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Focus on GCC countries

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The Mediterranean: a sea of opportunity, but beware of the waves!

Editorial: A multi-faceted region

With the Eurozone recession refusing to let up, the outlook for businesses is worrying. Opportunities in Europe are melting away like snow in the sun, while one austerity plan follows another, making the situation even worse. The answer is to look elsewhere for growth, particularly from innovation and the emerging economies. Exporting might look simple on paper. For a small business, on the other hand, the lack of information about a target country and the absence of qualified personnel to supervise proceedings and safeguard the business against major risks like non-payment by customers, represent real barriers. Large scale exports to the emerging nations of Asia, Africa, or South America is therefore even more of a challenge. Yet very close to home lies a region rich in history and promise, where barriers are drawn by the sea rather than by politics. Though doubtlessly complex and sometimes risky, this region could well offer an injection of prosperity to offset ailing growth rates at home.

The Mediterranean region forms a crossroads between three continents: Europe, Africa and Asia. As a region, it is made up of almost thirty politically and economically heterogeneous nations, including not only those with coastlines around the sea itself, but others with close historic and economic links, with special reference to the nations of the GCC (the Gulf Cooperation Council).

In this paper we shall show that the nations of the GCC, like many Middle Eastern nations, have every reason to keep a close watch on events across the sea of which poets have sung for so long. We shall also examine the Mediterranean region in terms of the opportunities and risks it offers for businesses, and see how three distinct blocks have formed.

Our conclusions are simple. For a start, we have the 'Old Europe' block (France, Italy, Spain and Greece) which represents a centre of economic power, logistics and competence. Then comes the 'Future Champions' block of North African nations where potential is vast but growth is currently held back by political instability. Finally, we can identify a third block: the 'Asian Gateway' nations, consisting of Turkey and the GCC countries, especially Saudi Arabia and the United Arab Emirates. These countries offer an important interface towards Asia, the continent where potential demand is likely to be highest over the next ten years. So why go further afield in search of growth when it is to be found next door?

Table 1: Country risk and GDP forecasts

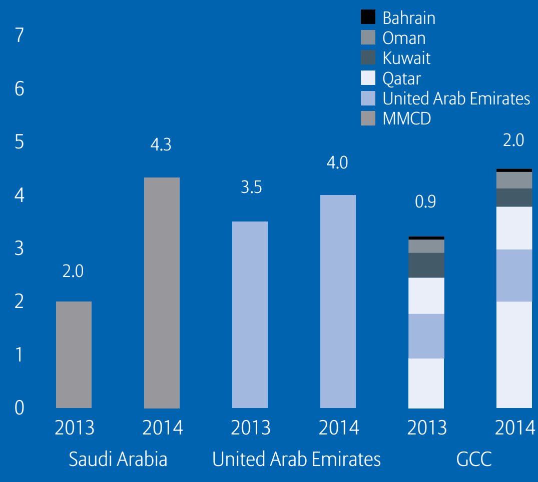
	Country risk	GDP forecasts	
		2013	2014
France	AA1	0.2	0.6
Italy	AA3	-1.8	0.3
Spain	AA3	-1.4	0.1
Turkey	C3	3.3	4.0
Saudi Arabia	BB1	4.0	4.5
United Arab Emirates	BB1	3.5	4.0
Egypt	D4	2.5	4.0
Greece	AA4	-4.2	-0.3
Algeria	C3	3.5	4.5
Qatar	BB1	4.5	5.0
Kuwait	BB1	4.0	3.0
Morocco	B2	4.5	4.5
Libya	D4	-5.0	5.0
Oman	BB1	5.0	6.0
Croatia	C4	-0.5	1.0
Syria	D4	-14.0	-10.0
Slovenia	AA3	-3.0	-0.5
Tunisia	B3	3.0	4.0
Lebanon	D4	2.0	3.5
Bahrain	B3	3.5	3.5
Cyprus	AA4	-8.5	-4.5
Albania	D4	1.8	2.5
Malta	AA2	1.0	1.2
Montenegro	D4	0.7	2.0

Source: Euler Hermes

A. The GCC countries: growth built on solid foundations

The GCC countries recorded sustained growth throughout 2011 and 2012 (+7.2% and +6.0% respectively), though rates for 2013 and 2014 will be slower (+4.0% and +4.3%). This downturn, mainly due to lower global demand (+2.2% in 2013), will affect everybody: Saudi Arabia and the United Arab Emirates (the two main protagonists in the GCC) should see growth of +4.0% and +3.5% respectively in 2013, and of +4.5% and +4.0% respectively in 2014. The financial foundations of the GCC, however, remain satisfactory (fiscal and budgetary balances in surplus and large foreign exchange reserves). In the medium term, diversification of the economy should also lead to: (i) the GCC playing a greater role in global trade outside of petroleum; (ii) growth that is more stable and less sensitive to external shockwaves. In the short term, the main risks include a deterioration in the geopolitical situation (with special reference to a possible worsening of the Syrian conflict), a slow-down in emerging demand and a drop in oil prices.

