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Major Political Developments

1) Brexit shocks the GCC

The result of the UK referendum endorsing Brexit was received with great consternation across the region. In his first response, UAE Prime Minister and ruler of Dubai, Sheikh Mohammed bin Rashid Al-Maktoum said that the UAE respected the British choice and affirmed that UAE-UK ties would continue to flourish. Perhaps, in response to suggestions that Great Britain could now become "Little England", the UK ambassador to the UAE, Philip Parnham, took pains to remind his resident community and the UAE that the UK "remains the fifth largest economy in the world, a permanent member of the UN Security Council and a member of G7, G20 and NATO (and will) continue to be the only member of those groups which spends both 2% of GDP on defence and 0.7% on development assistance".

Most UK and other European nationals have generally reacted with dismay, many of them asserting their mixed "European" identity. One fiercely criticized the UK's rightwing politicians and media for their "toxic and untruthful campaign", while another felt that "international cooperation" was the urgent need today, and that the UK vote went against this global trend. All wondered about how trade ties between the UK and the EU would now be managed, given that they were bound by "a hundred treaties". A few diehard patriots thought that Britain would emerge "more stable and powerful" in coming years.

The economic implications of this momentous decision are not clear and first reactions are confusing. An economist thought that the vote has placed the global economy on the verge of another recession, besides raising questions about the continued territorial integrity of the UK itself, the fate of 2.4 million EU nationals working in the UK, and two million UK citizens employed in Europe. Some GCC nationals feel that, with the precipitate fall of the pound, their investments in the UK would lose value, while also noting that future investments will be more attractive.

The positive aspect for most observers is that UK-GCC trade will receive a boost: The UK will try harder to compete for the GCC market, while for the GCC, it will be easier to finalise bilateral agreements with the UK, such as the free trade agreement, which has not been possible with the EU for several years. On the negative side, the fall in the value of the pound could dampen arrivals and spending by UK tourists to the GCC.

A day after the result, Saudi Arabia and the UAE calmed their business community by stating, they would not be greatly affected by the vote. The Saudi monetary authority head said that the Kingdom had already made "adjustments" in its pound and euro assets before the vote, and was now less exposed to fluctuations in these currencies. Similarly, the UAE Central Bank said that due to "limited interconnectedness" between the UAE and UK financial systems, there would be very limited impact on UAE financial institutions.

2) Mohammed bin Salman in the US

Saudi deputy crown prince and Minister of Defence, Prince Mohammed bin Salman, went on a 14-day visit to the USA for wide-ranging engagements with US political, security, technology and business leaders. The interactions served the dual purpose of exposing the young and powerful prince to the US political and business establishments, making the latter a partner of the Kingdom in its security regionally, and realising the ambitious Vision-2030 domestically.

In Washington, Prince Mohammed met President Barack Obama, the Secretaries of State, defence, treasury and commerce, the CIA and NIA chiefs, the leaders of Congress, and the US Chamber of Commerce. Then, in California, he engaged with technological leaders and made them his country's associates in its efforts to diversify its economy with investments in energy, infrastructure, manufacturing and training, estimated at $120 billion. Two contracts were signed with Microsoft- one, to train Saudi youth, and the other, to develop and run a "decision-making support centre" in the royal court. The prince also visited Facebook and met its head, Mark Zuckerberg.

In New York, Prince Mohammed had an important meeting with UN Secretary General Ban Ki Moon, when they reviewed military operations in Yemen and the need to protect children. (This was in the context of reports that Saudi Arabia had pressurized the UN to delete negative references to Saudi conduct in the war in Yemen, particularly with regards to the killing and abuse of children by its troops.)

While the prince was in the USA, presidential candidate Hillary Clinton demanded that Saudi Arabia and other GCC countries "stop their citizens from funding extremist organisations and stop supporting radical schools and mosques around the world". In response, the Saudi Foreign Minister, Adel al-Jubair, said these charges were incorrect and unfair. For good measure, he added that Saudi relations with the US would remain strong "regardless of who becomes the president next year".

The visit has evoked deep interest in the prince and familiarised policy-makers with his vision. It has also encouraged some thoughtful comment on the Kingdom's policies and its future. In an editorial comment, the Washington Post compared Prince Mohammed to Mikhail Gorbachev, who had also wanted to effect wide-ranging changes in his country while preserving the Soviet Union. The paper reminded the prince that "Saudi Arabia has fallen out of favour with the US public and much of the political establishment" for its "murky role" in promoting Islamist extremist ideology and its "repressive internal policies", particularly with regard to women.

The distinguished commentator, Jon Alterman, warned that governments seeking economic changes without changes in politics were likely to fail since, he noted, "entrepreneurs are hard to lead and even harder to contain".

3) Fallujah Re-taken

The Iraqi government announced on 18 June that the town of Fallujah had been re-taken from the Islamic State, and its forces have now turned their attention to Mosul, that had been dramatically captured by ISIS two years ago: two army divisions, backed by special forces and US-led coalition air support, are said to be advancing on Mosul by slowly clearing ISIS-held villages and small towns on the way to the ISIS "capital" in Iraq.

