OUTLOOK

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Sovereigns – Middle East and North Africa (MENA)

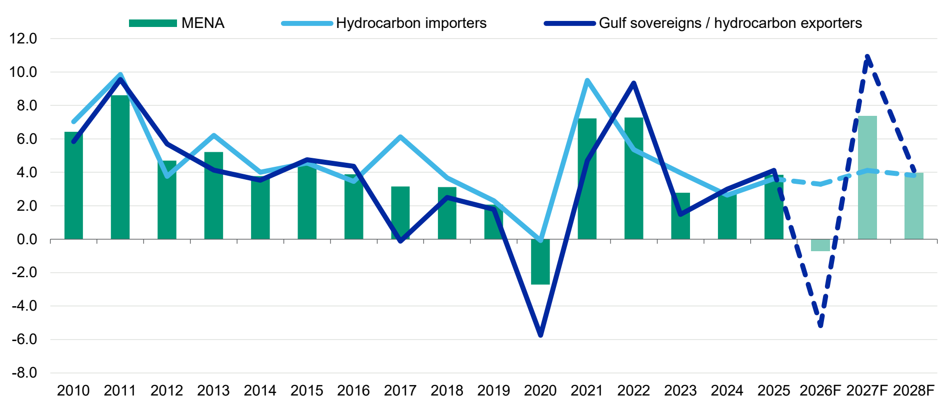
2026 Outlook update: turns negative as conflict weakens regional credit conditions

Summary

Our outlook for credit fundamentals for sovereigns in the Middle East and North Africa (MENA) has changed to negative from stable. The escalation of long-standing geopolitical tensions in the Middle East into an open military conflict since late February 2026 is materially weakening regional credit conditions through disruptions to trade flows and the impact of elevated security risks on sentiment-sensitive sectors. For hydrocarbon-exporting Gulf sovereigns, the main transmission channel is the impairment of shipping through the Strait of Hormuz, which will weigh on growth, as well as fiscal and external positions (Exhibit 1). However, over the next 12-18 months, large fiscal and external buffers and/or alternative export routes will mitigate the credit impact for most. In the longer term, the full impact will depend on how quickly trade flows normalize and whether the conflict durably damages the economic models of the Gulf sovereigns, weakening their prospects for diversification away from the hydrocarbon sector. For the hydrocarbon-importing sovereigns outside the Gulf, the transmission is mainly indirect through elevated global energy prices, supply-chain disruptions, and sentiment-driven shifts in short-term foreign capital flows.

Exhibit 1

MENA economic activity is set to contract in 2026, driven by hydrocarbon exporters
Real GDP growth, %



Gulf sovereigns / hydrocarbon exporters include Bahrain, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE. Hydrocarbon importers include Egypt, Israel, Jordan, Morocco, Lebanon, Tunisia, and Turkiye.
Sources: Haver Analytics and Moody's Ratings

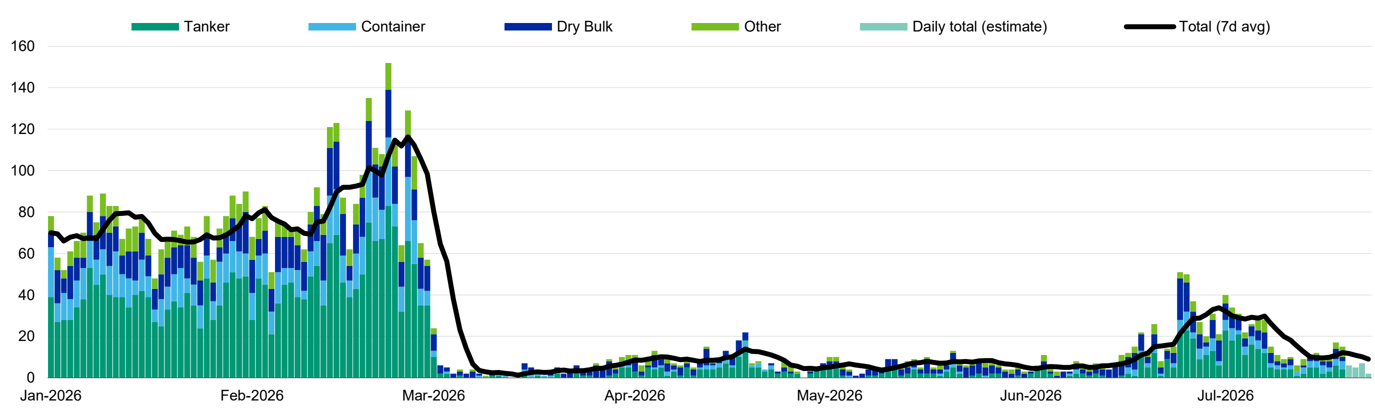
Growth will slow and become more uneven across the region as trade disruption and confidence shocks weaken earlier momentum