Graph 1: GDP forecasts



Source: Euler Hermes

A solid financial and trading background.

Thanks to their strategic role as the world's leading oil exporters, the GCC countries benefit from a strong trading and financial position. Saudi Arabia registered a trade surplus equivalent to 35.6% of GDP in 2012; that of the UAE came to 32.4% of GDP. Growth in oil production is likely to slow down in 2013 because of reduced demand from the United States (where shale gas production has expanded rapidly) and from China (where growth rates have fallen). This will lead to a slight drop in these statistics, but this should be partly offset by a rise in non-petroleum exports. The same applies to current account surplus, which is likely to fall from 20.2% to 14% of GDP in Saudi Arabia and from 7.5% to 4.8% of GDP in the UAE but remain perfectly satisfactory. The budget surplus of both countries, which was impressive in 2012 (+15.9% for Saudi Arabia and +6.3% for the UAE), is also likely to fall in 2013 and 2014 though neither country risks entering the red. The break-even prices for the oil that fuels both countries' consolidated budgets remained low in 2012: $78/barrel for Saudi Arabia and $63/barrel for the UAE. Though these figures are likely to rise in 2013 (to $84 for Saudi Arabia and $66 for the UAE according to the IIF), they will remain well below the current market price (around $108/barrel as of September 2013).

Proactive policies to sustain growth.

In Saudi Arabia, public expenditure will provide a powerful boost to growth in 2013 and 2014.
The objective of the government's current five-year plan (2010-2014) is to develop and improve infrastructure and invest in human capital through education and training. Furthermore, following the events of the Arab Spring in 2011, the Saudi government has also announced two major programmes to improve housing and create employment. In the UAE, major progress has already been made towards developing infrastructure and improving the business climate, though much remains to be done in the field of education. The Saudi government is currently engaged in integrating the Saudi people (who make up only 11.5% of the total population) into the labour market by encouraging training to meet economic needs and by limiting access to foreign labour.

Table 2: Financial solidity indicators

Saudi Arabia	2011	2012	2013	2014
GDP growth (% change)	8.5	6.8	4.0	4.5
Inflation (%, end-year)	3.6	3.7	3.1	3.0
Fiscal balance (% of GDP)	11.6	15.9	9.4	4.1
Public debt (% of GDP)	5.4	4.1	4.5	4.8
Current account (% of GDP)	23.7	20.2	14	9.1
External debt (% of GDP)	13	12.9	12.7	13

UAE	2011	2012	2013	2014
GDP growth (% change)	3.9	4.4	3.5	4
Inflation (%, end-year)	0.8	1.1	3	1.9
Fiscal balance (% of GDP)	6.4	6.3	4	1.9
Public debt (% of GDP)	17.8	20.4	23.4	25.6
Current account (% of GDP)	14.6	7.5	4.8	2.7
External debt (% of GDP)	42.9	40.8	45	44.1

Source: Euler Hermes

Economic diversification and trading partners.

