MENA WATCH

New Saudi bankruptcy law a step in the right direction

- ***Law will hasten process of dealing with company failures and boost credit to SMEs…***
- ***…but other areas need to be addressed to make it easier to start a business.***
- ***This month's key data: Egypt's monetary easing cycle to continue***

Saudi Arabia's new bankruptcy law, which was approved by King Salman last month, will make it easier to deal with the fallout from corporate failures and, through improving access to credit, support the development of small and medium-sized enterprises and boost productivity growth. However, as we explain in this *Watch*, many of the barriers that prevent the emergence of new firms remain in place.

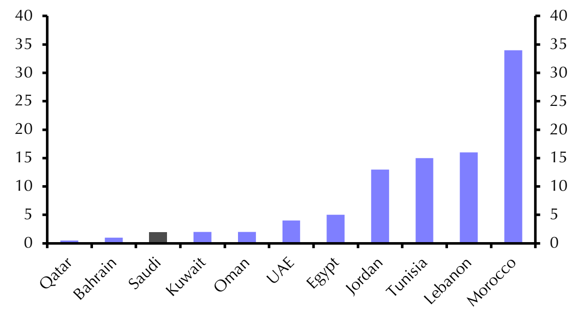
New law fills a big gap

The adoption of the new bankruptcy law marks a key milestone in Saudi Arabia's reform plans that are being spearheaded by King Salman's son, Crown Prince Mohammed bin Salman. **Previously, the country had no legislation in place to deal with the fallout from corporate insolvencies**. In the World Bank's latest Doing Business Report, Saudi Arabia ranked 168 out of 190 countries for the ease of "resolving insolvency".

The result was that struggling firms were often forced into a fire sale of assets in order to service their debts or had to negotiate debt restructuring with all creditors on a case-by-case basis, often resulting in a messy and drawn-out process. To take one notable example, negotiations over the settlement of $22bn debts of the Al-Gosaibi Group – which defaulted in the midst of the global financial crisis in 2009 – are still ongoing.

The lack of bankruptcy legislation has acted as a key deterrent to entrepreneurs in Saudi Arabia as well as to the willingness of local banks to provide financing to business start-ups. The upshot is that small- and medium-sized enterprises (SMEs) make up a smaller share of the economy in Saudi Arabia, around 33%, compared with other major economies. Moreover, SMEs only account for around 2% of total bank lending. (See Chart 1.)

Chart 1: Loans to SMEs (2010, % of Total)



Source: World Bank

Investment should receive a boost

The new bankruptcy law is a positive step towards streamlining the process for companies that run into financial difficulties. Full details have yet to be released, but on the basis of earlier drafts we have a good sense of what the new law is likely to entail.

For firms that are deemed to be no longer viable, formal liquidation procedures will be introduced. This will speed up resolutions to bankruptcies and mean that resources do not get tied during the period in which settlements are negotiated. One provision is likely to mean that struggling firms can push ahead with debt restructuring plans if they receive the agreement of at least two-thirds of creditors. That could finally bring an end to the saga surrounding the Al-Gosaibi Group. There is also expected to be a simplified liquidation process for smaller companies.

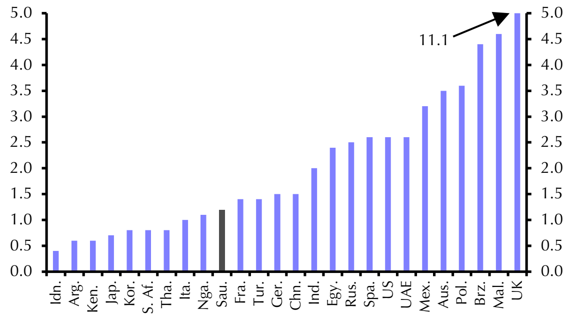
Meanwhile, for firms that are still considered viable but have run into temporary financial problems, the new law takes a similar approach to the Chapter 11 bankruptcy procedures in the US. Firms will be protected from creditors for a limited period of time

Jason Tuvey, Middle East Economist, +44 (0)20 7808 4065, jason.tuvey@capitaleconomics.com

in order for them to put forward a plan to restructure their finances.