At the start of the year, we expected MENA region growth to accelerate in 2026 on higher oil production and further progress on large-scale investment projects and pro-business reforms. However, the Middle East conflict has since disrupted that baseline, with early indicators pointing to a real GDP contraction. Nearly all hydrocarbon exporters in the Gulf have been forced to cut production because of disruption to shipping through the Strait, and Qatar's (Aa2 stable) liquefied natural gas (LNG) facilities have been directly damaged by Iranian strikes. Nevertheless, the economic impact will be less severe for those with alternative export routes – notably Saudi Arabia (Aa3 stable) and Abu Dhabi (Aa2 stable). Oman (Baa3 stable), whose ports and energy infrastructure lie to the east of the Strait, is the only sovereign that has so far faced no material constraints on exports.

In our central scenario we assume that even if the conflict continues, it will not lead to further material damage to energy or other civilian infrastructure in the Gulf region. However, we expect trade flows will remain disrupted through autumn and will not return to pre-conflict levels before early 2027 (Exhibit 2). This will lead to a significant contraction of economic activity for the region's hydrocarbon exporters. Meanwhile, the shock to non-hydrocarbon activity in the Gulf will be broad-based because the conflict affects sectors that have become central to the region's economic diversification strategies. Aviation, hospitality, retail, logistics (centred around maritime transshipment flows), real estate and construction will be affected by reduced tourism inflows, supply chain disruptions, weaker confidence, and delayed investment decisions. The United Arab Emirates (UAE, Aa2 stable), including the constituent emirates of Abu Dhabi, Sharjah (Ba1 stable) and Dubai, as well as Qatar have already seen a sharp fall in tourism arrivals, and the conflict has set in motion a long-anticipated correction in the UAE's real estate market after a five-year boom. Together with Bahrain (B2 negative) and Kuwait (A1 stable) these Gulf sovereigns have been most directly impacted by Iran's military responses and have all or most of their ports located inside the Gulf. In comparison, Saudi Arabia and Oman's exposure to Iran's military responses has so far been more limited.

Recovery in non-oil growth will likely take longer and depend on the durability of the ceasefire, the pace of normalization of non-oil trade flows, and a lasting improvement in confidence and security conditions — all of which remain highly uncertain. Although not part of our baseline, a lasting change in perceptions of the Gulf region's security and overall stability would undermine its non-oil economic model and hurt its long-term growth and diversification prospects. Such a scenario would become more likely the longer the underlying tension between the US (Aa1 stable)/Israel (Baa1 stable) and Iran remains unresolved, raising the prospect of periodic re-escalation and the risk of further collateral damage to the region's economic assets and infrastructure. This risk is one of the key factors underpinning the region's negative outlook.

Exhibit 2
Shipping traffic through the Strait of Hormuz has returned to a trickle
Number of daily crossings by vessel type



As of 23 July 2026. Crossings may be underestimated due to GPS jamming, AIS spoofing, and vessels going dark
Sources: UN Global Platform, IMF PortWatch (portwatch.imf.org). Estimates for the most recent period based on hormuz.data-tracking.net

For most hydrocarbon importers outside the Gulf, the growth impact will be more indirect but still negative. Egypt (Caa1 positive), Jordan (Ba3 stable), Morocco (Ba1 positive), Tunisia (Caa1 stable) and Turkiye (Ba3 stable) are exposed through varying combinations of higher energy import costs and weaker external demand as well as tighter global financing conditions, and supply chain disruptions. Lebanon's (C stable) exposure is more direct because of Israel's military operations in the country since the start of the conflict. On balance, we expect a relatively modest slowdown in the MENA region outside the Gulf bar Lebanon.

