S&P Global
Ratings

Emerging Markets:

MENA Sovereigns, Corporates, And Banks Enter A New Chapter As COVID-19 Concerns Linger

Sept. 7, 2021

Key Takeaways

- **Key Middle East and North African (MENA) countries' greater reliance on energy exports and travel and tourism meant last year's regional economic loss closely tracked the world composite.** Regional growth started to rebound in third-quarter 2020, but what seemed to be a sharp recovery path has been thwarted by subsequent virus waves. The pace of rebound is insufficient to bring these economies back to their prepandemic GDP trajectories by 2024.
- **Hydrocarbon endowments are a key differential between Gulf Cooperation Council (GCC) and North African sovereigns.** Weak fiscal positions continue to weigh on North African countries, while GCC sovereigns' accumulation of high levels of government assets support both their fiscal and external positions. External imbalances remain a concern for Egypt. Meanwhile, Qatar's sizeable external financing needs reflect the funding profile of its banking sector. Governments have, to a large extent, provided stability; however, political institutions are still developing, and decision-making processes lack transparency and remain centralized.
- **S&P Global Ratings sees gradual recovery across most industries, but corporates remain cautious.** We expect continued pressures in some corporate sectors, particularly tourism and aviation, with a gradual recovery in certain real estate segments. Stronger oil prices are a key catalyst for the GCC region. Improving price trends are supportive for operating conditions in most segments of the larger oil, gas, and commodities sectors--including contract renewals in oil field services.
- **Most MENA banks have remained resilient despite the pandemic's economic shock.** We expect credit losses to peak across most of the region in 2021 and gradually trend down to historical values over 2022. However, we anticipate that nonperforming assets will linger in some countries due to idiosyncratic factors. These include a sluggish economic recovery due to higher tourism dependance in Egypt and Morocco and intensifying political unrest in Tunisia. GCC banks' performance should improve as the rise in oil prices since last year supports local economies.

CONTACTS

Satyam Panday
New York
+1-212-438-6009
satyam.panday
@spglobal.com

Trevor Cullinan
Dubai
+971-4372-7113
trevor.cullinan
@spglobal.com

Mohamed Damak
Dubai
+971-4372-7153
mohamed.damak
@spglobal.com

Timucin Engin
Dubai
+971-4372-7152
timucin.engin
@spglobal.com

Jose Perez Gorozpe
Madrid
jose.perez-gorozpe
@spglobal.com

CONTENTS

Macroeconomic Environment

MENA Growth Prospects Are Governed by The Virus, For Now

ECONOMIST

Satyam Panday
New York
+1-212-438-6009
satyam.panday
@spglobal.com

RESEARCH CONTRIBUTOR

Debabrata Das
Mumbai

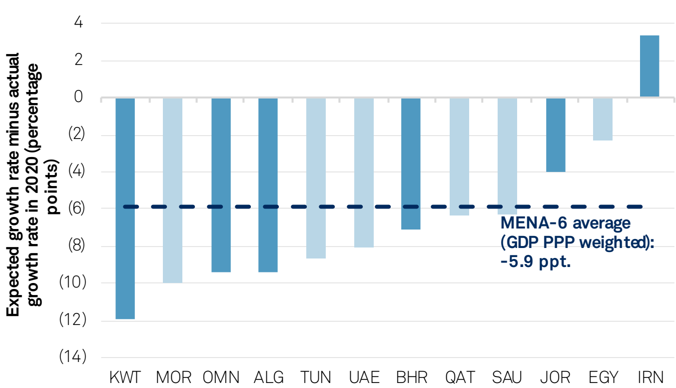
Editor's Note: The views expressed in this section are those of S&P Global Ratings' economics team. Although these views can help to inform the rating process, sovereign and other ratings are based on the decisions of ratings committees, exercising their analytical judgment in accordance with publicly available ratings criteria.

Much like the global economy, the six countries in the MENA region profiled in this report (MENA-6: Egypt, Morocco, Qatar, Saudi Arabia, Tunisia (no published rating), and the United Arab Emirates [UAE; no published rating]) are still operating in the shadow of the COVID-19 pandemic[1].

The MENA-6's greater reliance on energy exports and travel and tourism meant the region's economic loss last year--as measured by real GDP growth shortfalls--closely tracked the world composite (and compared to the emerging markets composite). Although the MENA-6 didn't see a larger contraction than global peers, the growth shortfall--defined as the overall loss of growth experience (i.e. growth underperformance relative to expected growth)--was 5.9 percentage points (ppt); versus 6.7ppt for the world and 5.3 ppt for the broader MENA region excluding fragile and conflict-affected countries[2] (see chart 1). All countries in the region besides Iran, which had a very low bar to begin with, experienced growth shortfalls in 2020[3].

Chart 1

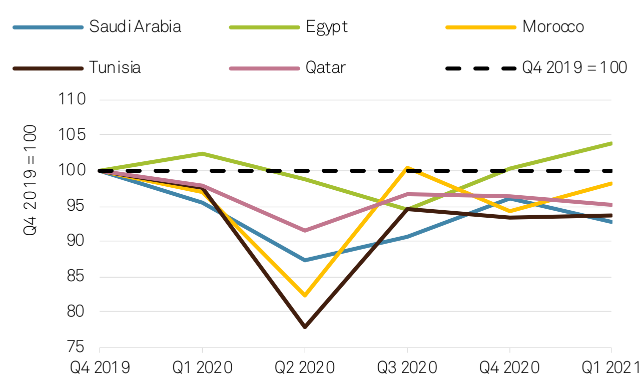
Growth Shortfall in 2020 (Selected MENA Countries)



Note: Egypt fiscal year is July-June; Iran fiscal year is April-March. Source: Oxford Economics, IMF, S&P Global Economics.

Chart 2

Egypt Already Surpassed Prepandemic Output Levels



Source: Central statistical office of each country, S&P Global Economics.

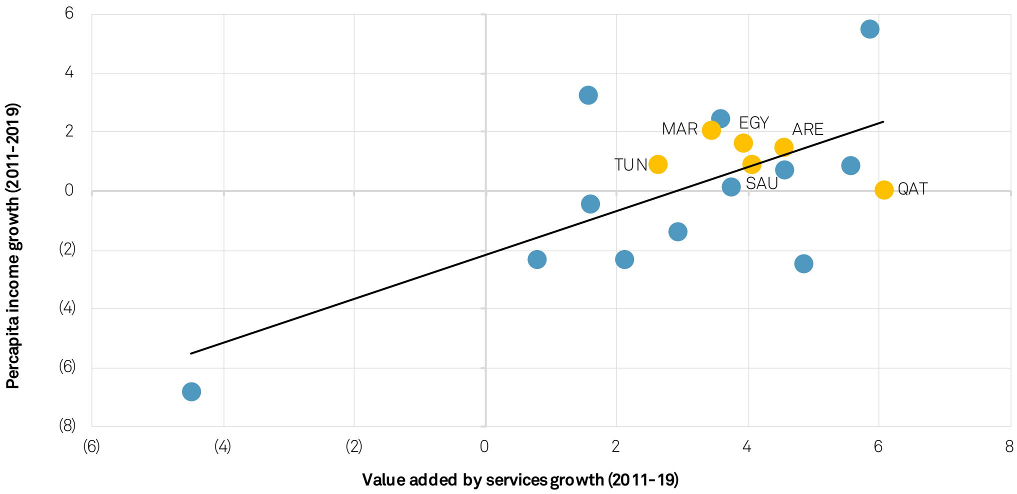
Regional growth started to rebound in the third quarter following a sharp contraction in first-half 2020 (see chart 2). However, what seemed like a sharp recovery path has been thwarted by subsequent virus waves (see chart 4). The rebound in oil prices to more than 10% above the fourth-quarter 2019 average has helped the recovery, but people-facing industries like travel and tourism remain subdued. Notably, touch sensitive service sectors such as accommodation and food services, transportation, and entertainment are still struggling. Activities related to hotels

[1] Information on sovereigns on which we do not publish ratings comes from publicly available sources.
[2] Composite numbers use weighted average of growth shortfall where the weights are GDP-PPP share of the total. Egypt is reported in fiscal year (July-June).
[3] Following a two-year recession, figures from the central bank show the economy fared significantly better-- despite continuing to grapple with COVID-19 ramifications-- as the oil sector expanded by 11.2% (albeit from a low baseline).

and restaurants were 26% below prepandemic levels in Egypt as of first-quarter 2021, 57% below in Morocco, 44% below in Tunisia, and 19% below in Qatar[4]. In the past decade, service sector spending growth (private and public sectors combined) has tended to be an important driver of income growth in the region (see chart 3), so it's important that the effects of the pandemic fade.