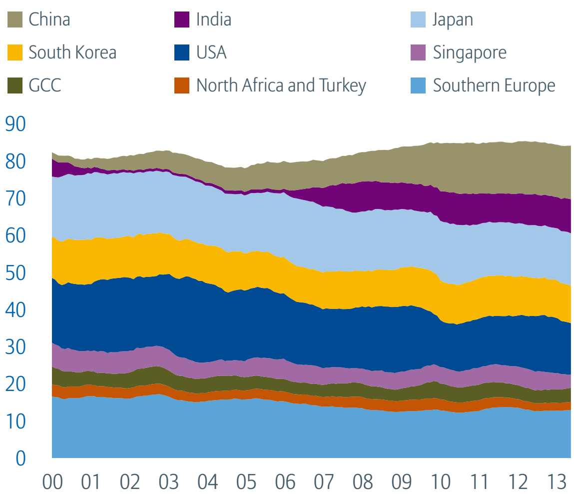
Over the last decade, the leading GCC countries have made a great effort to diversify their economies and reduce their dependence on oil. The contribution of petroleum products to Saudi Arabia's total GDP has fallen from 34% in 2000 to 21% in 2012; in the UAE this figure has dropped from 47% to 33%. Dubai has become the region's main service centre while Abu Dhabi is now relying increasingly on manufacturing, petrochemicals and renewable energy. In the same way, the GCC countries have also succeeded in diversifying their trading partners (i) by focusing increasingly on Asian brands, and (ii) by reducing petroleum exports to developed nations in favour of non-petroleum exports. By way of example, only 7% of Saudi Arabia's exports were destined for the United States in 2011 against 12% in 2000, while 11% went to China compared to 4% in 2000. Though Asian prospects are currently falling away as a result of a slow-down in the Chinese economy, other opportunities could well emerge in the neighbouring nations of North Africa (especially Morocco), in Turkey where demand is certain to grow, and also in the nations of Southern Europe, which represent a strategic gateway for the GCC's non-petroleum exports and a trampoline towards the rest of Europe.

Short term risks: major drops in oil prices, a slow-down in emerging demand, and the geopolitical situation.

The main risk to economic growth in the GCC countries lies in a major fall in the price of oil (which remains the area's main source of income), and this could well occur if world demand drops, especially as non-OPEC nations have significantly increased their oil production. Nevertheless, even in the event of a shock fall in oil prices, economic growth in the main GCC countries would suffer only a slow-down and not a reversal, since the alert threshold ($84 for Saudi Arabia) is well below today's market price for oil ($108).

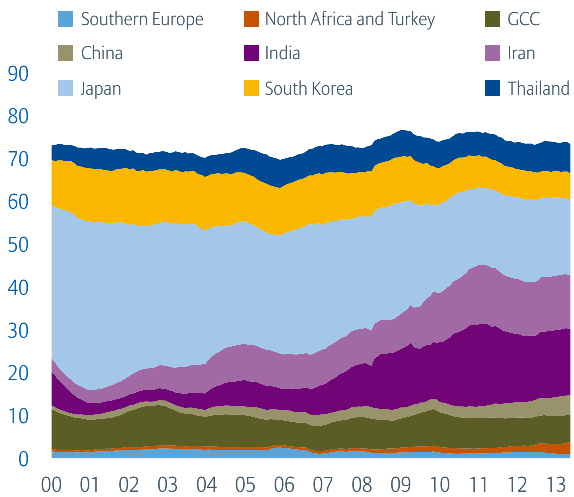
A down-turn in emerging markets, particularly in Asia, represents a second possible risk as these countries have become the main trading partners of the GCC countries for non-petroleum products. Finally, though Saudi Arabia and the UAE currently enjoy good political stability, the level of geopolitical risk in these countries remains high as a result of troubles across the region (the aftermath of the Arab Spring and the Syrian conflict in particular).

Graph 2: Exports diversification (Saudi Arabia)



Source: Euler Hermes

Graph 3: Exports diversification (UAE)



Source: Euler Hermes

To be watched:

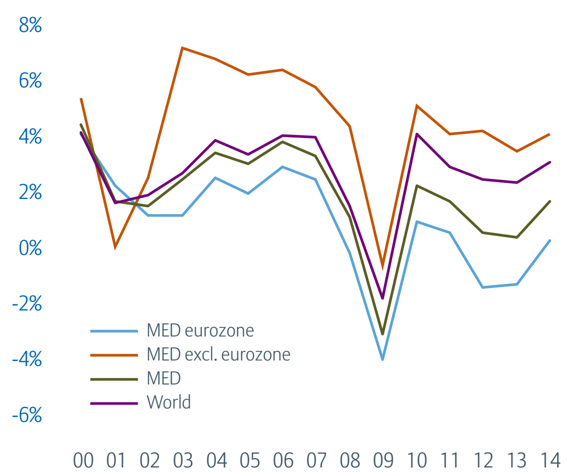
- Demand from emerging markets.
- The price of oil.
- Developments in the Syrian conflict.
- Political measures to promote growth.