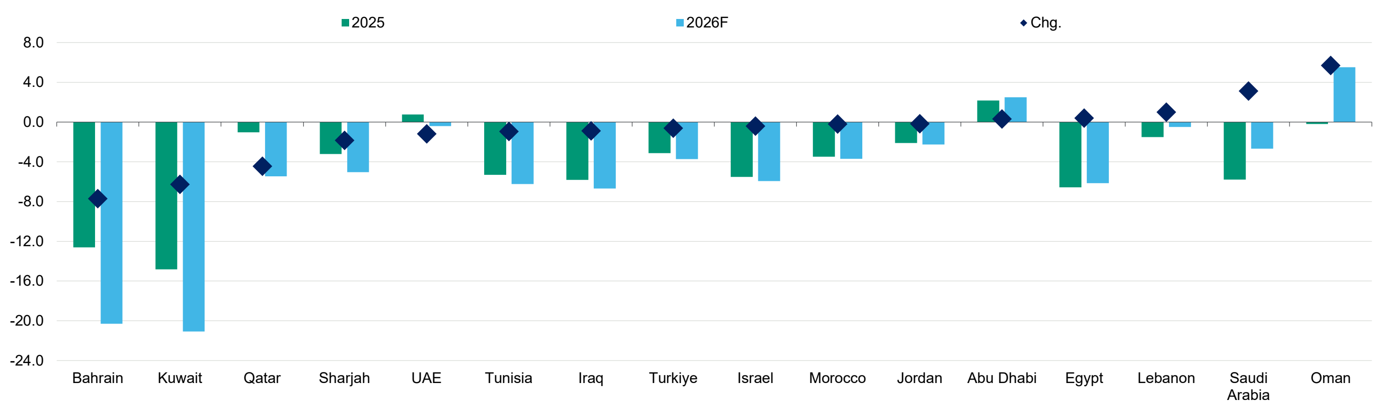
Fiscal and external pressures will rise, with the credit impact differentiated by exposures, mitigants and buffers

At the start of the year, we expected lower oil prices to weigh on the hydrocarbon exporters' public finances, notwithstanding higher production volumes due to the unwinding of OPEC+ production cuts, while we expected most hydrocarbon importers to continue their fiscal consolidation despite high interest costs and social pressures. However, the conflict has shifted the fiscal outlook for the hydrocarbon exporters to one driven by a combination of export disruptions, which have been offset, in some cases, by the sustained ability to export oil at significantly higher prices (Exhibit 3). For the hydrocarbon importers, the consolidation paths will be challenged by the increase in domestic fuel subsidies, especially in Turkiye and Egypt. The Gulf sovereigns that are most exposed to the fiscal fallout from the conflict are Bahrain, Qatar and Kuwait, and Iraq (Caa1 negative). None have access to meaningful alternative export routes that bypass the Strait while their hydrocarbon fiscal revenue before the conflict was very large at more than 35% of GDP. In contrast, Saudi Arabia and Abu Dhabi, whose pipelines provide a partial mitigant to the Strait's disruption, will benefit from higher oil prices, which we expect to more than offset lower production volumes.