Chart 3

The Services Sector (Private and Public Combined) Remains An Important Driver Of Growth In MENA Countries

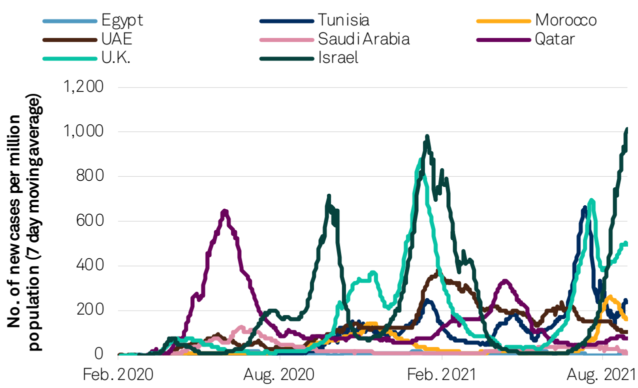


Source: World Bank (WDI), S&P Global Economics.

Vaccine drives have been uneven in the region, with splits evident by per capita income classification (as defined by the World Bank). Among the MENA-6, high-income economies Qatar, Saudi Arabia, and the UAE are ahead of the pack in vaccination rates, approaching so-called herd immunity (70%-80% of the population vaccinated), while lower-middle income economies Egypt, Morocco, and Tunisia remain well short (see chart 5).

Chart 4

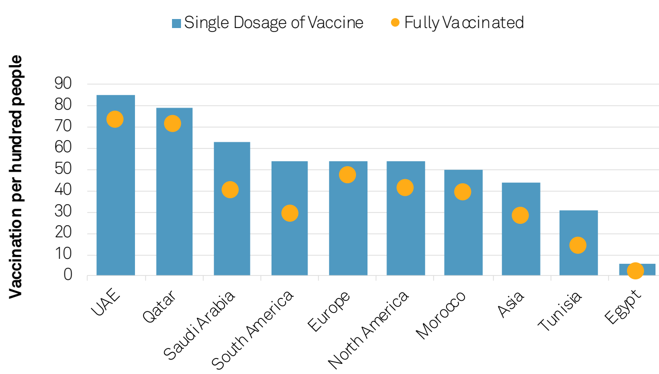
Daily New Confirmed COVID-19 Cases Per Million



Data as of Aug 30, 2021. Source: Ourworldindata.Org, S&P Global Economics.

Chart 5

Vaccination: Middle East Countries Are Well Ahead



Data as of Aug 30, 2021. Source: Ourworldindata.Org, S&P Global Economics.

[4] Department of statistics (each country).

Egypt stands out with under 4% of its population vaccinated, which is well below comparable lower-middle income countries around the world. However, virus flare ups in Egypt have also been tamer in comparison, and it is the only MENA-6 country that escaped economic contraction during the pandemic. This is because the drag on the tourism sector (12% of 2019 GDP) was more than offset by growth in non-tourism sectors, led by both private and government consumption. Remittance receipts (8.2% of GDP) were up a surprisingly strong 10.5% in 2020 (versus a 1.6% drop in low- and middle-income countries), and policy response from the government was swift to counteract the fallout from the pandemic. As of first-quarter 2021, Egypt was already 4 ppt above its fourth-quarter 2019 GDP level (see chart 2).

Despite this, a year and a half into the pandemic, virus mutations and vaccination rates continue to govern economic prospects across the globe. Growth normalization is not assured even in countries where infections appear to be dormant if the virus is circulating elsewhere, and there remains exceptional outlook uncertainty.

The MENA-6 economies are projected to expand 2.5% this year followed by a slightly above trend 3.2% on average in the following three years (see table 1). The bumper harvest and commodity price recovery in the year to date have been better than anticipated for Morocco and the three Middle Eastern nations, respectively, but the ongoing pandemic continues to provide downside risk for these countries and the region overall.

Table 1

Real GDP Growth

	2018	2019	2020	2021f	2022f	2023f	2024f
Egypt	5.3	5.6	3.6	2.5	4.8	5.4	5.6
Morocco	3.2	2.5	(6.7)	5.0	3.9	3.6	3.6
Qatar	1.2	0.8	(3.6)	1.8	2.2	1.7	1.4
Saudi Arabia	2.4	0.3	(4.1)	2.0	2.7	2.2	2.2
Tunisia*	2.7	1.0	(8.6)	3.8	2.4	2.0	1.8
United Arab Emirates	1.2	1.7	(6.1)	2.7	2.7	2.0	2.0
MENA-6	3.0	2.2	(2.5)	2.5	3.4	3.1	3.2
Three North Africa	4.7	4.7	0.9	3.0	4.5	4.8	5.0
Three Middle East	2.0	0.7	(4.6)	2.2	2.7	2.1	2.1
Selected Other							
U.S.	3.0	2.2	(3.5)	6.7	3.7	2.6	1.8
Eurozone	1.9	1.3	(6.7)	4.4	4.5	2.2	1.6
China	6.7	6.0	2.3	8.3	5.1	5.0	4.8
India	6.0	4.1	(7.3)	9.5	7.8	5.7	6.5
World	3.6	2.8	(3.4)	5.9	4.3	3.7	3.3

Source: S&P Global Ratings Forecasts, IMF. Note: (1) Aggregate growth is based on PPP weighted GDP share, (2) Egypt and India GDP (fiscal year); (3)* IMF World Economic Outlook – April 2021.

The three North African countries as a group will, in our view, lead the way as growth rebounds to 3% in 2021 and averages 4.8% in 2022-2024--a pace seen before the pandemic. Egypt, which was a growth leader prior to the pandemic, will expand more than 5% in fiscals 2022-2024, underpinned by ongoing fiscal and economic reforms that will likely lead to higher investment. Morocco, which is emerging from the double whammy last year of the COVID-19 pandemic and severe drought will likely expand 5% this year and average 3.7% growth in the next three years. A bumper harvest helped real GDP increase 6.3% (year over year) in first-half 2021, but the recent return to stricter COVID-19 regulations amid the deadliest wave of infections so far means a slower pace of recovery in the coming months. In Tunisia, recent political upheaval has created an uncertain environment, at least in the short term, and it will likely see the slowest recovery among the MENA-6's three North African countries of only 3.8% this year and 2.1% on average over the next three years, according to the IMF. This follows an 8.6% decline last year.

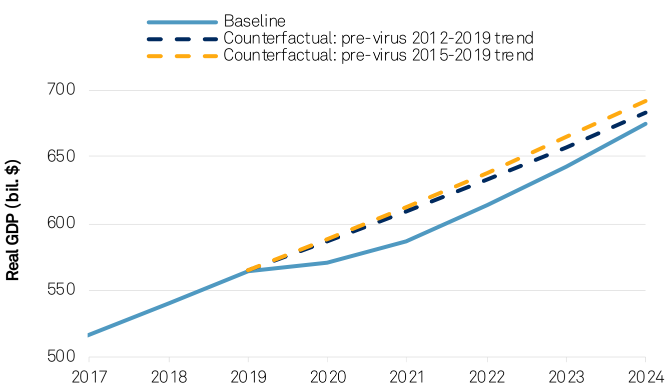
On the other hand, the MENA-6's three Middle Eastern countries will see growth of 2.2%-2.6% in 2021-2024, which is slightly above the 2015-2019 pace (when the Brent crude oil price averaged $57 per barrel [/bbl]). However, it lags the 6.0% average experienced during 2011-2014 (when Brent averaged $107/bbl). Prospects of higher oil output have increased following the OPEC+ deal in July to taper production cuts starting in August.

Our Brent crude oil price assumption for the remainder of 2021 is $65/bbl, before edging down to $60/bbl and $55/bbl in 2022 and 2023, respectively--underpinned by OPEC+ supply restraints, even though global demand may not return to 100 million barrels per day until late 2022. Together with strong vaccination rates and purchasing managers' indexes in high expansion territory in the past three months (consistent with strengthening demand), GDP growth in the three countries is running ahead of our 2021 forecasts. However, we note oil prices have settled at $70/bbl-$80/bbl since June and have lately come under pressure due to the resurgence of COVID-19 weakening short-term global demand.

Nevertheless, the pace of recovery is not enough, in our view, to bring these economies back to their prepandemic GDP trajectories by 2024 (see charts 5 and 6)[5]. In the MENA-6, the three North African countries are poised to at least close the gap partially while the three Middle Eastern countries' return to their prepandemic trajectory is tenuous at best.