Formalised bankruptcy procedures should help to support a pick-up in investment in Saudi Arabia. Foreign firms are more likely to establish operations in the Kingdom if they know that there is a legal procedure in place in the event that their venture fails. As we've noted before, foreign direct investment inflows into Saudi Arabia are low by the standards of other countries. (See Chart 2.)

Chart 2: Net Foreign Direct Investment Inflows (2016, % of GDP)



Source: World Bank

Moreover, banks are likely to be more willing to lend to firms in the knowledge that they have recourse to recover their funds. SMEs are likely to be the main beneficiaries from this and we expect to witness a growing share of bank credit allocated towards fledgling firms over the coming years.

A number of studies show that SMEs are key to supporting stronger productivity growth through fostering competition and increasing the churn of firms within an economy. They are also crucial in creating greater employment opportunities, which is much-needed in Saudi Arabia where unemployment rates are already high and threaten to rise even further over the coming years.

Firms still face many hurdles

That said, the new bankruptcy law is by no means a silver bullet and there remain a number of areas that still need to be addressed in order to break down the barriers that prevent the emergence of new firms.

A first step would be to bring down minimum investment levels, and thus legalise a large proportion of SMEs. As many migrants cannot afford to meet the minimum investment levels to establish a business outlined under the Foreign Investment Act, they are required to seek out a Saudi national to act as a business partner. The Saudi national's sole purpose is to register the company in their name and in return they receive a monthly fee, usually a share of the profits. This practise is known as *tasattur* and is legally prohibited. But enforcement is light at best.

Second, the authorities need to take further steps to address the bloated bureaucracy. For many years, rather than try to reform the bureaucracy, the government has created new agencies and ministries to try to deal with problems that arise. This has resulted in a multi-layered system that many struggle to penetrate. Most businesses rely on an army of "brokers" – who have privileged access to ministers or those in high-level government positions – to cut through the red tape.

Third, efforts to tackle deep-seated clientelism would be welcome. The non-oil private sector is dominated by a small number of large firms that have prospered due to their close relationships with the royal family, stifling competition from SMEs.

Summary

Overall, then, the new bankruptcy law helps to address one of the previous major pitfalls in Saudi Arabia's legislation and will streamline the process for dealing with corporate failures and also make it easier for SMEs to access credit. But other areas need to be addressed in order to make it easier for new firms to emerge and support a sustained pick-up in investment.

Data Preview – Saudi Arabia GDP

26th – 31st Mar.

Forecasts	Time (GMT)	Previous	Consensus	Capital Economics
Saudi Arabia GDP (% y/y)	-	-0.4	-	-0.5

Past the worst, recovery on the way

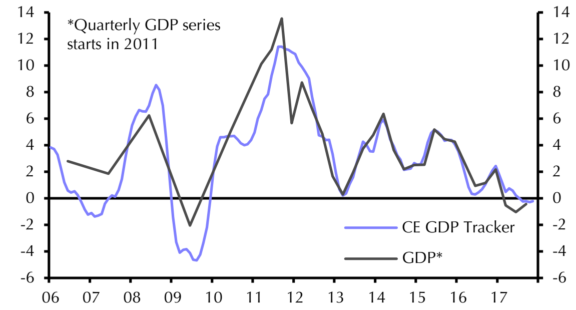
The worst of the downturn in Saudi Arabia's economy appears to have passed in late 2017 – we have pencilled in a contraction of 0.5% y/y in Q4. And a recovery should get underway this year.

The Saudi economy contracted by 0.4% y/y in Q3, which was broadly in line with the performance show by our GDP Tracker and was better than the 1.0% y/y decline in GDP recorded in Q2.

Our Tracker suggests that the economy contracted in Q4 at a similar pace as in Q3. (See Chart 3.) The downturn in the oil sector has passed its trough, while the non-oil sector seems to have lost steam. The bigger picture, though, is that the non-oil sector has emerged from its downturn in 2016.

Looking ahead, the economy should embark on a recovery this year as the drag from the oil production cuts fades and looser fiscal policy supports a pick-up in growth in the non-oil sector. We have pencilled in GDP growth of 1.5% for 2018 as a whole 2018.