Exhibit 3

Fiscal impact of the conflict on the MENA region will be uneven

Fiscal balance, % of GDP

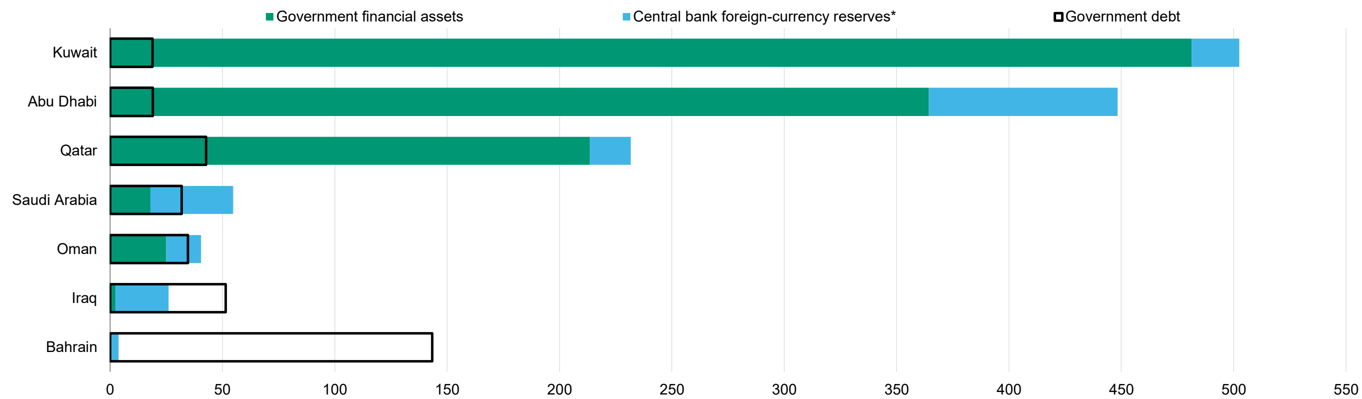


Source: Moody's Ratings

Very large sovereign buffers mean the impact of expected fiscal deterioration on credit metrics will be transitory for Qatar and Kuwait and we retain a stable outlook for both (Exhibit 4). In contrast, Bahrain and Iraq are more vulnerable to credit pressure because weaker fiscal starting positions and more limited financial buffers, including central bank foreign-currency reserves in the case of Bahrain, leave less room to offset the impact of lower export receipts and weaker domestic activity. However, in the case of Bahrain we would expect financial assistance from the neighboring Gulf Cooperation Council governments to be forthcoming in a timely manner if needed. The $5.4 billion bilateral currency swap line provided to Bahrain by the UAE in early April is an example of such support.

External positions will weaken as well. For the Gulf hydrocarbon exporters, fiscal deterioration (or improvement in the case of Oman and Saudi Arabia) will broadly mirror the deterioration in the current account balance, driven mainly by lower oil and LNG exports but also weaker tourism and logistics services receipts. Bahrain and Iraq have so far experienced the largest drop in central bank foreign-currency reserves. For hydrocarbon importers, we expect current account balances to deteriorate because of higher energy import bills and weaker tourism inflows. Tourism exposure is particularly large for Jordan, but also for Morocco, Tunisia, Turkiye, Egypt and Lebanon. Furthermore, Egypt and Jordan are exposed to potential disruption of natural gas imports from Israel, which could only be replaced with significantly higher-cost LNG imports. Turkiye and Egypt are also vulnerable to tighter global financing conditions; both already experienced large outflows of short-term foreign capital during the first two months of the conflict. In the case of Turkiye this led to a large drop in foreign-currency reserves, because of central bank interventions to limit exchange rate volatility in an effort to preserve disinflation momentum. The drop has since only partially reversed.

Exhibit 4
Kuwait, Abu Dhabi and Qatar have exceptionally large fiscal and external buffers
GFAs, central bank foreign-currency reserves, and government debt, % of GDP



Excludes government deposits included in GFAs
Sources: Haver Analytics and Moody's Ratings