Chart 6

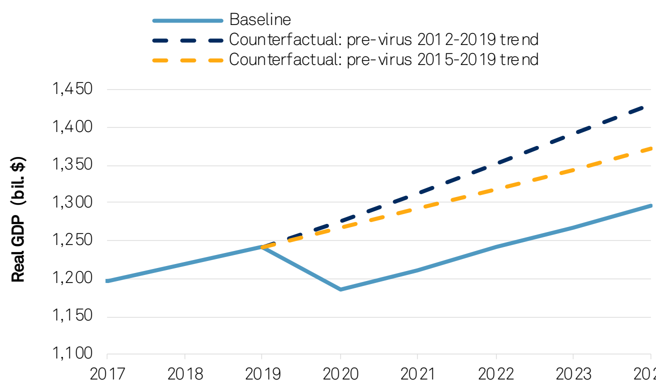
GDP Evolution: Three North African Countries



Note: Aggregate growth is based on PPP weighted GDP share. Egypt fiscal year. North African countries: Egypt, Morocco and Tunisia. Sources: IMF, S&P Global Ratings, S&P Global Economics.

Chart 7

GDP Evolution: Three Middle East Countries



Note: Aggregate growth is based on PPP weighted GDP share. Middle East countries: Saudi Arabia, Qatar and U.A.E. Sources: IMF, S&P Global Ratings, S&P Global Economics.

[5] The size of the MENA-6 economy will be 4.5% smaller than the prepandemic trend (2015-2019 growth based) by 2024 (forecast horizon), the North African trio will be a little over 2.5% smaller while the Middle-Eastern trio will be a little above 5.5% smaller.

Selected MENA Sovereigns

PRIMARY CONTACT

Trevor Cullinan
Dubai
+971-4372-7113
trevor.cullinan
@spglobal.com

Hydrocarbon Endowments Are A Key Differential Between GCC and North African Sovereigns

The stark contrast in economic wealth levels between Egypt and Morocco and the GCC countries is an important factor in our lower rating assessments for North African sovereigns. Egypt and Morocco are relatively poor with GDP per capita of less than $4,000 in 2021. We view higher levels of GDP per capita as indicating broader potential tax and funding bases upon which governments may draw, which generally supports creditworthiness. Qatar ($59,000) and the UAE's Abu Dhabi ($101,000) at 15x and 25x these levels respectively, are two of the wealthiest sovereigns we rate. Saudi Arabia ($23,000) and the UAE's Ras Al Khaimah (RAK; $29,000) and Sharjah ($23,000), are middle income sovereigns.

Our institutional assessment and economic assessments have a higher weighting in our analysis compared to other factors (see "Sovereign Rating Methodology," published Dec. 18, 2017, on RatingsDirect). In general, we can also say that the North African sovereigns have weaker external and fiscal positions than the GCC sovereigns (see table 2). The one area where Egypt and Morocco are in-line with or stronger than GCC sovereigns is with regards to monetary policy flexibility.

Having made these broad statements, in the rest of this section we will further compare some of the key characteristics of the individual sovereigns and provide a forward-looking view on how we see their credit stories developing.

Table 2

Sovereign Rating Score Snapshot

Issuer	Institutional assessment	Economic assessment	External assessment	Fiscal assessment: budget performance	Fiscal assessment: debt	Monetary assessment	Indicative rating	Notches of supplemental adjustments and flexibility	Sovereign Foreign-Currency Ratings
North African sovereigns									
Egypt	5.0	5.0	6.0	6.0	6.0	4.0	b-	1	B/Stable/B
Morocco	4.0	5.0	3.0	4.0	4.0	3.0	bb	1	BB+/Stable/B
GCC sovereigns									
Qatar	4.0	1.0	4.0	1.0	2.0	4.0	a+	1	AA-/Stable/A-1+
Saudi Arabia	4.0	4.0	1.0	5.0	1.0	4.0	bbb+	1	A-/Stable/A-2
Of which: UAE emirates									
Abu Dhabi	4.0	1.0	2.0	1.0	1.0	4.0	aa-	1	AA/Stable/A-1+
Ras Al Khaimah	4.0	3.0	2.0	1.0	1.0	5.0	a-	0	A-/Stable/A-2
Sharjah	4.0	3.0	2.0	6.0	5.0	5.0	bb+	1	BBB-/Stable/A-3

Our analysis of sovereign creditworthiness rests on our scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published Dec. 18, 2017, details how we derive and combine the scores, and then derive the sovereign foreign currency rating. Source: S&P Global Ratings, Sovereign Ratings Score Snapshot, Sept. 6, 2021.

Hydrocarbon Endowments Support GCC Public Finances

A fundamental supporting factor for most GCC sovereign ratings, compared to those on Egypt and Morocco, is the Gulf states' significant oil and gas reserves. High income from the oil and gas sector results in high economic wealth levels, with double-digit general government surpluses as a percentage of GDP prior to the structural correction in oil prices beginning in second-half 2014. This allowed some Middle East countries in the MENA-6 to build up significant net government and external asset positions, which supported the ratings as investment income flows to the budget and external accounts remained substantial following the sharp fall in oil prices, even as hydrocarbon-related revenue contracted. Notably Abu Dhabi (in the UAE) and Qatar's very strong fiscal positions reflect this dynamic.

The Middle East Countries in the MENA-6 and GCC governments in general have also cut back on government spending to differing degrees and diversified their revenue streams. The flagship revenue measure introduced across much of the GCC--which generally applies very low or zero tax rates--was the introduction of value-added tax (VAT) by Saudi Arabia and the UAE (no published rating) in 2018, Bahrain in 2019, and Oman in 2021 (Kuwait and Qatar currently have no plans to introduce the tax). However, hydrocarbon-related revenue still dominates their budgets. We expect Abu Dhabi and Qatar to generate net fiscal assets over the period to 2024. In contrast, we expect Saudi Arabia to continue to draw down its fiscal assets over the same period. Saudi Arabia has a high level of fiscal assets compared to most sovereigns globally, but they are an order of magnitude lower than those of Abu Dhabi and Qatar (see chart 8). Its fiscal breakeven oil price is also higher than those of these peers. This suggests that, other than using its role as swing producer in the global oil market to achieve production and price levels to support its budget, or introducing significant new taxes, government expenditure would need to be reined in to bring about a budget surplus and reduce the ongoing deterioration in the government's asset position.

Chart 8

MENA-6 Countries' Net General Government Debt, Average 2021-2024

Source: S&P Global Ratings.

Of the seven emirates within the UAE, we rate Abu Dhabi, RAK, and Sharjah. RAK and Sharjah do not have significant hydrocarbon endowments but they are indirectly affected by regional oil market dynamics. Notably, when oil prices are high demand increases in their trade, transport, and manufacturing sectors and, in the case of RAK, its large mining sector. We view RAK's fiscal position as very strong due to is low debt levels and our expectation that the government will continue to maintain small budgetary surpluses over the period to 2024. Both emirates, benefited from the UAE's introduction of VAT as 70% of the tax collected remains with them, while 30% goes to the federal government. Sharjah's fiscal position, on the other hand, is more akin to that of Egypt and Morocco. The government has accumulated a relatively large amount of debt in recent years, and we expect its fiscal deficits to remain above 5% of GDP over the period to 2024.

We expect Egypt to post general government deficits closer to 7% of GDP over the same period, moderating slightly due to falling interest payments and revenue growth. At the same time, Egypt's near-term government and central bank external debt maturities are large, at about $21 billion over 2021. However, close to 70% of the maturing debt is owed by the Central Bank of Egypt, and the majority of this comprises deposits that will likely be rolled over by the UAE, Saudi Arabia, and Kuwait.

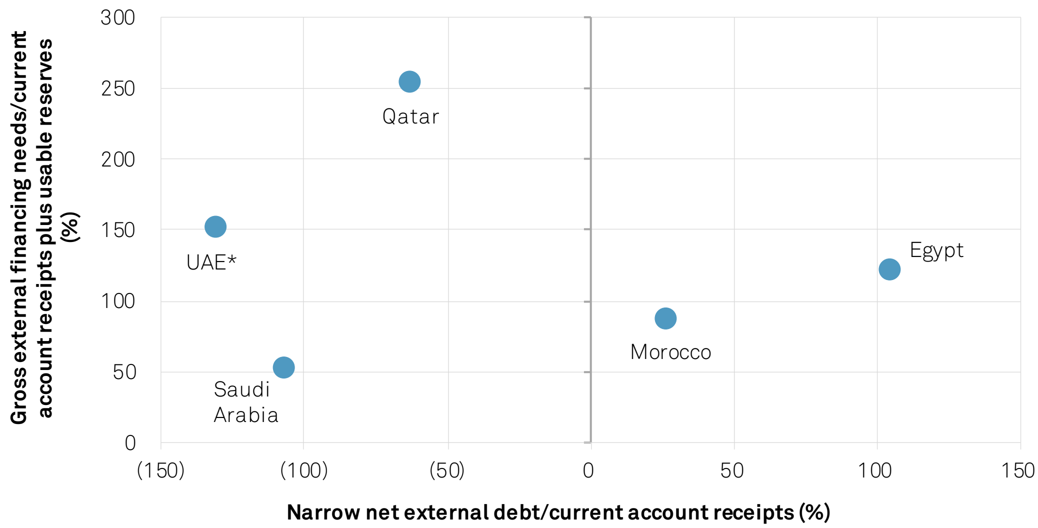
In Morocco, we expect the general government deficit to decline to 4.6% of GDP in 2024 from 7.7% of GDP in 2020 on the back of higher revenue and public wage bill reductions. Nevertheless, we expect the ongoing deficits to increase net general government debt above 70% of GDP in 2024.

