonization of regulations.** The GCC has issued a number of unified legislations for specific financial sectors, such as insurance and anti-money laundering, thereby creating a more consistent regulatory framework across member states.
- **Standards setting.** The GCC Standardization Organization develops unified standards for various sectors, including financial services, helping to ensure a baseline level of regulatory coherence.
- **Integration of payment systems.** Payment systems have been integrated as the Gulf Payments Company established the Arabian Gulf System for Financial Automated Quick Payment Transfer (AFAQ) which enables fast and secure cross-border payments between member states.[1] Specifically, the AFAQ connects the Real-Time Gross Settlement Systems (RTGS) of each member country, facilitating instant interbank transfers. Also, the GPC promotes standardization of payment processes and infrastructure across the GCC, making cross-border transactions smoother and more efficient.

Recent Developments in Financial Integration

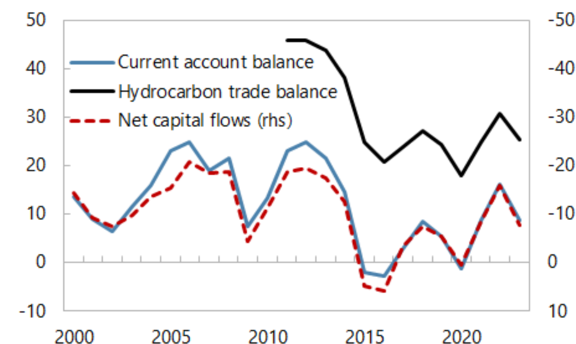
5. Net capital flows, including FX reserve accumulation, have been largely driven by the hydrocarbon balance, given the exchange rate peg and the lack of economic diversification (Annex III. Figure 1). Specifically, during periods of favorable hydrocarbon environment (e.g., mid-2000s, early-2010s, 2022-23), the current account surplus translated into the acquisition of foreign assets (including in the form of FX reserve accumulation), while shocks to oil and gas prices (e.g., 2015-16, 2020) were characterized by sizable deficits typically financed by the drawdown of FX reserves and SWFs assets. The ongoing economic diversification efforts, however, affected both the composition and the size of net capital flows. Specifically, compared with previous periods of elevated hydrocarbon prices, the most recent episode (2022-23) has witnessed a shift, with the current account surpluses increasingly 'invested' in other foreign assets (including by SWFs in some GCC) as opposed to reserve accumulation by the central banks (Annex III. Figure 1). Also, in addition to the hydrocarbon balance, the size of net capital flows is increasingly affected by elevated investment-related imports amid Vision reform implementation, as the latter necessitates an increase in capital inflows.

[1] The AFAQ is currently operational in Saudi Arabia, Bahrain, Kuwait, and the UAE, with Oman and Qatar expected to join soon.

Annex III. Figure 1. GCC: Net Capital Flows

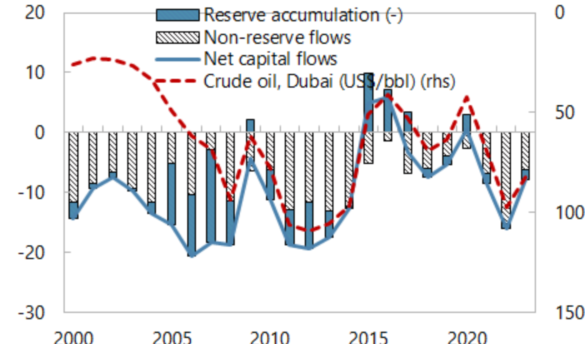
Net capital flows (including reserve accumulation) have been driven by the hydrocarbon balance….

GCC: Balance of Payments
(Percent of GDP)



…with surpluses leading to reserve and other foreign assets accumulation before 2015, and predominantly other assets in the most recent episode.

GCC: Net Capital Flows
(Percent of GDP)



Sources: World Bank Commodity Price Data, IMF WEO, IMF staff calculations.

