



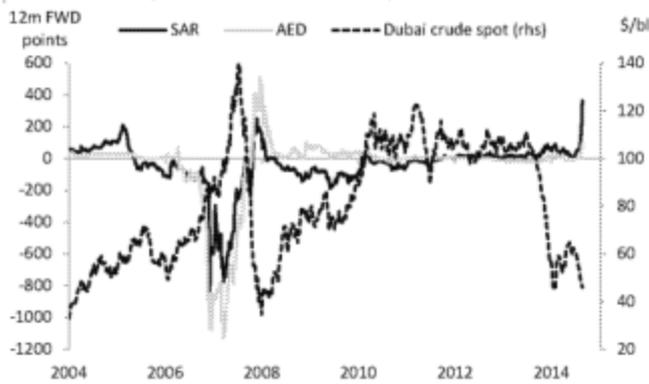
with a stronger broad dollar. 12m forwards give some indication of this pressure on the the dirham and particularly riyal pegs over the past fortnight (Figure 21).

We expect Middle Eastern governments to continue to lose significant reserves in the coming months. Low oil prices are only one ingredient in the mix. The exacerbating factor is our economists' prediction that the main dollar pegs in Saudi and the UAE will hold, albeit at considerable costs in terms of reserves.⁴

One reason for our economists' confidence in the pegs is that both governments can afford to withstand the pressure. They note that Saudi FX reserves have fallen by 10% since last September but remain abundant at \$665bn, roughly 100% of GDP. As shown by Figure 21, pressure on the Saudi peg was also considerable in 1998 when FX reserves amounted to a third of today's stocks and government debt, now negligible, stood at 100% of GDP. And yet the peg held.

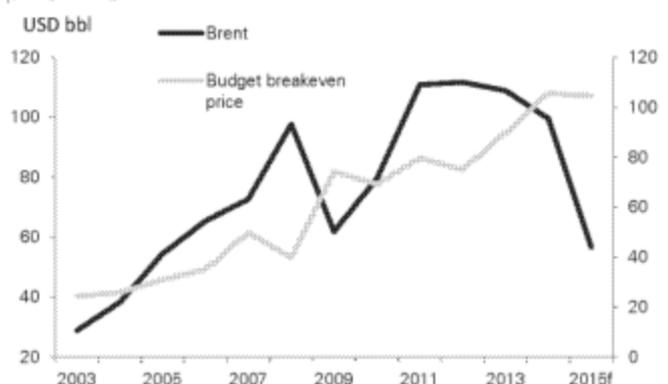
Nor is there a compelling macroeconomic incentive for SAMA to devalue. Given the economy's export dependency on oil, which is invoiced in USD, a weaker riyal would not make it significantly more competitive. The net effect would be negative due to higher import prices. The same arguments can be made more forcefully for the UAE, which retains even greater assets and a stronger fiscal position. Hence, until oil prices recover meaningfully, both governments and central banks will likely continue to bleed fast.

Figure 21: SAR and AED dollar pegs have lately come under considerable pressure from low oil prices



Source: Deutsche Bank, Bloomberg Finance LP

Figure 22: Saudi-Arabia requires an oil price above \$100 to plug budget deficits



Source: Deutsche Bank, Bloomberg Finance LP

If oil prices do recover in the medium term, pressure on the pegs would naturally diminish. Our economists note, however, that Saudi public spending has increased by about 10% a year over the past decade. This has lifted the oil price needed to balance the budget from \$25/bbl in 2004 to \$105/bbl (Figure 22). This may be reduced with government spending cuts. Yet it seems unlikely that the budget breakeven will fall back to levels seen in the 2000s. Unless oil prices rise to unprecedented levels, therefore, OPEC reserve accumulation is unlikely to return to the run rate of the past decade. The more realistic baseline is that, over time, OPEC countries will slowly burn reserves.

⁴ Robert Burgess, "Is the Saudi riyal the next currency peg to break?", DB Global Markets Research, 14 August 2015, http://pull.db-gmresearch.com/cgi-bin/pull/DocPull/1004-04A7/85109503/DB_SpecialReport_2015-08-21_0900b8c08a14294b.pdf