Qatar's External Position Is Much Weaker Than Other GCC Sovereigns'

High government external debt is one of the factors weakening Egypt's external position. For both Egypt and Morocco external debt exceeds liquid external assets, while in Qatar, Saudi Arabia, and the UAE the high level of government assets, which are largely invested abroad, results in very strong external balance sheets (see chart 9).

Chart 9

MENA-6 Countries' External Positions



*We use the UAE external data as a proxy for its constituent emirates. Source: S&P Global Ratings.

Qatar's stock of net external assets provides the economy with sizable buffers to external shocks, but its external financing needs are significant. This factor, in our view, places Qatar's external position closer to the level of the North African sovereigns rather than those of the MENA-6 Middle East sovereigns or Qatar's GCC peers. As a result, we lowered our ratings on Qatar in 2017 when six Arab countries, including Saudi Arabia and the UAE, imposed a boycott on the country (see "Qatar Long-Term Rating Lowered To 'AA-'; On Watch Negative After Six Arab Countries Sever

Ties," published June 7, 2017). In our view, Qatar's significant external financing needs, which largely stem from short-term external debt accumulated by its large banking system, represented a vulnerability should investor sentiment change toward Qatar. Our concerns were realized when more than $20 billion was withdrawn from Qatar's banking system following the imposition of the boycott. We believe this risk remains, given Qatar's external financing needs continue to increase over our forecast period to 2024.

The UAE economy's external funding needs are also relatively high, again, largely driven by the banking sector. However, we note that the banking system in the UAE has more than sufficient external assets to offset its liabilities. In Qatar, external liabilities became one of the main financing sources of domestic credit growth in the past few years and net external debt funds nearly 40% of domestic loans. Market instability can make these flows volatile and, given the region's inherent geopolitical risks, we view this dependence on external funding as a potential risk. In Saudi Arabia, due to its much larger population--about 36 million, compared to 10 million in the UAE and 3 million in Qatar--and largely deposit funded banking sector, external financing needs are much lower.

Institutional Settings Are Broadly Similar

The MENA-6's Middle East Sovereigns and the GCC states in general have their own individual attributes, but they also share several characteristics. We view the MENA-6 Middle East sovereigns and the GCC as exhibiting centralized policymaking, which in our view could undermine institutional effectiveness and policy predictability. Political institutions are still developing and decision-making processes lack transparency and remain centralized. That said, the current regimes have provided stability and overseen the implementation of long-term economic and social development objectives. We do not expect any pronounced changes in the government's policy stance. In our view, shortcomings remain in the dissemination of data in terms of availability and timeliness. In particular, we see shortcomings in the dissemination of macroeconomic data, including relatively weak transparency and reporting delays compared to nonregional peers in the same rating category. Disclosure related to the government's external assets is also limited.

Bahrain and the UAE normalized relations with Israel in September 2020, which, over time, could significantly increase cooperation and trade. Bahrain, Egypt, Saudi Arabia, and the UAE also normalized relations with Qatar in January 2021, ending the trade boycott. We note that there is always a risk of heightening tensions between Iran and the rest of the region. In our base case, we expect geopolitical risks will have a limited effect on GCC rated sovereigns' domestic economies and social stability in the near term.

In the medium term, we expect GCC governments to continue policies toward planned economic diversification; nationalization of the workforce (replacing expatriates with nationals); attempting to improve the business environment; and socioeconomic liberalization, especially when it comes to increasing female employment. They will also attempt to improve educational and skills levels and raise the private sector's role in the economy, while simultaneously driving large infrastructure and entertainment projects.

We assess Morocco in-line with the GCC states as policymaking is somewhat centralized, but this has largely resulted in political and social stability. King Mohammed VI chairs the Council of Ministers, which deliberates strategic laws and state policy orientations. Policy choices may weaken support for sustainable public finances and balanced economic growth. The king's policymaking role has increased since 2017, when he intervened in curbing social tensions in the Rif and Jerada regions.

We assign Egypt a weaker institutional assessment than the other sovereigns under consideration. We believe the sociopolitical environment in the country remains fragile. Sporadic small-scale protests reflect the broader social discontent of more vulnerable and younger sections of the population, and this continues to be a possible risk to the fiscal consolidation program and reforms. However, unemployment decreased to 7.2% of as of December 2020, from 9.6% in June 2020. Security threats, with skirmishes between the Egyptian security forces and militant groups affiliated with Daesh, are likely to remain largely contained to Northern Sinai. Still, there have been some targeted attacks on police and military forces on Egypt's mainland. Geopolitical tensions with neighboring Libya and Ethiopia (the latter relating to the Grand Renaissance Dam) could increase, although this is not our base-case scenario. Potential terrorist incidents affecting civilians or tourists could have repercussions for a recovery in tourism and dampen investor sentiment, in our view.

Pegged Exchange Rate Regimes Limit Monetary Policy Flexibility

For the MENA-6's Middle East sovereigns and the GCC generally, monetary policy is both constrained and anchored by currency pegs with the U.S. dollar (apart from Kuwait, which is pegged to a basket of currencies dominated by the dollar). Interest rates move in tandem with the U.S. Federal Reserve.

The Moroccan dirham is pegged to a currency basket of 60% euros and 40% U.S. dollars. The foreign exchange peg limits monetary policy flexibility, in our view. However, this is gradually changing. Last year, authorities launched the second phase of the gradual currency liberalization by widening the fluctuation band for the dirham to plus or minus 5.0% from plus or minus 2.5%. We view exchange rate liberalization as supportive for our overall monetary assessment because we believe it helps the country's external competitiveness and ability to withstand external macroeconomic shocks, including the current one.

The Egyptian exchange rate regime is floating with a short track record and intermittent intervention in the foreign exchange market. The central bank has limited operational independence, given its substantial holdings of government securities. Annual inflation will average under 10% over 2021-2024. Local currency bond and equity markets are underdeveloped.

GCC Corporates

PRIMARY CONTACT

Timucin Engin
Dubai
+971-4372-27152
timucin.engin
@spglobal.com

Gradual Recovery Across Most Sectors, But Corporates Remain Cautious

Following the emergence of the COVID-19 pandemic in late first-quarter 2020 and the accompanying oil price shock, we saw a sharp deterioration in operating conditions for most Middle East Corporates in the MENA-6 and the GCC generally last year. Many companies endured visible stress on their revenue and EBITDA generation and as a result over 25% of our currently rated issuers saw downgrades in 2020. Cyclical sectors such as those related to oil and gas and real estate represented most of our rating downgrades. In addition, Dubai-based issuers represented over 50% of these actions, while our corporate ratings in Saudi Arabia and Qatar (excluding Ezdan Holding, a Doha based real estate operator) were unchanged.

After a sharp economic contraction in 2020, we expect the three largest GCC economies--Saudi Arabia, the UAE, and Qatar--to move back to positive, albeit moderate, GDP growth this year. We expect pressure will decrease but continue in some sectors, particularly for companies operating in tourism and aviation. We also note a gradual recovery in certain segments of real estate, particularly in Dubai, and see a reversal of price trends and visibly improving operating conditions in most segments of the larger oil, gas, and commodities sectors--including contract renewals in oil field services. As a result, we revised the outlooks on some entities in the larger oil and gas sector and real estate to stable from negative this year.

Reflecting this gradual recovery, less than one-quarter of our GCC corporate and infrastructure ratings are currently on a negative outlook versus about 38% earlier this year (see: "GCC Corporate And Infrastructure Outlook 2021: Proceeding With Caution," published Feb. 2, 2021). About 15% of our rated issuers in Saudi Arabia, the UAE, and Qatar are on a negative outlook.