B. The Mediterranean: three speeds of growth

The Old Europe, the Future Champions and the Asian Gateway: three blocks around the same sea. There are three distinct economic blocks among the nations of the Mediterranean and the associated region. Firstly, there is the 'Old Europe' block, made up primarily of France, Italy, Spain and Greece. This block can be characterised as a centre of (1) economic prosperity, given its level of wealth, (2) logistics, given its excellent infrastructure and (3) competence, given the high level of qualification of its workforce. Secondly, we have the 'Future Champions' block (*Abtal* in Arabic) composed of the North African nations, whose potential for growth is great, but currently limited by political instability. In our opinion, the Moroccan economy will lead this block's growth cycle, partly because Morocco has already proved its resilience during the global economic crisis and the political crisis that swept the region, and partly because the factors needed for stable, long-term growth are already being reinforced (improved infrastructure and a focus on education and innovation). Finally, there is the 'Asian Gateway' block consisting of Turkey and the GCC countries, especially Saudi Arabia and the United Arab Emirates. These countries form a trade interface towards Asia, the continent with the greatest potential demand for the next ten years. The GCC countries have already established structurally significant links with Asia in raw materials trading, and Turkey is following close in their footsteps thanks to rapid improvements in its economy in terms of competitiveness and trade diversification. Turkey therefore has an excellent chance of becoming another interface between Europe and Asia. Other nations outside these blocks also have good potential for growth, but cannot easily be attached to any geopolitical grouping.

Things look brighter south of Southern Europe. In 2013, the economy of the Mediterranean region should enjoy growth of around +0.4%, though this rate is poor compared to the region's average for the last decade (+2%) and to the global average (+2.3%). This figure, however, hides significant variation between the nations of the Eurozone and the other countries of the region: the latter, in fact, should achieve a far better average growth rate of +3.5%. Growth outside the Eurozone will be driven mainly by the 'Asian Gateway' block (Turkey, Saudi Arabia and the UAE), and by the 'Future Champions', with Morocco showing the greatest resilience. Prospects for 2014 are more favourable: the entire Mediterranean region should return to growth, encouraged by the gradual resolution of the Eurocrisis and by the global recovery. It is true that the south of Europe will continue to bear the scars of the present crisis, with growth in 2014 limited to +0.5%, some three times lower than the long-term average, but growth in the rest of the region is likely to accelerate to +4.1% (+4.5% over the medium-long term). Bearing in mind this encouraging performance by the nations outside the Eurozone, greater integration across the entire region, especially by the formation of stronger trading links, can only have a positive effect on growth.

Graph 4: Comparative regional growth

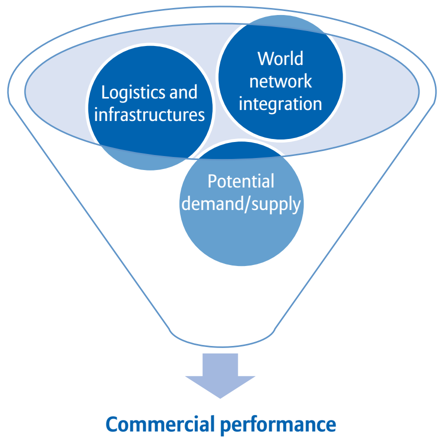


Sources: IHS Global Insight, Euler Hermes

C. A region of opportunities

An ideal trading position. Having an opening onto the sea gives an advantage in terms of international trading, as it encourages exchanges. When combined with adequate export infrastructures (construction of ports, improvement of logistics), and a competitive effort on the part of the economy, this can have a lasting effect on development.

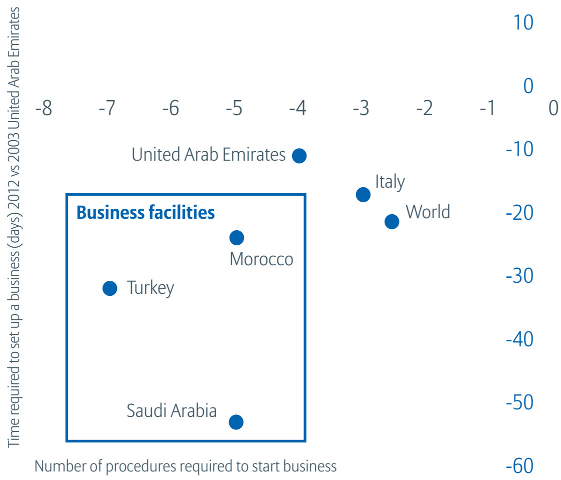
Graph 5: Three key points to improve commercial performance of the region as a whole