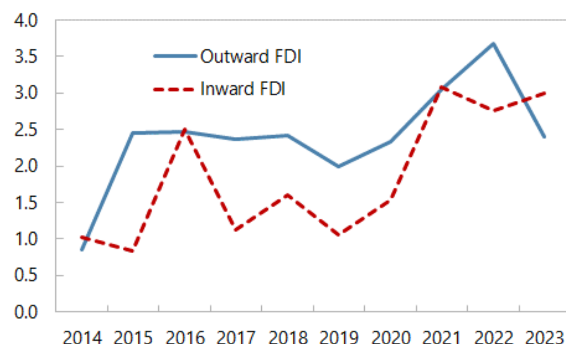
Note: Net capital flows do not include either flows in the capital account or Errors & Omissions.

6. Inward FDI has increased in recent years, albeit to a different extent across countries, supported by policy efforts (Annex III. Figure 2). Following moderate levels (1-1.5 percent of GDP) in the aftermath of the 2015-16 oil price shock, inward FDI has picked up (exceeding 2 percent of GDP on average between 2020-23) in the GCC (Annex III. Figure 2), supported by business-friendly reforms and policy initiatives aimed at attracting FDI. However, there are major differences across GCC countries, with the aggregate increase largely driven by the sharp acceleration in inward FDI in Bahrain, Oman and the UAE (around 5 percent of GDP between 2020-23 up from 2-3 percent of GDP between 2014-19), while the rest of the GCC continued to record modest inward investments (Annex III. Figure 2). Nonetheless, the recent sharp increase in the number of foreign investment licenses in Saudi Arabia indicates the potential for a pick-up in FDI in the coming period (IMF 2024a). At the same time, outward FDI has also increased in recent years, driven largely by Kuwait that invested a large part of the hydrocarbon revenue windfall abroad in the form of FDI, and the UAE that have been increasingly undertaking foreign investments in strategic sectors (e.g., mining and logistics in Africa) and extending support to other countries, including in the form of the largest-ever bilateral FDI agreement to develop real estate projects in Egypt (IMF 2024b).

Annex III. Figure 2. GCC: Foreign Direct Investment

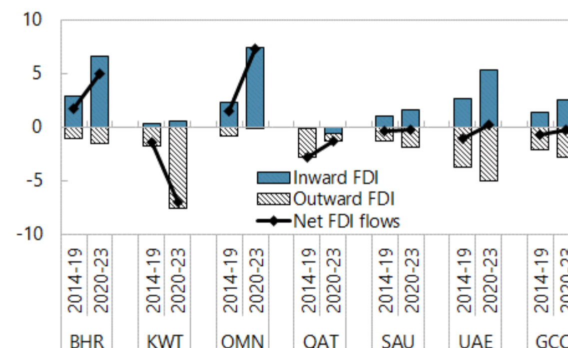
Both GCC inward and outward FDI flows picked up in recent years….

GCC: Inward and Outward FDI
(Percent of GDP)



…with increases in inward FDI driven by Bahrain, Oman, and the UAE, and in outward FDI by Kuwait and the UAE.

GCC: Net FDI Flows
(Percent of GDP)



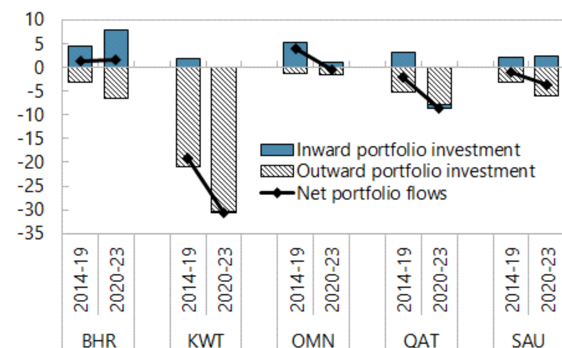
Sources: IMF WEO, IMF staff calculations.