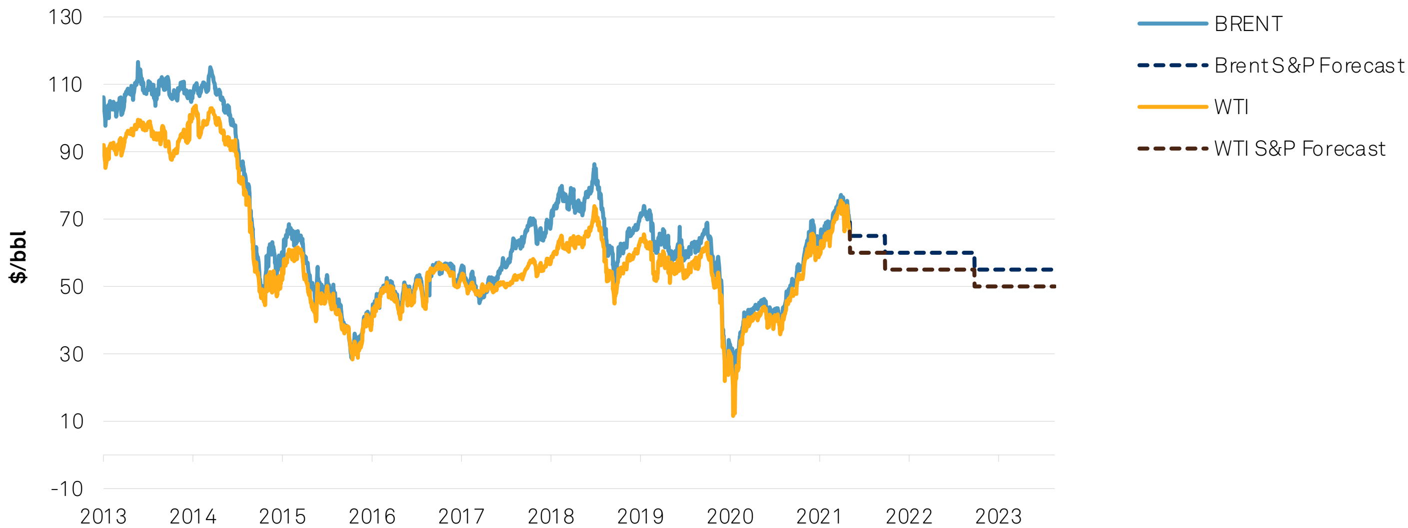
Stronger Oil Prices Are A Key Catalyst For The Region

On June 16 we raised our price assumptions for Brent crude oil for the remainder of 2021 to $65/bbl from $60/bbl and maintained our 2022 and 2023 assumptions at $60/bbl and $55/bbl, respectively. We expect the oil price recovery in2021 to have been underpinned by OPEC+ supply restraints, even though global demand may not return to 100 million barrels per day until late 2022. Although we expect the improved price environment to support cash flow for oil and gas producers this year, we expect capital expenditure (capex) plans to remain prudent, and as such financial policies and commitment to those policies will be important for free cash flow generation and debt reduction. Most of the national oil companies in the GCC benefit from access to large reserves, assets across the hydrocarbon value chain, and low production costs, which support solid credit metrics and cash flow visibility. As such, financial policies and adherence could be a differentiating factor between players, in our view. We expect other subsectors, such as oilfield services, to take longer to recover than oil producers, although we view positively the contract renewals and additions that are supporting backlogs for some operators. Similarly, for commodity chemicals players we expect the recovery in the global macro environment to support a demand rebound, and subsequently drive price and volume growth, in line with recent trends. Regional chemical players benefit from gas-based feedstock at competitively low levels, which would further support profit levels.

Since April 2021, we have revised our outlooks to stable from negative on EQUATE Petrochemical Co. in the commodity chemicals sector, and Shelf Drilling Holdings Ltd. in the oilfield services sector to reflect the overall improved pricing environment, strengthening utilization rates and contract additions, and overall better cashflow visibility.

Chart 10

Oil Price Movements
As of Aug. 10, 2021



/bbl--per barrel. Source: S&P Global Ratings

The UAE Remains A Tale of Two Cities

Our credit ratings for companies operating in Abu Dhabi's (AA/Stable/A-1+) oil rich economy are generally higher than our ratings for issuers based in Dubai's more diversified but also cyclical economy. Government-related entities (GREs) in key sectors represent most of our ratings in Abu Dhabi, where despite an economic contraction our ratings have been largely unchanged since the emergence of COVID-19, supported by government relief efforts. We expect a modest return to economic growth from 2021, supporting the recovery, but the tourism sector will remain under pressure.

Based on publicly available information about Dubai's economy, we note that it relies heavily on retail, logistics, aviation, tourism, and real estate. As these key employment sectors came under significant pressure, we also observed spillover effects on other industries.

The UAE has been one of the most successful nations in terms of COVID-19 vaccinations. Over the past 12 months, the country has also introduced several initiatives, including changes in restrictions on foreign ownership for onshore companies, extending a 10-year golden visa to groups of investors and highly skilled talent in strategic fields, and implementing social law changes, to increase its attractiveness to global investors and skilled talent.

Given the gradual lifting of global travel restrictions, and its hosting of the World Expo in October, we expect Dubai to register stronger tourism inflows in 2021, relative to 2020, while recovery to 2019 levels will likely take time. However, the recovery remains dependent on global travel demand and restrictions as well as COVID-19-related developments, which could also limit the pace of recovery in Dubai's retail and hospitality sectors.

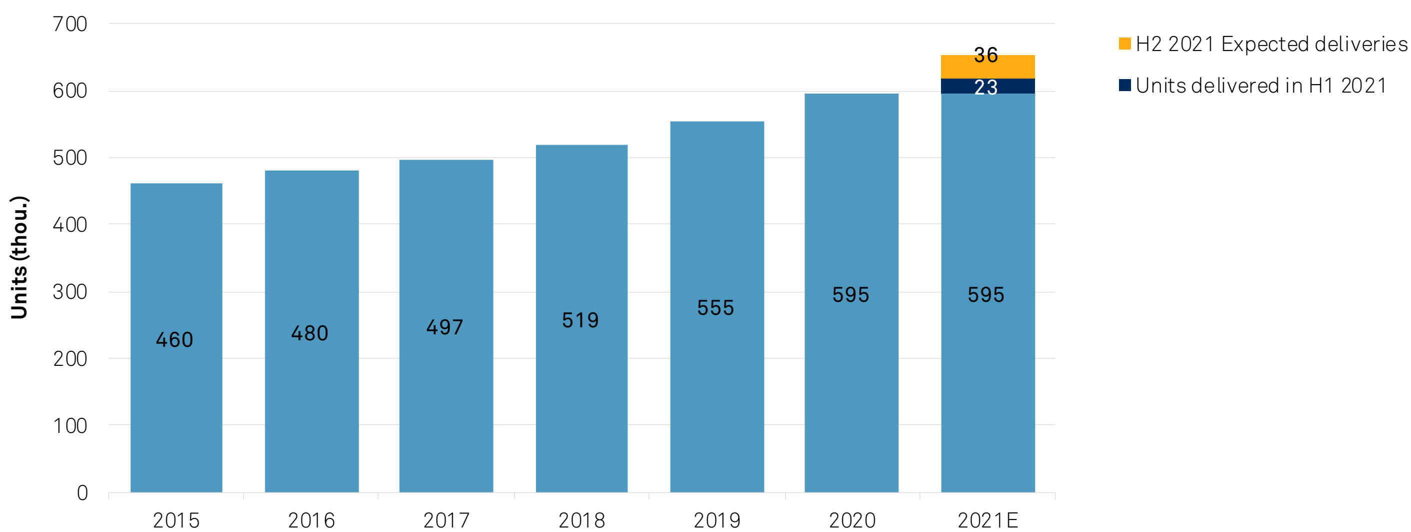
Dubai Real Estate Sees Momentum In Residential But Hospitality Is Lagging

This year we have seen some positive momentum in Dubai's residential segment, where pent-up demand resulted in price increases for better quality assets in good locations for the first time since a 2015 peak. We recently revised the outlook on Emaar Properties (BB+/Stable/--) to stable from negative to reflect this. As a premium developer that is very focused on presales, we believe the company will capture a large share of the growth. The overall market exhibited continued price declines at the beginning of the year, but the trend reversed in the second quarter for both villas and apartments, with double-digit and single-digit price increases respectively (according to Asteco's Dubai Real Estate Report, second-quarter 2021). However, we believe that price increases will not be sustained over a long period due to the structural oversupply of residential real estate in Dubai.

We also anticipate a gradual recovery for mall operators, as COVID-19-related relief measures are slowly lifted and retailers see stronger sales. Still, lower rents on lease renewal, as well as subdued footfall and a struggling tourism sector, will prevent a full recovery of profitability, in our view, because continued new supply is sustaining high competition. We see lingering risk of high vacancy rates and rental pressures for offices because tenants may reconsider their needs following changing work patterns triggered by COVID-19 including increased remote work. Given abundant offers in Dubai, we believe that cost-conscious tenants will continue to drive rents down.

Chart 11

Residential Units Supply in Dubai



E--Estimate. H1--First half. H2--Second half. Source: JLL, S&P Global Ratings

Vision 2030 Is The Key Story For Saudi Corporate Growth

In 2020, Saudi Arabia also saw negative economic growth and similar employment trends and tripled its VAT rate to 15% from 5% and imposed higher import fees on a large range of products to support the government budget. These measures came at a time when the economy, disposable income, and consumer demand were already under pressure. Despite the general weakening in the corporate cycle over the past 12 months, given lockdown measures and travel bans, we saw increased consumption in select consumer segments and now expect gradual softening.

