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BRIEFING PAPER

UNCHARTED TERRITORIES

Oil producers face renewed challenges in the form of Covid-19

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MEED
Middle East business intelligence

OIL'S BALANCING ACT

Despite economies across the globe easing lockdowns and airports gradually resuming activity, the fallout of Covid-19 continues to harshly impact oil demand recovery. Major upstream oil and gas megaprojects are being delayed by regional NOCs, as they divert focus towards brownfield projects.

Breakeven oil prices needed to balance government budgets are still much higher than current oil prices across the region. For most nations, the breakeven prices are between $50-$70 a barrel ($/b), but dangerously exceeds $80/b in countries such as Algeria, Bahrain, Iran and Oman.

Governments, including those with considerable sovereign wealth funds, are feeling the strain on state finances, slashing budgets for infrastructure and capital investment projects.

Most analysts believe the slope to recovery will remain slippery until 2021, with at least a few years until demand bounces back to pre-Covid levels, especially if a second wave is around the corner.

UNCERTAIN FUTURE

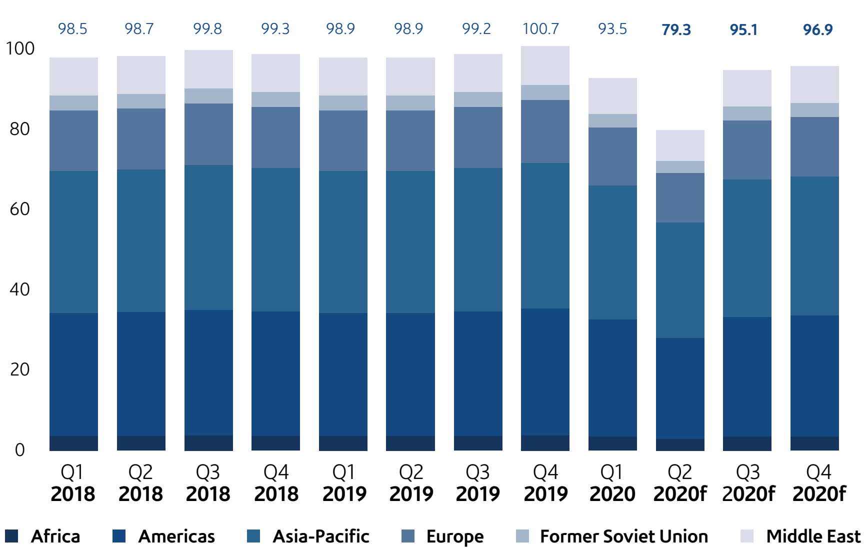
The global economy is still struggling to shake off the coronavirus, with the International Monetary Fund revising its growth outlook for 2020 to -4.9 per cent, 1.9 percentage points below the April forecast.

The historic agreement between Opec producers and their non-Opec allies to cut output to cope with the scale of the demand shock helped ease concerns around a supply gut. However, it is difficult to be optimistic about oil prices and demand in 2020 and even 2021.

Brent is expected to average $43.70 per barrel this year, an increase on its earlier estimate of $37 per barrel, still significantly below the breakeven point for most regional oil exporters.

Analysts point to signs of improvement ahead on both the supply and demand fronts, as lockdowns in many parts of the world are starting to ease.

Global oil demand (million barrels per day)



Source: IEA

Demand from China is rebounding to nearly 90 per cent of its pre-Covid levels, according to data from IHS Markit.

At the same time, a resurgence of cases in the US, India and Brazil sparks fresh worries. Uncertainty continues to cloud the future of international travel.