Chart 3: Saudi Arabia GDP & CE GDP Tracker (% y/y)



Sources: CEIC, Thomson Reuters, Capital Economics

Data Preview – Egypt Interest Rates

29th Mar.

Forecasts	Time (GMT)	Previous	Consensus	Capital Economics
Egypt Interest Rate	-	17.75%	-	16.75%

Easing cycle to continue

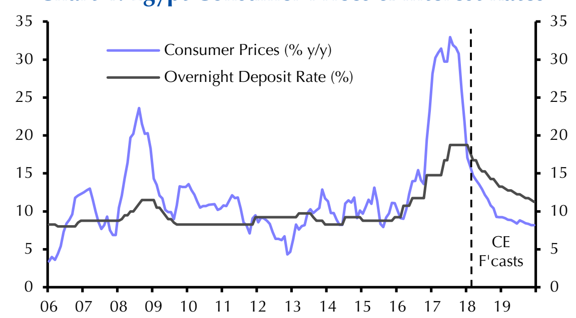
We expect the Central Bank of Egypt to continue its easing cycle with another 100bp cut to its overnight deposit rate, to 16.75%, when the monetary policy committee (MPC) meets in late March.

The latest consumer price data show that inflation fell to 17.1% y/y in January, from 21.9% y/y in December and a 30-year high of 33.0% y/y in July 2017. This reflects the unwinding impact of the pound's 50% drop against the dollar, hikes in administered prices and the introduction of a value-added tax, all of which came in November 2016.

This process has further to run and there are a couple of other reasons to think that inflation will continue to ease. After several years of weak growth, there is probably some spare capacity in the economy. What's more, the central bank has stopped financing the budget deficit.

The MPC's greater emphasis on tackling Egypt's long-standing inflation problem means a series of very steep rate cuts is unlikely. But that doesn't rule out a significant and prolonged easing cycle. We expect the overnight deposit rate to be lowered to 13.25% by the end of this year and to 11.25% by the end of 2019. (See Chart 4.)

Chart 4: Egypt Consumer Prices & Interest Rates



Sources: CEIC, Thomson Reuters, Capital Economics

Latest Data & Main Forecasts

Main Economic Forecasts

	Share of World	GDP 2016	GDP 2017	GDP 2018	GDP 2019	Inflation 2016	Inflation 2017	Inflation 2018	Inflation 2019
Saudi Arabia	1.4	1.7	-0.7	1.5	1.0	2.1	-0.8	3.5	2.0
Egypt	0.9	3.9	4.8	5.3	5.5	13.8	29.5	15.0	10.0
UAE	0.5	3.0	2.0	2.8	2.5	1.6	2.3	3.0	2.0
Algeria	0.5	3.5	2.0	2.3	2.5	6.4	5.5	7.0	7.0
Qatar	0.3	2.2	1.5	2.0	2.5	2.8	0.5	2.0	2.0
Kuwait	0.2	3.5	0.0	1.8	1.8	3.2	2.0	2.0	3.8
Morocco	0.2	1.2	3.8	3.0	4.5	1.6	0.7	2.3	3.0
Oman	0.2	4.0	0.5	1.0	1.0	1.1	1.6	2.0	3.5
Tunisia	0.1	1.1	2.0	2.5	3.0	3.7	5.3	6.0	5.0
Lebanon	0.1	2.0	2.0	2.5	2.8	-0.8	3.3	2.5	2.8
Jordan	0.1	1.0	1.3	1.5	1.8	-0.8	4.3	2.2	1.5
Bahrain	0.1	3.2	3.5	2.5	2.5	2.7	1.5	3.5	3.0
MENA	4.6	2.7	1.8	2.8	2.8	4.9	7.3	6.0	4.5