Source: Euler Hermes

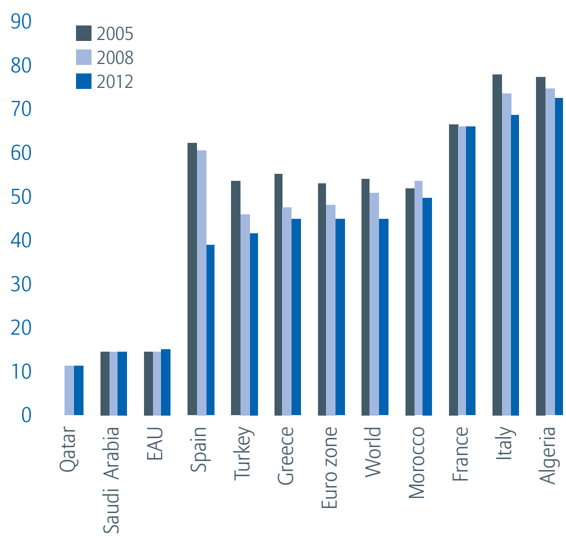
A more favourable business climate. In addition to these rather satisfactory micro and macro economic factors, these countries gain an advantage from an improvement in the situation regulating the terms and conditions of loans, which favours dynamism in the private sector. Since 2005, creation of businesses has been dynamic in the majority of countries in the MENA region, and has been accompanied by the creation of many jobs, supported by private investments. For the future, the private sectors in MENA region countries will have to strengthen themselves thanks to (i) an improvement in the business climate and (ii) funding terms as well as (iii) a favourable tax regime and (iv) the pursuit of privatisation. However, efforts to diversify production will be necessary in order to guarantee lasting investment dynamics.

Graph 6: Administrative requirements for the creation of businesses



Sources: Euler Hermes, World Bank

Graph 7: Tax, % business profits

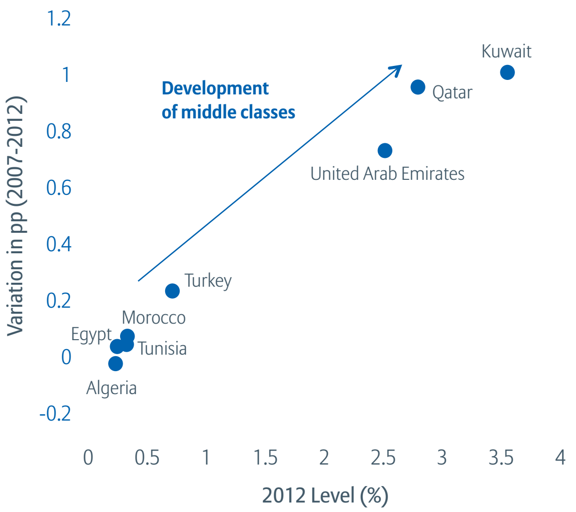


Sources: IMF, Euler Hermes

The emergence of sectors: a sequential but necessary development. Two sectors will accompany this strengthening of perspectives: on-line construction with development of infrastructure, and transport as a further encouragement for trade. Public and private joint ventures will play a leading role, encouraging development of the construction sector with projects like those carried out in Morocco (road system) and in Turkey (railway system) - see box. The strategies favouring development of air transport particularly reflect the will to strengthen the economic and trade influence of the region's stakeholders, following the example of the United Arab Emirates *(Emirates)* and Turkey *(Turkish Airlines)*. The sectors linked to consumer goods, in particular cars, will benefit as a result thanks to the consequent adjustments and to expansion of the middle classes. In fact, while the Northern Mediterranean countries continue to see a decline in the car market, the prospects are much more favourable in the United Arab Emirates, in Saudi Arabia, in Turkey and in Morocco. In the two GCC states, sales should increase in 2013 by +5% and +8%, respectively. In Turkey and Morocco the markets are small (embryonic in the case of Morocco), but their potential is clear thanks to the dynamic demand. The number of cars sold will rise by +4% to 600,000 in 2013 in the case of Turkey, and by +10% to 132,000 in Morocco.

In the end, whether it be construction or transport, the needs are there for countries that already have the know-how. In Saudi Arabia, for example, over the next five years projects in the construction sector will rise to a value of 613 Bln USD, of which 17 billion for construction of a Metro in Mecca through a tender issued by the city authorities. Saudi Arabia is the largest market in the Middle East in terms of construction. The construction sector occupies second place and provides 8% of the total GDP. In terms of transport, you only have to look at air transport. The Turkish example highlights the basis for this progress: a domestic market of 70 million inhabitants with solid economic growth, strong competitiveness with respect to the traditional European airlines coupled with lower running costs, an ideal geographical location within Europe and Asia and a dynamic national company. The next few years will all continue in the same vein. For example, Turkish Airlines, which increased its capacity by +24% in 2012, is looking at 90 million passengers for 2020 (39 million in 2012) thus providing itself with the resources to achieve its ambitions, witness the recent order for 117 A320 aircraft worth 9 billion dollars each (without mentioning the plans for an airport with a capacity of 150 million passengers, at a cost of 7 billion dollars).