7. Inward portfolio and other investments increased only moderately in recent years (Annex III. Figure 3). Specifically, inward portfolio investments increased slightly in Bahrain and remained broadly unchanged in the rest of the GCC during 2020-23. In 2024, however, the sizable international bond issuances and initial public offerings, including the secondary offering of Saudi Aramco, might result in a pick-up in inward portfolio investments across the region. U.S. investors, for example, have continuously increased their exposure to GCC debt and equity markets in recent years. Moreover, the region continues to be attractive to foreign investors amid reform implementation (Box 1). Other capital inflows have also remained modest. Foreign bank claims on the GCC, however, picked up in recent periods. In terms of outward investments, Kuwait and UAE used a part of their oil revenue windfall to further increase its portfolio investments abroad, including sizable purchases of U.S. long-term securities, while the sale of other foreign assets resulted in an inflow of capital in Kuwait.

Annex III. Figure 3. GCC: Portfolio and Other Capital Flows

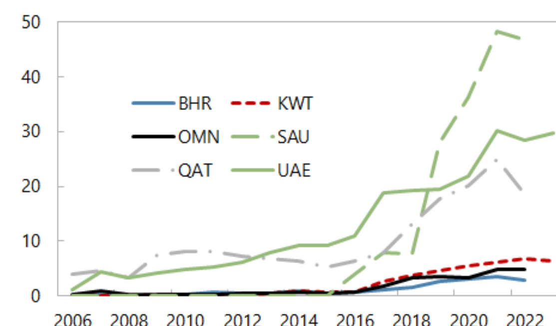
Inward portfolio investments during 2020-23 did not increase relative to 2014-19....

GCC: Portfolio Inflows and Outflows
(Percent of GDP)



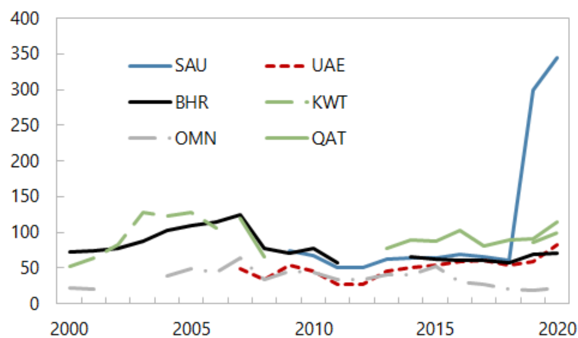
...with US investments in GCC equity and debt securities leveling off in 2022-2023...

U.S. Holdings of GCC Equity & Debt Securities
(EoP, billions of US$)



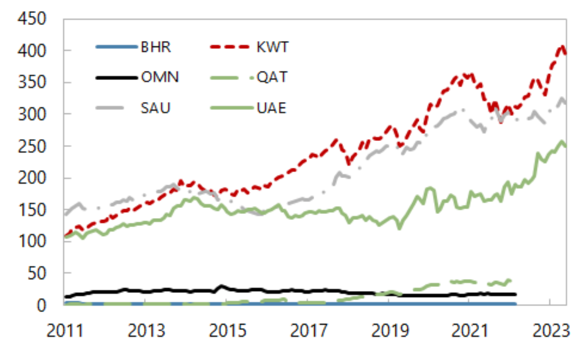
...amid major efforts to increase stock market capitalization.

GCC: Stock Market Capitalization
(Percent of GDP)



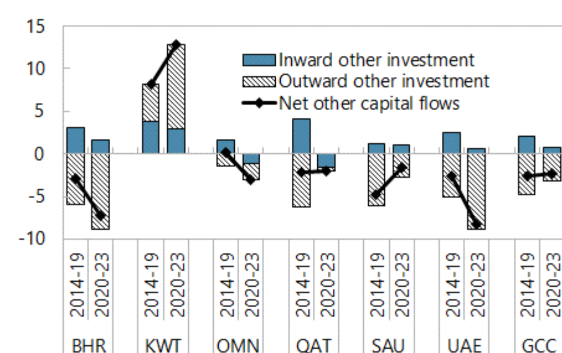
GCC outward portfolio investments into US long-term securities have increased by 50 percent since 2020.