Sources: CEIC, Thomson Reuters, Capital Economics

Latest Market Data

	Equities 1 mth ago	Equities Latest	CDS Premia 1 mth ago	CDS Premia Latest	Bond Yield 1 mth ago	Bond Yield Latest
Abu Dhabi (UAE)	4,639	4,595	52.0	56.6	3.66	3.86
Algeria	-	-	-	-	-	-
Bahrain	1,352	1,373	243.8	245.0	6.30	6.74
Dubai (UAE)	3,440	3,209	116.9	108.2	3.19	3.46
Egypt	15,316	15,443	261.5	256.9	6.22	6.60
Jordan	2,194	2,217	349.8	349.9	6.14	6.32
Kuwait	6,664	6,808	-	-	3.58	3.81
Lebanon	1,184	1,171	430.5	483.7	6.74	7.46
Morocco	10,600	10,713	108.0	110.7	3.29	3.71
Oman	5,008	5,012	-	-	5.41	5.55
Qatar	9,328	8,730	89.6	82.4	3.93	4.10
Saudi Arabia	7,631	7,411	85.2	82.3	3.87	4.23
Tunisia	6,423	6,696	-	-	5.99	6.89

Sources: Bloomberg, Thomson Reuters

Jason Tuvey, Middle East Economist, +44 (0)20 7808 4065, jason.tuvey@capitaleconomics.com

Monthly Diary

The Month Ahead

	Country	Release / indicator / event		Time (GMT)	Previous	Median	CE Forecast
March							
28th – 5th	**Sau**	Non-Oil Trade (Dec)		-	(+18.2%)	-	-
Mon 5th	**Egy**	Whole Economy PMI (Jan)		04.15	49.9	-	-
Mon 5th	**Sau**	Whole Economy PMI (Jan)		04.15	53.0	-	-
Mon 5th	**UAE**	Whole Economy PMI (Jan)		04.15	56.8	-	-
Mon 5th	**Leb**	Whole Economy PMI (Jan)		09.00	47.1	-	-
Sun 11th	**UAE**	Dubai Economy Tracker (Feb)	(sa)	04.15	56.0	-	-
Tue 20th	**Mor**	Consumer Prices (Feb)		-	+0.1%(+1.8%)	-	0.0%(+2.7%)
	Mor	Interest Rate Announcement		-	2.25%	-	2.25%
Thu 29th	**Egy**	Interest Rate Announcement		-	17.75%	-	16.75%
Expected during this period:							
3rd – 8th	**Egy**	Foreign Exchange Reserves (Feb)		-	$38.2bn	-	-
8th – 11th	**Egy**	Urban Consumer Prices (Feb)		-	-0.1%(+17.1%)	-	+1.6%(+15.9%)
8th – 11th	**Egy**	Core Consumer Prices (Feb)		-	(+14.4%)	-	-
9th – 14th	**Jor**	Industrial Production (Jan)		-	(+0.1%)	-	-
10th – 20th	**Oma**	Consumer Prices (Feb)		-	+0.1%(+1.1%)	-	+0.8%(+1.4%)
10th – 20th	**Qat**	Consumer Prices (Feb)		-	+0.4%(+0.9%)	-	+0.3%(+2.5%)
11th – 18th	**Jor**	Consumer Prices (Feb)		-	+0.7%(+3.0%)	-	-0.8%(+2.3%)
15th – 20th	**Egy**	Trade Balance (Jan)		-	-$3.3bn	-	-
15th – 25th	**Sau**	Consumer Prices (Feb)		-	+3.9%(+3.0%)	-	+0.1%(+3.0%)
17th – 12th	**Bah**	GDP (Q4)		-	(+3.6%)	-	(+2.5%)
19th – 25th	**Bah**	Consumer Prices (Feb)		-	+1.6%(+2.8%)	-	+0.3%(+2.7%)
20th – 31st	**Mor**	GDP (Q4)		-	(+3.8%)	-	(+3.5%)
20th – 30th	**Kuw**	Consumer Prices (Feb)		-	-0.1%(+1.0%)	-	+0.1%(+1.5%)
21st – 23rd	**Leb**	Consumer Prices (Feb)		-	0.0%(+5.5%)	-	+0.4%(+3.8%)
26th – 31st	**Sau**	GDP (Q4)		-	(-0.4%)	-	(-0.5%)
29th – 25th	**Qat**	GDP (Q4)		-	(+1.9%)	-	(+1.1%)
30th – 2nd	**Jor**	GDP (Q4)		-	(+1.9%)	-	(+2.5%)

*m/m (y/y) unless otherwise stated; p = provisional estimate
Source: Bloomberg, Thomson Reuters, Capital Economics