A reduced number of visitors for Islamic Pilgrimage Hajj, which was limited to the local population in 2020, and the ban on international travel also meant weaker operating conditions for Saudi Arabia's tourism, aviation, and hospitality sectors. Although travel restrictions have recently been lifted, we don't expect a meaningful recovery in tourism this year. Gradual recovery and relaxation of COVID-19 measures will be supportive for the general corporate cycle, while companies operating in the petrochemical sectors should largely benefit from stronger oil prices and the recovery in global demand.

A key story for Saudi corporates over the next few years is the government's ambitious Vision 2030 program, which entails significant investments by the government, GREs, and the private sector in the kingdom. We expect the potential roll-out of some of these projects to provide momentum for Saudi corporates, particularly in the energy, construction, contracting, and infrastructure spaces. We also believe this will translate into further opportunities for the kingdom's capital markets (see "Vision 2030 Will Push Forward Saudi Arabia's Debt Capital Market," published May 4, 2021).

A Gradual Normalization Is Under Way In Qatar

In addition to two infrastructure transactions, our eight publicly rated entities in Qatar include four key GREs in strategic sectors such as telecommunications or the larger oil and gas sector, where the ratings were unchanged in 2020. Other than Ezdan Holding all our ratings have stable outlooks.

The return to positive, albeit limited, economic growth should support relatively stronger operating conditions for corporates. Bahrain Egypt, Saudi Arabia, and the UAE also normalized relations with Qatar in January 2021, ending the trade boycott. Over time, we expect this will likely result in a material softening of pressures experienced by the Qatari aviation, tourism, and real estate sectors.

Qatar is scheduled to host the FIFA World Cup football tournament in 2022. We believe this will provide additional support to the aviation, tourism, real estate, and other sectors. Qatar is also involved in several megaprojects, such as the expansion of the North Field, which could further strengthen Qatar Petroleum's (AA-/Stable/--) position in the liquefied natural gas market.

MENA Banks

PRIMARY CONTACT

Mohamed Damak
Dubai
+971-4372-7153
mohamed.damak
@spglobal.com

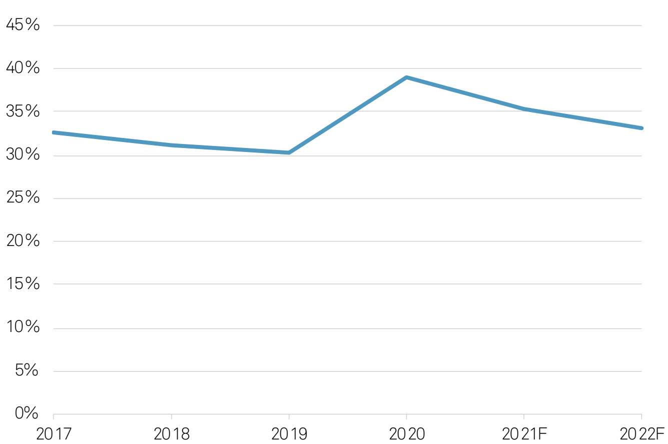
Egyptian Banks' Creditworthiness Is Closely Linked To That Of The Sovereign

Significant investments in Egyptian government securities have supported Egyptian banks' profitability in previous years and allowed them to place their excess liquidity, while increasing their link to the sovereign. Direct exposure to sovereign debt accounted for about 34% of total banking system assets as of March 31, 2021. Although we expect customer loans to expand faster than sovereign debt in the coming years, we anticipate the ratio will remain at about 30%-35% until fiscal 2022 (ended June 30, 2022).

The pandemic's effect on Egypt's economic growth will, in our view, be less severe than in other countries. Although we forecast real GDP growth will slow to 2.5% in fiscal 2021 from 3.6% in 2020, we note that Egypt was one of the few countries to not experience an economic contraction in calendar year 2020. Instead, the country registered real GDP growth of 1.5% thanks to relatively limited lockdown measures, ramp-up of health care capacity, and resilient remittances. We expect banks' asset quality to deteriorate with nonperforming loans (NPLs) increasing to 6.0%-6.5% of total loans by June 30, 2022, compared with 3.9% as of June 30, 2020, primarily because of the implications of the pandemic on exposed sectors such as tourism and small and midsize enterprises (SMEs). We think the banking sector can handle such an increase. We forecast credit losses for Egyptian banks will average 150 basis points (bps)-200 bps in 2021-2022, owing to the impact of the pandemic on private borrowers, particularly SMEs. We expect banks' preprovision income will be more than sufficient to offset this increase. Furthermore, we forecast that Egyptian banks' liquidity will remain strong, owing to low loan leverage and sizable customer deposits. Despite global uncertainties, we estimate that systemwide deposits increased about 20.0% in the fiscal year ended June 30, 2021.

Chart 12

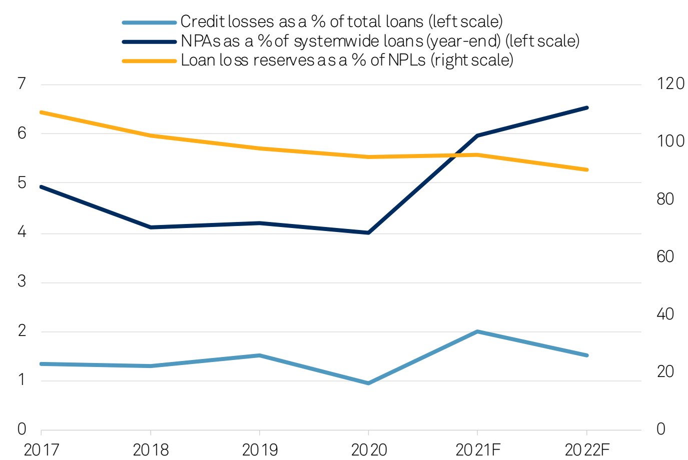
Government Debt Held By FIs / Total Assets (%)



F--Forecast. FI--Financial institution. Source: S&P Global Ratings.

Chart 13

Egyptian Banks' Asset Quality Indicators



F--Forecast. NPA--Nonperforming asset. NPL--Nonperforming loan. Source: S&P Global Ratings.

Morocco's Post-Pandemic Economic Recovery Remains Uncertain

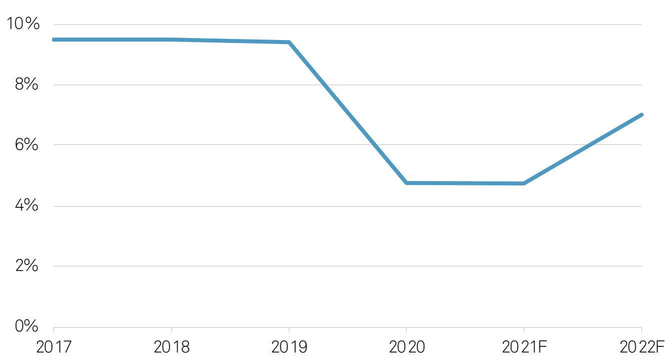
We forecast GDP growth will average 4% in 2021-2024. Economic expansion will be supported by the government's economic recovery package, valued at 11% of GDP, despite Morocco's deteriorated budgetary position. The recovery hinges on when the effects of the COVID-19 pandemic in Morocco and its key trading partners subside. Potential long-term issues could include further hindrance of tourism activities and real estate developers.

Before the pandemic, the banking sector reported an average return on equity of 9.4%, with an adequate solvency ratio of 15.6%. Although we expect these ratios to deteriorate, banks' earnings will provide some buffer to absorb additional credit losses. Credit growth in 2021 will likely be less resilient than in 2020. Government measures aimed at supporting corporates, including lending facilities, subsidized interest rates, and a partial state guarantee, were relatively successful and lower interest rates boosted mortgage lending. For 2021, we expect credit growth to lose steam as state-guaranteed loan programs finish. We expect banks' cost-cutting efforts will continue, which will partly offset the impact of margin contraction and lower lending volumes on bottom-line earnings. Improved efficiency is crucial for some banks, given their tight regulatory capital buffers. At the same time, we forecast a deterioration in banks' asset quality indicators and expect tourism, SME, and real estate exposures to contribute the most to this trend. Reported asset quality metrics are yet to show the true impact of the pandemic. Excluding a regulatory ban, we expect banks to pay dividends but it remains to be seen if some will prematurely release their excess provisions linked to the pandemic to support their bottom-line earnings.

Over the past decade, large Moroccan banks have expanded rapidly into sub-Saharan Africa, where economic and credit risks are typically higher than in Morocco. That said, we do not expect major acquisitions during 2021, because banks are still digesting the effects of the pandemic and integrating past deals.