GCC Holdings of U.S. LT Securities
(EoP, billions of US$)



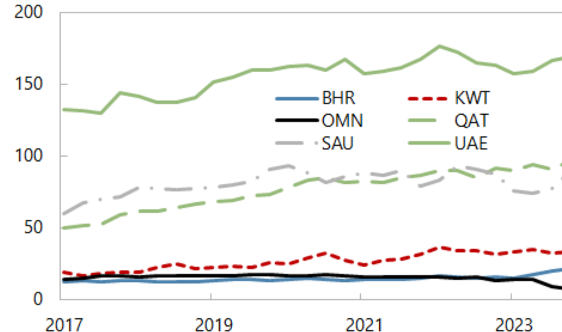
Net other capital flows were boosted by the sale of foreign assets in Kuwait...

GCC: Other Capital Inflows and Outflows
(Percent of GDP)



...while foreign banks' claims on the GCC picked up recently.

Foreign Banks' Total Claims on GCC
(EoP, ultimate risk basis, billions of US$)



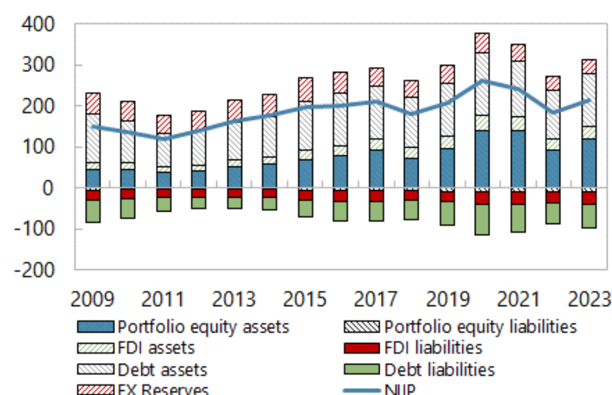
Sources: IMF WEO, World Bank, HAVER, and IMF staff calculations.

8. The net international investment position (NIIP) of the GCC has remained strong (Annex III. Figure 4). Specifically, the GCC's NIIP hovered around 200-250 percent of GDP in the early-2020s, with assets dominated by debt and portfolio equity assets, and liabilities consisting of debt and FDI liabilities (Annex III. Figure 4). However, there are large differences across GCC countries, with the NIIP ranging from above 500 percent of GPD in Kuwait to slightly negative in Oman (Annex III. Figure 4). Moreover, the composition also differs. Portfolio equity assets, for example, constitute a large part of foreign assets in Kuwait, Qatar, Saudi Arabia, and the UAE, while only modest in Bahrain and Oman.

Annex III. Figure 4. GCC: Net International Investment Position

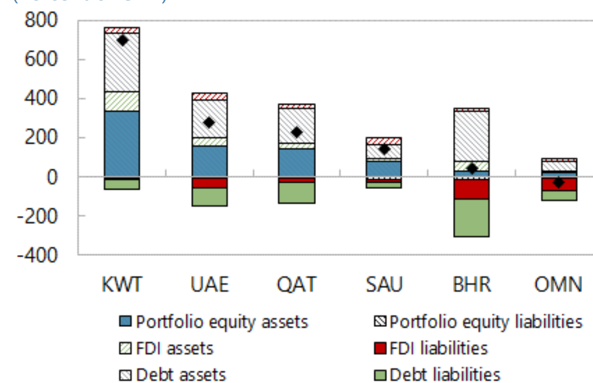
The GCC NIIP remains strong....

GCC: Net International Investment Position
(Percent of GDP)



...but there are large differences across GCC countries in terms of both the size and the composition of NIIP.

GCC: Net International Investment Position, 2023
(Percent of GDP)



Sources: Milesi-Ferretti (2024), IMF staff calculations.

