Prospects

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GULF STATES – Oil: navigating back to basics amid stormy seas

On "Liberation Day", the Gulf States were relatively spared by the threat of trade tariffs. However, there are other channels through which "Trump risk" can be transmitted. In particular, over the past few weeks oil prices have reflected global turbulence triggered by a cardboard chart held up on live TV at the beginning of April, combined with deeper uncertainty over the global balance between supply and demand. But amid the innumerable attempts at quantification and prediction, which areout of date within 24 hours and needconstant updating in light of this or that new event, has anyone evaluated the cost of the amount of collective intelligence expended on trying to keep up with the latest up-to-the-minute news? The reality is that, when an economy is dependent on commodities, all of its variables are exposed tovolatility in their prices. **Fundamentally, then, the assessment of a country's risk should not change because of market turmoil; rather, it should reflect the country's ability to resist it.** This would help reduce agitation. Fortunately, there is a practical tool for just that purpose: the fiscal breakeven. But this analysis does not necessarily fit neatly inside the box of a uniform indicator: sometimes various forms of rigidity make the wealthy Gulf States more vulnerable to storms than they appear.

An oil market rocked by events and a geopolitical shift within OPEC+

The first week of April was a memorable one for oil. The announcement of harsher than anticipated trade tariffs, while expected, exacerbated doubts over global growth and, by extension, demand for oil. Less than 24 hours later, OPEC+ caught the market off guard when it issued a press release announcing plans to accelerate the unwinding of voluntary production cuts, by increasing the May output to three times the amount originally planned. **The first concern is that this could reflect the group's growing difficulty in agreeing on how to fulfil its role as an oil price regulator.** Indeed, some of its members (notably Iraq and Kazakhstan) have significantly exceeded their production quotas, suggesting that cooperation is difficult. **Under this scenario, the surprise increase in May is an attempt by the group to realign itself** by giving these countries room to offset their overproduction – a test of the group's unity. But the timing of the OPEC+ release, the day after reciprocal tariffs were announced, also raises questions about **the American president's influence over the organisation and its de facto leader, Saudi Arabia**. One of his constant refrains has been a desire to keep oil prices low. But the potential levers of influence are a matter of pure speculation: is this a quid pro quo for Saudi Arabia's positioning as host diplomatic of negotiations over Ukraine? Is it the part the Gulf States have agreed to play to avoid Israeli or American military intervention in Iran's nuclear programme? Or is it progress on a nuclear cooperation deal with the United States that is in the balance for Saudi Arabia? Whatever the reasons behind it, if US influence were to dominate the decisions of OPEC+, this would only weaken the group's cohesion and increase volatility in a market that is trying to digest its decisions while swimming against the tide.

Quiet militancy vs. breakeven as an analytical tool

Amid this turbulence, the breakeven – the oil price needed to balance an oil-exporting country's budget – is a useful thing to calculate. It is a quick, simple and comparable entry point for analysing how resilient economies are to oil price shocks: the more a country's breakeven exceeds the current price, the more room that country has to maintain its fiscal policy, without additional trade-offs, in the face of oil shocks. However, its analytical power is sometimes overused to the point where it leads to false conclusions.

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Firstly, **breakeven analysis makes no distinction between the types of fiscal spending covered by oil revenue**. It thus does not take into account how much flexibility a budget has to adapt to a potential shock. The example of Saudi Arabia is instructive in understanding this. Calculating the fiscal breakeven between 2018 and 2024 shows a deterioration in the budget's sensitivity to an oil shock. What appears more interesting, however, is that the share of the public sector wage bill – difficult to adjust in the event of a shock – covered by non-oil revenue increased substantially over that same period. Secondly, **the breakeven is a static measurement that reflects the procyclicality of fiscal policy**. This means that, when a government reduces its discretionary spending in response to a shock, or increases discretionary spending when prices are high, the breakeven changes. However, in the absence of budget reform, this does not translate into greater or lesser resilience to shocks. In short, while the breakeven is a useful measure, on its own it is insufficient and perhaps even misleading. In any event, it should only be considered as part of an evolutionary and structural analysis. And even that is not enough: **the effective rigidity of a given type of expenditure varies from country to country depending on how much compromise the political system will tolerate and how attached the population is to this or that expenditure – i.e. depending on the social contract.** Beyond relative wealth, then, understanding these rigidities is key to evaluating a country's strengths and weaknesses in the face of an oil shock.

