The equities market rout on Monday left the Shanghai Composite Index down over 40 percent from its peak in June.

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The equities market rout on Monday left the Shanghai Composite Index down over 40 percent from its peak in June. Investors scrambled in Europe and the United States to react to an economic slowdown in Asia. Part of the reaction stems from a global market frustration with government management of the economy in China, and a lack of transparency in the way the government deals with its debt in local bank markets, and how it anticipates demand for infrastructure and housing. Many investors have long anticipated a slowdown, but the timing couldn't be worse for the Arab Gulf states.

For the Gulf Cooperation Council states this decline in equity markets is especially unwelcome. Declining oil prices can be correlated to the slump in demand from China and Asian markets, a key destination for exported Gulf oil. The GCC states provide China with more than 35 percent of its oil imports, with nearly 20 percent originating in Saudi Arabia. India relies on the GCC states for as much as 45 percent of its oil imports, while South Korea and Japan receive 70 percent or more of their oil imports from the Arab Gulf states.

The Gulf has had its own pivot to Asia. According to the Economist Intelligence Unit, in 1980 the Organization for Economic Cooperation and Development countries accounted for almost 85 percent of GCC trade partners. The GCC states used that trade surplus from selling oil to the West to reinvest the proceeds in Western markets, especially stock markets. Meanwhile, trade partners have changed. According to research by Deutsche Bank, since the early 2000s, there have been major changes in trade patterns in the GCC states. Japan remains important, but India and China are far outpacing the OECD countries in demand for Gulf exports. Non-Japan Asia absorbs more than 40 percent of all GCC exports; combined with emerging and developing economies (as defined by the International Monetary Fund), more than half of GCC exports are destined for the global South and Asia. Some Arab Gulf states are more sensitive to Asian consumption of oil exports than others. For example, Emirates NBD estimates that Oman exports over 60 percent of its crude oil to China. Saudi oil exports to China have averaged around 9 percent of production from 2010-14.

The decline in oil prices has not led to a decrease in production by Organization of the Petroleum

Exporting Countries (OPEC) states. Saudi Arabia in particular, refuses to decrease production. There is a competition for market position underway. Some of it relates to the threat of Iran coming back to international oil markets anticipated for some time early next year. Though competition from familiar places, including Iraq, is also keeping production levels high in the Gulf.

The fiscal situation in the Arab Gulf states is worrisome, as deficits are anticipated across the GCC this year. The IMF expects the Saudi deficit to be close to 20 percent of gross domestic product this year. Moody's predicts the United Arab Emirates to experience a 27 percent drop in government revenue this year with a fiscal deficit of just 2.3 percent of GDP. In Saudi Arabia, income from oil accounts for about 90 percent of revenue, and the more than 50 percent drop in prices over the past year has led to a flurry of bond issues and a new government interest in reducing at least some capital spending (mostly in infrastructure investments.) Other Arab Gulf states, including the UAE and Oman, are experimenting with reduced subsidies on gasoline products, electricity, and water, but not to the extent that will dramatically improve their budgets for 2015-16.

Bankers are talking about non-performing loans and the related problem of higher loan to deposit ratios. This is because there is less cash being deposited in banks in the Gulf now as governments, related entities, and national oil companies are key deposit holders, providing from 10 to 35 percent of banks' non-equity funding across the GCC. This puts additional pressure on bank systems and creates increased demand for liquidity, especially in U.S. dollar foreign exchange.

Some analysts are even beginning to question the stability of the Arab Gulf states' monetary policies that tie the value of local currencies to the U.S. dollar, a currency peg (or basket of currencies and commodities in the case of Kuwait). There is not any immediate indication that there is a devaluation coming to the Arab Gulf state currencies, but with so little flexibility in their monetary policies a devalued peg, or even a release from the peg, is not completely out of the question. Competitive devaluations (and capital flight) were the root cause of the 1997 Asian financial crisis. Asian currencies have recently devalued, which makes imported oil more expensive in local economies, which could depress already reduced demand. Though, there is some debate among economists on how sensitive Asian oil demand is to price, given there are few other available sources of energy in most of these markets.

The spillover effects in the wider Middle East from a slowdown in Gulf economies will be important to watch. As so many regional economies are dependent on Arab Gulf states for remittances, a slowdown in the Gulf will also mean a contraction in remittance flows. This could mean additional pressure on fragile political economies like Egypt, Jordan, and Yemen. Egypt and Jordan are also likely to devalue their currencies, which will make imports more expensive locally and the need for incoming remittance payments more dear.

According to Middle East Economic Digest, Egypt is the largest destination in the Middle East for remittances, with inflows of $19.2 billion in 2014. Saudi Arabia is the largest source of Egyptian destined remittances, with almost $7.6 billion sent from the kingdom to Egypt last year. Egyptians have sent more money home from the GCC over the past two years, with an increase of 44 percent between 2012 and 2014. Some of this increase could be explained in changes in migration patterns as fewer Egyptians seek work in Libya and may now prefer working in the Gulf, while the political crisis in Egypt has also likely prompted more people to seek work abroad.

Likewise, Yemenis working in the GCC sent home $3.5 billion, $2.2 billion from Saudi Arabia alone. As the civil war makes travel and communication more precarious, the availability of remittances will mean survival for many Yemeni families.

The largest destination for Gulf-based remittances is India, which received $37 billion from expatriates in the GCC in 2014, nearly $12.4 billion coming from the UAE alone. Pakistan and the Philippines are close behind, receiving $10.6 billion and $9 billion respectively.

The Arab Gulf states are staring down a dismal economic growth trajectory for the next couple of years. Some of this is out of their control, as in the reduced demand for oil in Asia and the wipeout of stock values in international stock exchanges in which many of their sovereign wealth funds are invested, while other factors, such as economic diversification and fiscal reform are well within the purview of government responsibility. While this offers a moment for innovative public finance reform, it also offers a preview of post-oil economic life. As Arab Gulf states integrate into the global economy, some structural features of their economies will have to adapt, and many other countries in the wider Middle East and North Africa region will be dependent on their ability to reform and continue to grow.

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