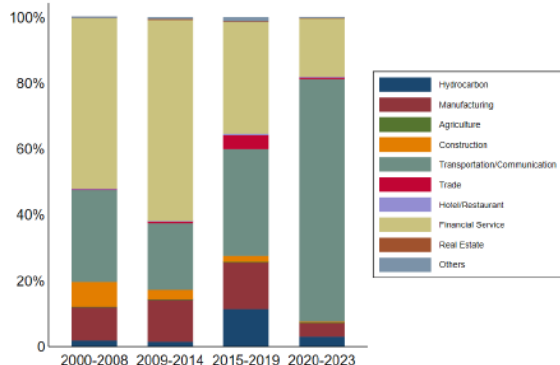
9. In line with the diversification efforts, the sectoral composition of inward investment has shifted away from the hydrocarbon sector (Annex III. Figure 5). In the past two decades, the composition of inward FDI has shifted from the hydrocarbon sector towards other sectors, especially financial services, transportation/communication, and manufacturing. Similarly, in addition to manufacturing, outward investments have increasingly targeted services, including transportation and communication, with the potential for technology transfer.

Annex III. Figure 5. GCC: Sectoral Breakdown of FDI

Inward FDI has focused on the services sector in recent years…

GCC: Stock of Inward FDI

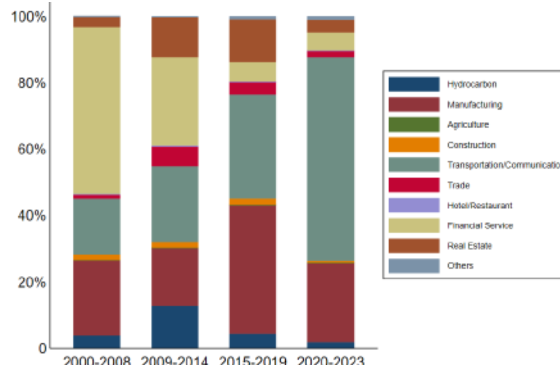
(Percent of total)



…while outward FDI targeted largely manufacturing and transportation/communication.

GCC: Stock of Outward FDI

(Percent of total)



Sources: Korniyenko and Xin (forthcoming).

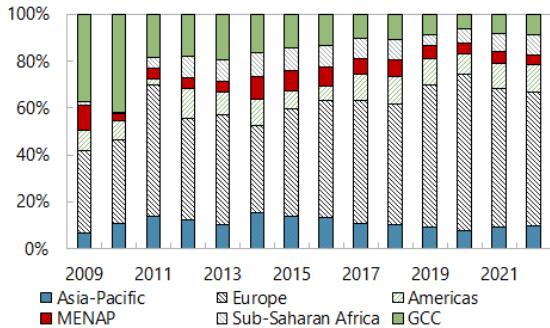
10. There has also been shift in the geographical composition of inward and outward investments (Annex III. Figure 6). Historically, inward FDI was dominated by investments by European countries (as reported by IMF CDIS statistics). In recent years, however, an increasing share of inward FDI originated from Americas and other GCC countries, with the latter highlighting the importance of intra-regional integration. Also, notwithstanding the dominance of Europe, the destination of outward FDI has shifted towards America, Asia-Pacific, and other GCC countries.

Annex III. Figure 6. GCC: Geographical Breakdown of FDI

The source of FDI inflows has slightly shifted from Europe to Americas in recent years….

GCC: Stock of Inward FDI

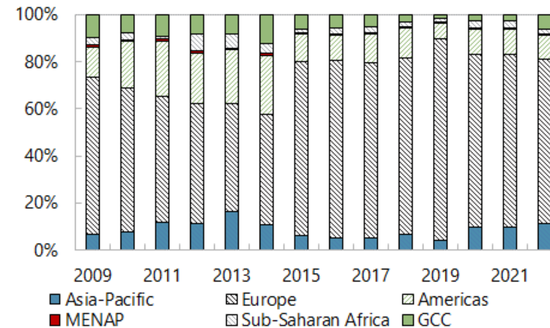
(By source region, percent of total)



…while outward FDI is increasingly directed to Asia-Pacific but remains dominated by Europe.