Chart 14

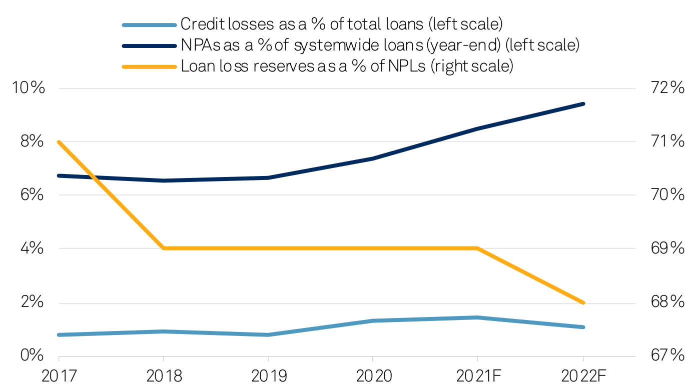
Return On Equity of Morocco's Domestic Banks



F--Forecast. Source: S&P Global Ratings.

Chart 15

Moroccan Banks' Asset Quality Indicators



F--Forecast. NPA--Nonperforming asset. NPL--Nonperforming loan. Source: S&P Global Ratings.

Tunisia's Political Unrest May Intensify Pressure For Domestic Banks

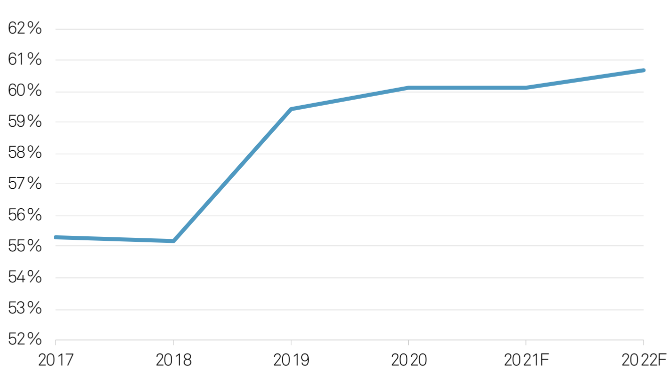
Political tensions escalated in Tunisia on July 25, 2021, when the president suspended parliament for 30 days, dismissed the government, and announced that he will rule by presidential decree. Although the suspension was extended indefinitely, the next steps are unclear, and developments are likely to affect the operating environment for Tunisian banks. This uncertainty comes on top of an already strained operating environment for banks due to COVID-19 fallout, which was exacerbated in recent weeks following a surge in new cases that has dampened the tourism season.

The pandemic already led to an unprecedented 8.6% GDP contraction in 2020, according to the IMF, exacerbating Tunisia's socioeconomic fragilities after a decade of shaky reform implementation and low growth. In this context, the Tunisian economy will likely see a slow return to prepandemic levels, with GDP growth averaging only 2.4% per year over the next five years, based on IMF projections. This growth level is unlikely to be sufficient to address the country's high unemployment and deteriorating living standards, fueling further social discontent. High fiscal deficits have pushed public debt onto an unsustainable path of dependence on multilateral lending institutions. However, ongoing political instability could jeopardize completion of an IMF deal and pose significant financial challenges for the country.

In turn, Tunisian banks face a tougher macroeconomic and operating environment with financial and risk profiles that are already weak. We anticipate that banks' profitability will deteriorate amid a highly competitive and fragmented operating environment, weak economic prospects, and rising credit losses. The banking system's current structure encourages price competition because banks compete for just a few blue-chip creditworthy names. These factors further erode Tunisian banks' already insufficient capital buffers, especially for the smallest entities. Banks will likely maintain high loan-loss provisions, given their large exposures to retail, tourism, real estate, and some exports, ultimately weighing on their profitability and capitalization. The central bank cut its key rate twice in March and October, by a cumulative 150 bps (to 6.25%), while continuing to provide banks with significant liquidity support. We expect this support to continue over the next few months to help the banking system cope with additional uncertainty related to the political situation. We view such support as critical due to the weak funding profiles of Tunisian banks.

Chart 16

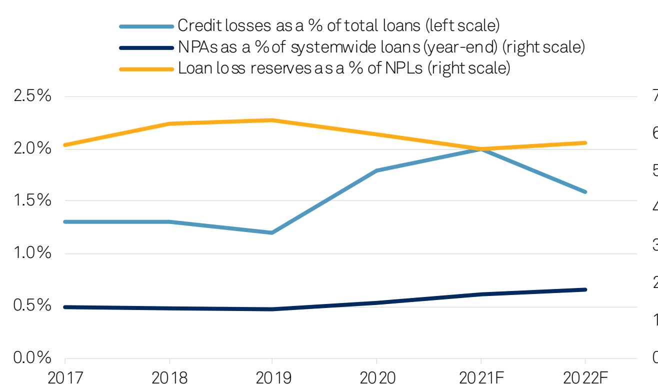
Systemwide Domestic Core Customer Deposits As A Percent of Systemwide Domestic Loans



F--Forecast. Source: S&P Global Ratings.

Chart 17

Tunisian Banks' Asset Quality Indicators



F--Forecast. NPA--Nonperforming asset. NPL--Nonperforming loan. Source: S&P Global Ratings.

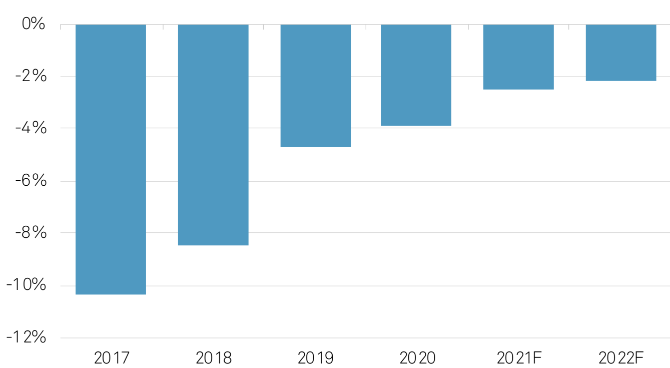
Saudi Arabia's Rapid Credit Growth Is Likely Here To Stay

The Saudi banking system has largely demonstrated its resilience to low oil prices and weak economic growth. However, the sector is still affected by oil price dynamics and government expenditure and is vulnerable to global economic and regional geopolitical trends.

Rapid lending expansion has already resulted in a sharp increase in leverage with private sector credit set to exceed 85% of GDP by year-end 2021 compared with 65%-70% before 2020. Greater penetration of credit and rapid growth in new projects will again test underwriting standards, but we expect banks will remain conservative. Growth of mortgage portfolios and the gradual launch of Vision 2030's landmark construction projects will support overall credit growth, which we expect will reach 15% in in 2021 and stay above 10% in 2022. We believe that the pandemic had a stronger impact on the nonoil economy than the decline in oil prices in 2014. As deferral programs are gradually phased out and the economy adjusts to the new normal, the cost of risk will stabilize at about 90 bps-100 bps (from 100 bps in 2020), before starting to normalize in 2022. Along with lower interest rates, this will pressure Saudi banks' profitability, and only partially be offset by a higher share of loans in total assets. We expect Saudi banks will navigate these headwinds and maintain a return on average assets of about 1.4%-1.5% in the coming years, which is weaker than the 2% observed before 2020. We expect banks' funding profiles to continue supporting their creditworthiness. Despite a gradual buildup of external funding, the Saudi banking sector remains predominantly funded by customer deposits, which have been stable. Although we expect a further increase in external debt, the banking sector will remain a net external creditor.

Chart 18

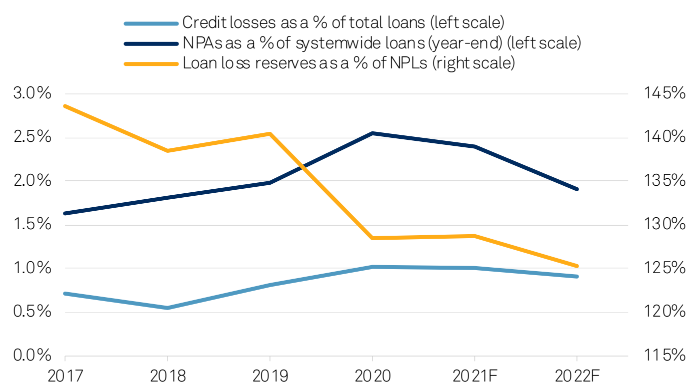
Net Banking Sector External Debt As A Percent of Systemwide Domestic Loans



F--Forecast. Source: S&P Global Ratings.

Chart 19

Saudi Banks' Asset Quality Indicators



F--Forecast. NPA--Nonperforming asset. NPL--Nonperforming loan. Source: S&P Global Ratings.