A tentative diagnosis to reduce turbulence

For Bahrain, there is little doubt: the country has no room to withstand another prolonged oil shock. The country's debt reached 123% of GDP in 2024, and its ever higher cost only adds to the budget's rigidity in the face of shocks. **This reflects a social contract aligned with the rentier states of the Gulf[1] but without the resources to back it up: in reality, Bahrain produces little oil.** Its political structure makes reform particularly challenging. It is the only Gulf State to have experienced an "Arab Spring" uprising in 2011; this was mostly quelled by repression, though the regime never fully regained its legitimacy. **However, unless the country transitions its model – which is politically difficult to do – its trajectory does not appear sustainable** and could yet deteriorate more quickly in the event of an oil shock.

Kuwait, meanwhile, stands on firm ground, underpinned by an exceptional store of wealth built up over decades[2]. This means that, from a sovereign risk perspective, the country can weather numerous storms. However, if we consider flows rather than stocks, its recurring deficits indicate that revenue no longer covers the growing fiscal cost of its welfare state model, now the most generous of any Gulf State. **Paradoxically, though, the thing that has made Kuwait's system rigid to reform is the fact that, unlike other Gulf States, it allows for political consultation through an elected parliament.** This regularly crystallises individual interests that run counter to proposed government reforms. In May 2024, Emir Mechaal decided to temporarily suspend parliament. While this resolves the deadlock, it does so at the expense of Kuwaiti political tradition. The country's fragility in the event of an oil shock is more about whether the government has the legitimacy to impose challenging reforms without parliament.

Oman's sovereign profile[3] has significantly improved recently, to the point where the country has regained its investment-grade rating. Of course, favourable oil prices since 2022 have helped. But the most important thing is that, since 2020, **Oman has embarked on an ambitious programme of institutional reforms and deftly used surplus revenue** to reduce its debt. **Recent reforms suggest that there is greater political will to deconstruct rentier dynamics. Nevertheless, rigidities remain, notably in the labour market, reflected in continuing high unemployment** that could, in the event of a lasting oil shock, test the resilience of reforms and thus the budget's flexibility to adapt.

Saudi Arabia has placed a different bet. **The divergence between its demographic trajectory and its oil rent was always going to lead to an unsustainable social contract.** Rather than gradually dismantling distribution channels (subsidies, reduced public employment), which would primarily affect the middle class (a uniquely Saudi reality), the Kingdom has set out to transform its social, societal and economic model: to inject fresh momentum by transitioning its social contract. It has already managed to restructure its budget, leaving more room to invest in diversification. However, **this is perhaps a specific case where capital investment, normally considered less rigid (because it can be adjusted in the event of a shock),**

[1] No direct taxes on the population, free utilities, subsidised basic products and public sector employment for the population.

[2] Net public assets of around 500% of GDP and net external asset of 650% of GDP. See article *Koweït – Le temps des arbitrages ?* dated 20 February 2025.

[3] See article *Oman – Laboratoire fiscal de l'après-pétrole ?* dated 10 October 2024.

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becomes more rigid. If the government is no longer able to deliver on all its promises, its Vision 2030[4] plan could lose momentum and be forced to stabilise around a more precarious interim equilibrium.

Qatar and the United Arab Emirates still have plenty of room for manoeuvre – enough not to call into question their rentier-based social contract. The political equilibrium is thus strong enough to support economic transition. If the Emirates wish to go beyond Dubai's model as a hub for diversification, the "moonshot" strategy of moving into cutting-edge sectors carries risks, but the resources to finance such a strategy, notably through a myriad of very well endowed sovereign wealth funds, appear secure. For Qatar, the North Field expansion will boost its revenue, particularly over the period 2026-2029, buying it some time. But the risk is that it will lag behind when it comes to diversification, which could ultimately force it to undergo riskier shock therapy.

To find out more, read the full article, *Pays du Golfe – Sous la houle pétrolière, cap sur les fondamentaux*, dated 25 April 2025.

[4] See *Can Saudi Arabia afford its ambitions?* dated 26 September 2024.

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