GCC: Stock of Outward FDI

(By target region, percent of total)



Sources: IMF CDIS, and IMF Staff calculations.

Implications for Growth and Diversification

11. Financial integration could enhance growth and economic diversification in several ways. There is a well-documented relationship between inward FDI and growth.[2] Specifically, FDI has the potential to boost growth by unlocking financing for investments, supporting innovation via knowledge spillovers and technology transfer, and creating high-skilled jobs, thereby providing an incentive for human capital development. Similarly, outward investments could also boost growth via technology transfer. Moreover, there is empirical evidence on the positive impact of inward FDI on economic diversification through the introduction of new technologies, production methods, and export markets. The impact on growth and diversification could be amplified if the investment focuses on high-technology sectors, as well as in the presence of strong institutions and business-friendly environment. Finally, increasing foreign investor participation in debt and equity markets could unlock financing for critical investments supporting economic diversification, while the related risks specific to asset classes, including from higher exposures to shifts in global investor sentiment should be monitored and contained through the continued implementation of sound macroeconomic policies.

12. Empirical evidence on the GCC also points to the potential growth-enhancing effect of financial integration. Focusing on the GCC, Elheddad (2021), for example, finds that resource-related FDI stifles economic growth, while non-resource FDI shows minimal impact, highlighting the importance of the sectoral allocation of FDI and contributing to the literature on the resource curse hypothesis. More recently, Korniyenko and Xin (forthcoming) find a positive relationship between inward non-hydrocarbon non-financial FDI and GCC growth, with a 1 percentage point increase in inward investment/GDP associated with a 1-1.2 percent increase in real GDP after 5 years (Annex III. Figure 7). They also emphasize the benefits of attracting investment in non-hydrocarbon non-financial sectors, given its potentially larger impact on growth, as well as the positive, albeit not significant, relationship between outward FDI and growth, highlighting the potential for technology transfer (Annex III. Figure 7). Finally, inward FDI is also positively associated with economic complexity, further highlighting the impact of investments on diversification.

Policy Implications

13. Policies should aim at targeting FDI in specific sectors. The attractiveness of the region for FDI investors could be enhanced by further improvement in the business environment, including human capital development. Also, in order to maximize benefits in terms of growth and diversification, policies should aim to direct FDI into high-technology sectors with relatively large spillovers into the domestic economy.

14. Portfolio flows would benefit from policies aimed at developing capital markets. Developing deeper and more integrated capital markets across the GCC would provide a wider range of financing options for businesses and governments, attracting more investment: (i) loosening limitations on foreign ownership of stocks and bonds in GCC markets would attract more international capital and boost overall market activity; (ii) establishing a pan-GCC stock exchange would increase