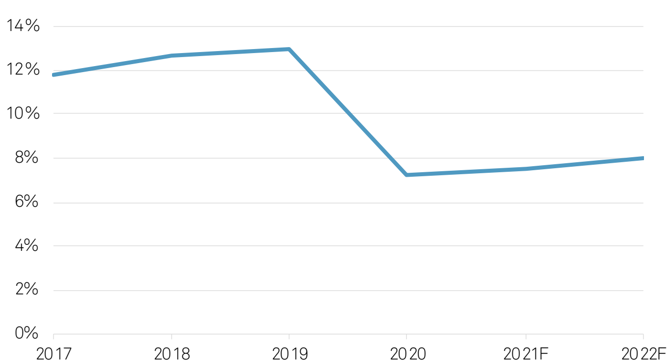
The UAE's TESS Extension Is Cushioning Banks' Asset Quality And Profitability

GDP growth in the UAE is recovering from the sharp recession of 2020, but the shock will reverberate through the economy and banking sector for some time. In turn, real GDP is only likely to return to 2019 levels by 2023. After the pandemic started, the central bank implemented a targeted economic support scheme (TESS), which helped ease pressure on corporate issuers and SMEs. The measures included requiring that banks not classify exposures as nonperforming if the borrowers suffered from cash flow pressures related to the pandemic; asking banks to defer loan repayments for struggling companies and retail clients; and providing banks with liquidity. The scheme has allowed banks to gradually build sufficient provisions against affected sectors, thereby tempering the pandemic's impact on asset quality and cost of risk. Still, the system hasn't gone unscathed, and we anticipate that cost of risk will moderate in 2021 but remain above historical levels--140 bps in 2021 from 167 bps in 2020--and that NPLs will peak in 2022. We expect cost of risk will moderate in 2021 because of the improved macroeconomic environment and the extension of the support program until June 2022.

COVID-19 brought an additional economic shock when the UAE real estate sector was already under significant stress. Other sectors, such as hospitality and discretionary consumer goods, also experienced a significant decline in revenue, weighing on credit quality. We expect lending toward Dubai's hosting of the World Expo and borrowing by the government and GREs to drive growth. Corporate borrowing will likely improve only slightly because some of the deferred capex in 2020 may be executed this year, along with refinancing existing debt. Improving operating conditions will support banks' performance. We expect UAE banks' profitability will improve slightly as the cost of risk declines from its peak in 2020 and they continue to focus on cost efficiencies. That said, lower-for-longer interest rates mean banks will remain less profitable than before the pandemic.

Chart 20

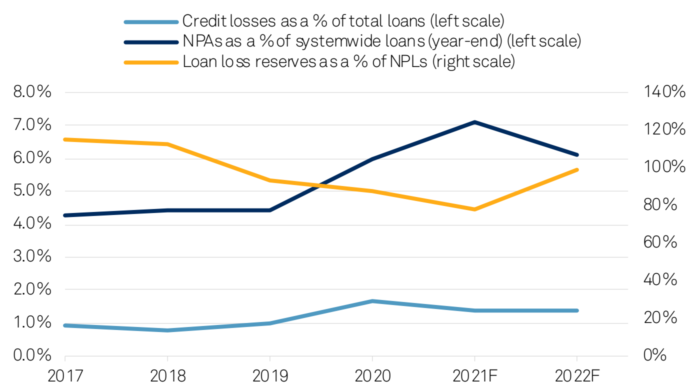
Return On Equity Of UAE Domestic Banks



F--Forecast. Source: S&P Global Ratings.

Chart 21

UAE Banks' Asset Quality Indicators



F--Forecast. NPA--Nonperforming asset. NPL--Nonperforming loan. Source: S&P Global Ratings.

Qatari Banks' Brisk Externally Funded Growth Carries Risks

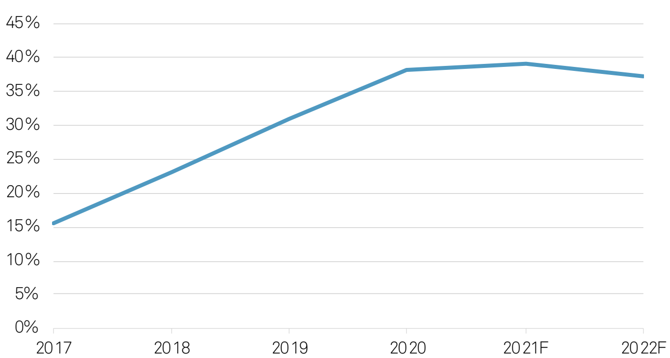
We expect real GDP growth to recover to an average of 2% over 2021-2022, slower than prepandemic levels, as the government completes its infrastructure plans and capex is curtailed. Qatar's economy is wealthy and GDP per capita is among the highest in the world. This should help support retail lending, which resumed in first-quarter 2021. Higher oil prices and the 2022 FIFA World Cup will likely support corporate lending activity and lead to overall credit growth of about 8% over 2021-2022. The development of new gas fields could also provide some additional lending opportunities.

The government and GREs have a significant presence in banks' loan books, which should mitigate the extent of pandemic- related asset quality deterioration. That said, we still expect that SMEs, particularly in hospitality, subcontracting, and real estate, will add to the formation of NPLs, highlighting a danger of building further related risk concentrations. We expect systemwide nonperforming assets to climb to 3.3% by 2021, but this figure likely masks a divergence between those banks with access to high-quality, strategically important borrowers, and those without.

External liabilities became one of the main financing sources of domestic credit growth in the past few years, and now total about $190 billion ($150 billion at year-end 2019, on a gross basis). Net external debt funds nearly 40% of domestic loans. External debt increased nearly the same amount in first-quarter 2021 as over the whole of 2020. Market instability can make these flows volatile and, given the region's inherent geopolitical volatility, we view this dependence on external funding as risky. Should nonresident deposit outflows become disorderly, the strain on funding sources could quickly develop and require more official support, as has been extended in the recent past. If external liabilities increase, banks could be more vulnerable to changing sentiment.

Chart 22

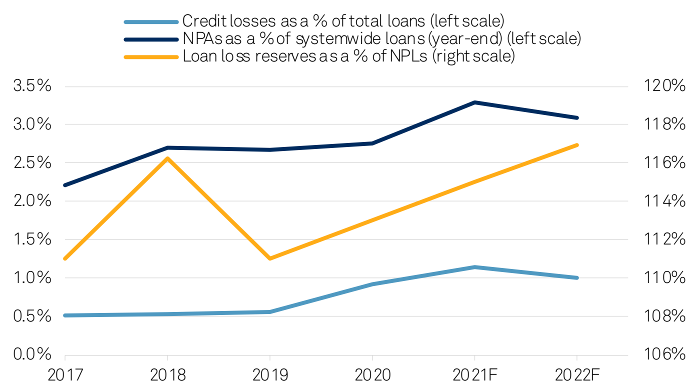
Net Banking Sector External Debt As A Percent of Systemwide Domestic Loans



F--Forecast. Source: S&P Global Ratings.

Chart 23

Qatari Banks' Asset Quality Indicators



F--Forecast. NPA--Nonperforming asset. NPL--Nonperforming loan. Source: S&P Global Ratings.

Related Research

- Sovereign Rating Score Snapshot, Sep. 6, 2021
- Credit FAQ: Can Egypt Weather Rising Global Interest Rates?, Sep. 5, 2021
- Emerging Markets Monthly Highlights: Delta Variant Causes The Summer To End On A Bleak Note, Aug. 12, 2021
- Emerging Markets Monthly Highlights: Faster Vaccination Pace Still Not Sufficient to Beat The Pandemic, July 15, 2021
- Sovereign Risk Indicators, July 12, 2021
- Credit Conditions Emerging Markets Q3 2021: Slow Vaccination Prevents A Robust Recovery, June 29, 2021
- EMEA Emerging Markets Sovereign Rating Trends Midyear 2021, June 29, 2021
- Economic Outlook Emerging Markets Q3 2021: Despite Rising Resilience, Vaccinations Are The Key To Recovery, June 28, 2021
- Economic Outlook EMEA Emerging Markets Q3 2021: Faster Recovery, Higher Inflation, June 25, 2021
- Full Analysis: Emirate of Abu Dhabi, May 31, 2021
- Full Analysis: Qatar, May 10, 2021
- Research Update: Egypt 'B/B' Ratings Affirmed; Outlook Stable, May 7, 2021
- Full Analysis: Emirate of Ras Al Khaimah, April 26, 2021
- Research Update: Emirate of Sharjah 'BBB-/A-3' Ratings Affirmed; Outlook Stable, April 23, 2021
- Morocco Ratings Lowered To 'BB+/B' From 'BBB-/A-3' On Fiscal Space Erosion; Outlook Stable, April 2, 2021
- Research Update: Saudi Arabia 'A-/A-2' Ratings Affirmed; Outlook Stable, March 26, 2021

This report does not constitute a rating action.