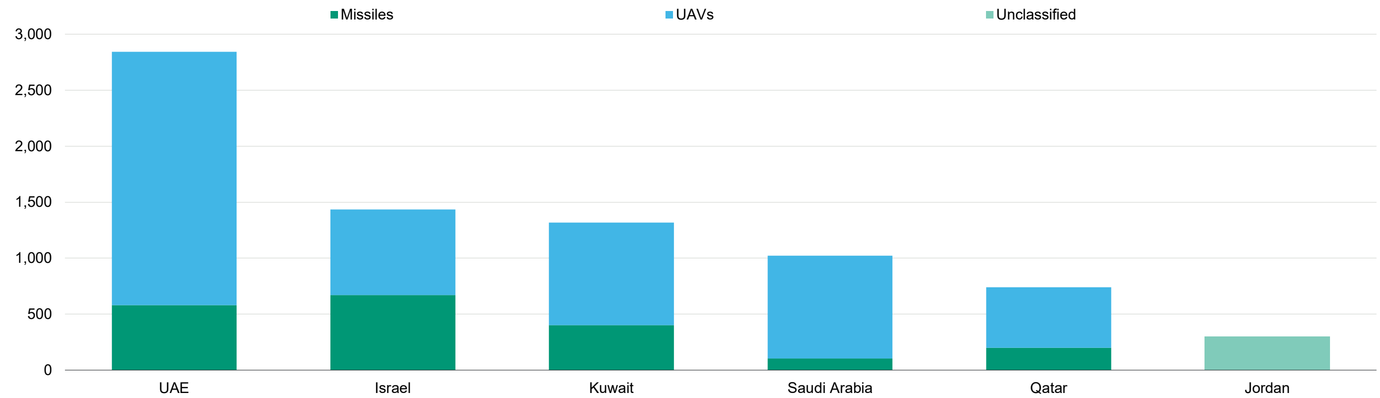
Long-standing geopolitical risks have crystallized and will remain elevated

The ceasefire agreed in early April and the subsequent signing of a memorandum of understanding between the US and Iran in June set a framework for a more durable military de-escalation and reduced the risk of the most adverse scenarios. However, the ceasefire has repeatedly broken down, fueled by fundamental disagreements about future control and management of the Strait, which Iran sees as the key to its national security and its main source of leverage in the conflict. The re-escalation since late June points to the likelihood of a slow and bumpy road toward a more durable settlement in the region, further underscored by renewed threats from the Iran-backed Houthi rebels in Yemen to disrupt Red Sea shipping through the Bab Al Mandab Strait that could compromise Saudi Arabia's alternative trade route.

The conflict has demonstrated Iran's ability to disrupt critical shipping lanes and threaten security and infrastructure of the GCC sovereigns through relatively low-cost means by using naval mines, short-range missiles, and a very large number of one-way attack drones (UAVs) (Exhibit 5). This has turned a previously low-probability, high-impact risk into an active constraint on regional credit conditions, highlighting geopolitical risk as a key constraint on our assessment of sovereign creditworthiness in the Gulf region. It has also underscored the role of alternative export routes that bypass the Strait of Hormuz as a key mitigant of elevated geopolitical risk.

We expect repeated setbacks in the US-Iran negotiations to keep a geopolitical risk premium embedded in elevated, albeit volatile, oil prices, which will benefit hydrocarbon exporters that retain export market access. However, in the absence of a credible long-term agreement, the conflict may increasingly weigh on the GCC’s attractiveness as a destination for capital, talent and tourism. Similarly, in the wider region, the fundamental tension between Israel and Iran is likely to remain a key source of geopolitical instability, particularly in Lebanon where Iran-backed Hezbollah retains strong support among a section of the population. Overall, geopolitics will remain in a state of flux and could shift in unexpected ways as underscored by the recent signing of a civil nuclear deal between the US and Saudi Arabia.

Exhibit 5
Iran's projectile launches against MENA countries since the start of the conflict
Number of projectiles



Data as of 21 July 2026
Source: Official announcements compiled by the Institute for National Security Studies (INSS)

» **What could change the outlook:** A durable and credible de-escalation, sustained reopening of the Strait of Hormuz, and a faster-than-expected recovery in trade, hydrocarbon production, tourism and investor sentiment could support a return to a stable outlook. Conversely, intensification of the military conflict leading to significant damage to the region's energy or civilian infrastructure, a slower-than-expected reopening of the Strait or a durable disruption of alternative trade routes, and evidence that security concerns are durably weakening the region's non-hydrocarbon growth model would deepen negative credit pressures.

Outlook definition

The negative outlook reflects our view of credit fundamentals for sovereigns globally over the next 12 months. Sector outlooks are distinct from rating outlooks, which, in addition to sector dynamics, also reflect issuers' specific characteristics and actions. A sector outlook does not represent a sum of upgrades, downgrades or ratings under review or an average of rating outlooks.

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