Graph 8: Sale of cars for private use (per head)



Sources: Euler Hermes, OICA

D. There is no tsunami on the horizon, but the seas are still rough: a guide is essential when trying to get into these markets

The economic situation remains difficult for businesses: the risk of failure is significant. In 2012, the level of failure remained high for the above regions as a whole. Greece and Spain registered failure levels that were more than double those of 2008. Italy and Turkey still remain well above their pre-crisis levels (over 50%). France and Morocco are in a better position, but the risk remains, with latest statistics still being higher than figures for 2008. These figures are even more alarming given that the current trend means no reversal can be expected in 2013. More notably, Greece and Spain should record two-figure rises (10% and 40%).

Table 3: Regulation of insolvency and deciding factors

	Business facilities	Regulation of insolvency		
		Period (years)	Cost (% value of asset)	Recovery rate (cents per dollar)
Algeria	152	2.5	7	41.7
Saudi Arabia	22	2.8	22	28
Bahrain	42	2.5	10	66.2
Egypt	109	4.2	22	17.6
Kuwait	82	4.2	10	31.7
Morocco	97	1.8	18	35.1
Turkey	71	3.3	15	23.6
Tunisia	50	1.3	7	52
MENA average	91.3	3.3	13.3	34.5
OECD average	29.3	1.7	8.8	70.6

Sources: World Bank, Euler Hermes

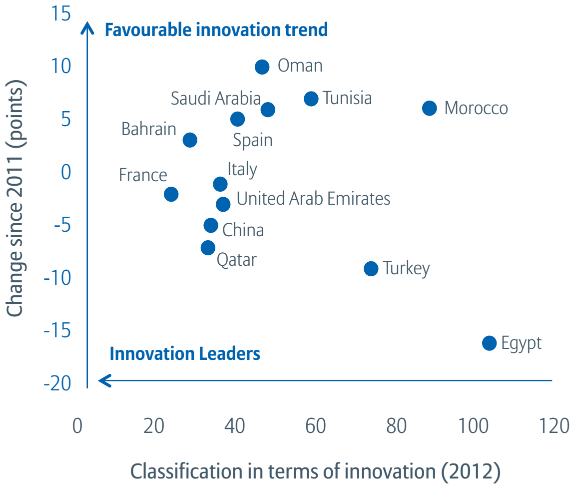
The prospects are good, but the risk of backsliding remains high.

In North Africa the risks are essentially political, and relate to the business climate. If an economy is to perform well, it requires a stable political context. The drawn-out Arab Spring now seen in many countries is increasing the risk of contagion for adjacent countries, and the aftermath of the political crisis threatens to be long-lasting, particularly in Libya and Syria. Moreover, the MENA countries as a whole represent a structurally weak business climate. The recovery rate in that region remains half that of the OECD countries, while costs and resolution times remain approximately twice the OECD average.

Efforts need to be made in terms of innovation and employment.

While the foundations necessary for durable growth are clearly present, efforts still have to be made towards innovation plans. Evolution of the situation in recent years has undoubtedly been favourable, but the determining factors (expenditure in R&D) are still a long way from those of world centres of excellence (OECD countries). In the medium term, this delay will without doubt be an advantage for the European countries in the region, as they are more advanced in this regard.
This will encourage the creation of a chain of value at Mediterranean level, in which all the sub-regions will be stakeholders: Southern Europe as a centre of competence and logistics, Morocco and Turkey as growing industrial powers, the GCC countries both as a cross-roads and financial centre. Moreover, the majority of the Mediterranean countries suffer from unemployment, particularly among young people, which is one of the main factors weakening the social pact in these large economies. Finally, a true industrialisation process will be the beating heart of this strategy of inclusive knowledge, and here again European, and especially Italian, industry will know how to take control of an attractive cost of labour and level of human resources to produce, transform and re-export products throughout the region.

Graph 9: Innovation rate



Sources: Insead, Euler Hermes *Index calculated based on the capacity of the economy to put into place innovative projects, in terms of institutions, human resources, infrastructures, the business climate, as well as on the local know-how and number of creative projects.

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