4) Egyptian court rejects transfer of islands

An Egyptian court has nullified a government decision to transfer two islands, Tiran and Sanafir, at the mouth of the Gulf of Aqaba, to Saudi Arabia. The transfer of these islands was the high point of King Salman's visit to Cairo in April this year and was linked to the Kingdom's promise to set up a land bridge across the Gulf of Aqaba and invest over $ 20 billion in the Egyptian economy [West Asia Digest, April 2016]. This decision comes after wide-spread demonstrations in Egypt against the transfer of "sovereign" territory. This decision, which will be appealed, has raised questions about the nascent strategic partnership between the two major Arab nations and the future of Saudi investments, which are of crucial importance for the al-Sisi regime.

5) Iran-GCC war of words

Following Bahrain's decision to deprive the senior Shia cleric, Sheikh Isa Qassim, of his Bahraini nationality, General Qassem Soleimani, head of the Al Quds force of the Iranian Revolutionary Guards Corps (IRGC), warned that this would "trigger a raging fire in Bahrain and across the region" which would result in "the destruction of this blood-thirsty regime". This led to stern condemnations from GCC officials and media, of Iranian "interference" in the domestic affairs of its neighbours. A local think-tank has said that between 2011-13, Iran had made 160 threatening remarks, including incitement to violence; these included six by the Supreme Leader, eight by the Foreign Minister, and the rest by parliamentarians and military and civilian officials.

Oil Price Scenario

Prices continued to hover between $49-50/barrel through the last fortnight. Saudi oil minister, Khalid al-Falih said: "The over-supply has disappeared", and envisaged a new chapter in the cyclical energy scenario. He noted that the market now only needed to "work out the global inventory overhang" which would determine the pace of price recovery. In remarks to CNN, the oil veteran rejected the need to specify price targets, but was confident that $ 60 could be reached by the end of 2016; as more non-OPEC oil comes off the market, prices next year could go higher as the inventories of three billion barrels will get used up.

The International Energy Agency (IEA) seems to agree with the Saudi minister to some extent. It projects a demand growth, mainly from emerging markets, of 1.3 million barrels per day (mbd). Even as non-OPEC production is falling in the first three months of this year, IEA estimates oil demand rising by 1.6 mbd to 95.2 mbd, with 90% of additional supplies going to emerging markets; at the same time, output has fallen by nearly 600,000 b/d, the first major fall in three years.

The principal concern that the oil market has across the board is about investments: the energy consultants, Wood McKenzie, have projected that, between 2015-20, the hydrocarbon industry will reduce its investments by a trillion dollars; this will include $300 billion in reduced exploration spending and another $740 billion in the development of oil and gas resources. The hardest hit is, of course, the USA, where decline in drilling has meant a fall in capital investment of $125 billion.

The Saudi Oil Minister has echoed these concerns about declining investment, pointing out that in the medium term, there could be a supply crunch, leading to sharp price rises and unstable markets.

Other Economic Developments

1) Major UAE banks in merger discussions

The National Bank of Abu Dhabi [NBAD] and First Gulf Bank [FGB] are in the early stages of merger talks. With combined assets of $170 billion and market value of $30 billion, the joint bank will be a regional powerhouse, with a larger market value than Deutsche Bank and Credit Suisse Group, and will compete with Qatar National Bank to be the largest bank in West Asia. Observers believe that the UAE has too many banks, serving a relatively small population of 9 million, in a scenario of limited growth prospects due to declining government spending, economic slowdown, and falling asset value. The merger, if effected, would yield diversification, cost optimization, and funding advantages; it will have a combined market share of 21.5% (as against 13.2% for NBAD and 8.4% for FGB). Other GCC banks are expected to join the merger bandwagon in coming months.

2) GCC countries approve VAT agreement

GCC MINISTERS OF FINANCE HAVE APPROVED, in principle, group-wide VAT and excise treaties; some administrative matters relating to the tax collection mechanism for intra-GCC trade are being looked at, after which the formal announcement will be made. These treaties will provide a common GCC framework for these taxes, and are expected to come into effect by 1 January, 2017, for VAT, and 1 January 2018, for excise duty. These taxes are seen as an important step towards diversifying GCC economies by yielding resources to governments to pursue economic and social policy goals.

Once the treaties are ratified, each country will issue national legislation, with implementation regulations. The UAE has already announced revenue limits and procedures for VAT, requiring that companies with annual revenues of over $1 million should be the first to register for the new VAT system. It is expected that the proposed VAT system will apply at 5% across the GCC.

3) Reduced projections for Saudi deficit

RIYADH-BASED ECONOMIC CONSULTANTS, Jadwa Investment, have reduced their projections for Saudi deficit: they now forecast a budgetary deficit of $75 billion for 2016, as against the earlier projection of $107 billion; similarly, for 2017, they now project a deficit of $56 billion as against their earlier estimate of $88 billion. They attribute these changes to higher oil prices, as also to the government's economic diversification plan, as set out in the National Transformation Plan (NTP) [details in West Asia Digest, 15 June, 2016].

4) Dubai Industrial Strategy announced

THE RULER OF DUBAI, Sheikh Mohammed bin Rashid, announced the Dubai Industrial Strategy on 25th June, which will elevate Dubai into "a global platform for knowledge-based, sustainable, and innovation-focused businesses". This strategy will generate $50 billion by 2030, facilitate the growth of the industrial sector by about $5 billion by 2030, create 27,000 jobs, and yield additional exports on over $ 4billion.Priority sub-sectors included in this strategy are aerospace, maritime, aluminum and fabricated materials, pharmaceuticals and medical equipment, food and beverages, and equipment and machinery.

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