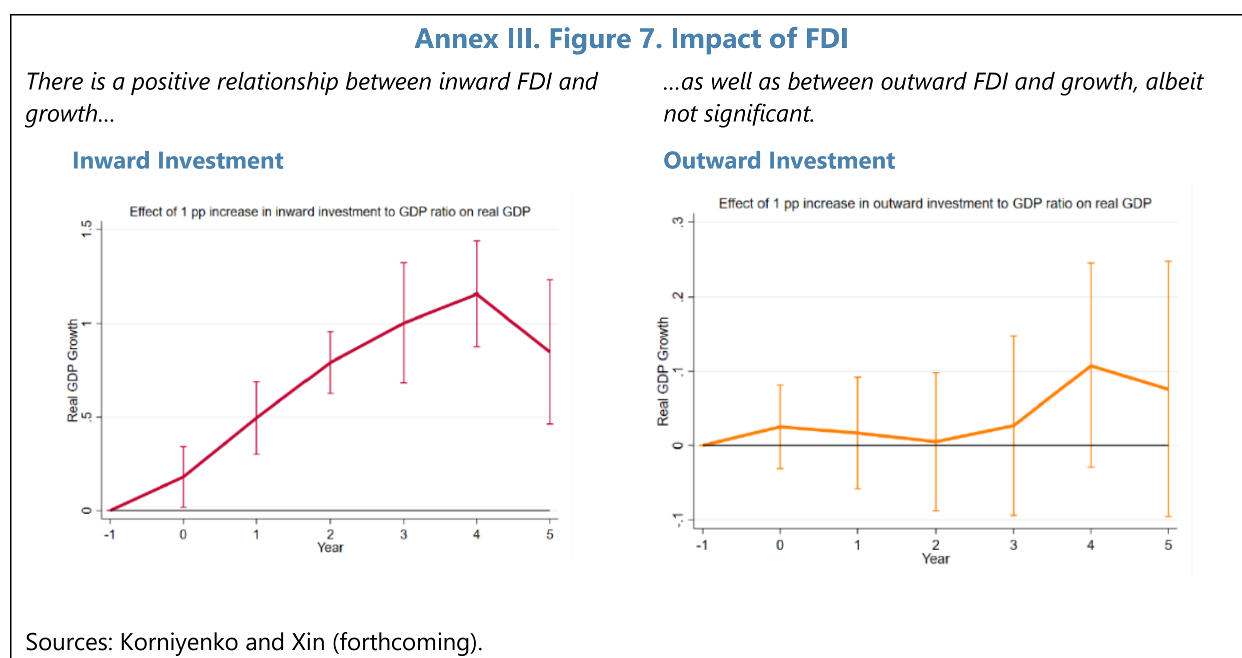
[2] For a detailed review of the literature, see Korniyenko and Xin (forthcoming).

liquidity, attract more investors, and provide a wider range of investment opportunities for businesses in the region; (iii) encouraging companies to list their shares on stock exchanges in other GCC countries would improve accessibility for investors across the region and strengthen regional capital markets; (iv) harmonizing listing requirements, disclosure standards, and trading rules across GCC markets would make it easier for companies to raise capital across the region and for investors to participate in different markets; (v) investing in modern trading platforms, clearing and settlement systems, and robust data dissemination is crucial to create an efficient and integrated capital market infrastructure; and (vi) encouraging the development of a strong investment research industry across the GCC would provide investors with better quality analysis and information, leading to more informed investment decisions.

Annex III. Figure 7. Impact of FDI

There is a positive relationship between inward FDI and growth…

…as well as between outward FDI and growth, albeit not significant.



Sources: Korniyenko and Xin (forthcoming).

15. Cross-border banking flows could be supported via further regulatory and administrative reforms. Streamlining regulations across member states for banking, insurance, and investment products would create a level playing field and boost cross-border financial activity. Also, loosening restrictions on bank licensing and allowing easier establishment of branches in other GCC countries would foster competition and regional financial networks. Finally, financial Innovation (Fintech and Virtual Assets) would enhance the efficiency and accessibility of financial services across the region: (i) Fintech solutions like mobile wallets and online payments can make financial services more accessible to a wider population across the GCC; (ii) innovative solutions can streamline cross-border transactions, lowering costs and making it easier for businesses and individuals to conduct financial activities across GCC countries; (iii) standardized technologies and platforms emerging from FinTech can promote interoperability between different financial systems in the GCC; and (iv) innovation can lead to the creation of new financial digital products and services, attracting investment across the region and fostering a more interconnected financial landscape.

16. A unified approach would enhance the pool of capital dedicated to sustainable projects, attracting a wider range of green investors. This could accelerate the development of essential green technologies and infrastructure across the GCC. Also, regional collaboration can help harmonize green finance standards and regulations, streamlining the process for project approval and implementation. This would incentivize green investments and foster a more attractive environment for both domestic and international green finance actors.

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