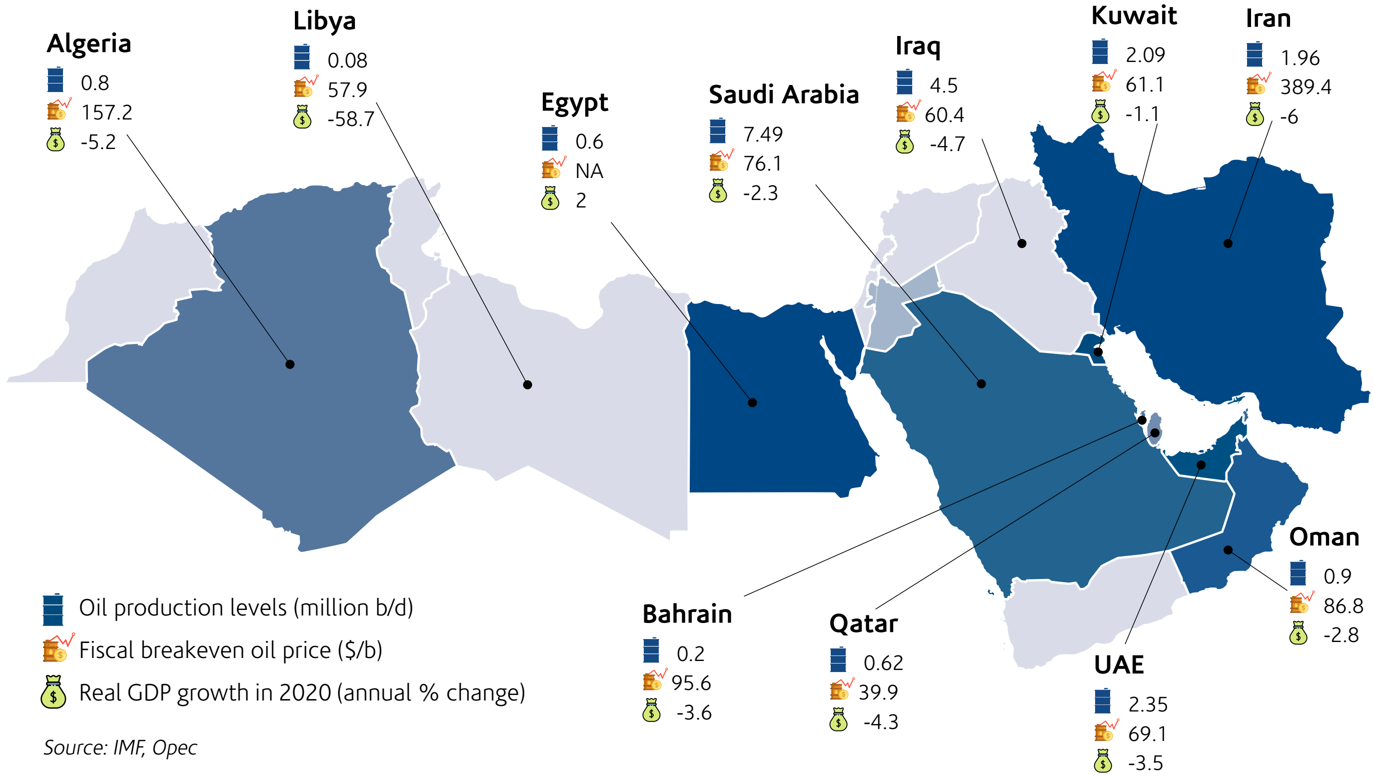
Opec's supply cuts have been fast and deep, particularly from Saudi Arabia and the UAE. Global oil supplies are expected to decline by 11.3 million b/d, the largest shut-in on record, with Opec accounting for at least 7.2 million b/d.

But there is a considerable disparity between its members over coordinating cuts. Two countries —sanctions-hit Iran and war-torn Libya have been exempt, while others such as Iraq face immense challenges in balancing cuts and maintaining precious revenues.

The key uncertainty will be around oil demand recovery. Most analysts expect it to be slow in 2020, and the International Energy Agency says that recovering to pre-crisis levels may take a couple of years.

The pipeline for new upstream mega-projects has also dried up. Most of the projects approved when oil prices were above $100 a barrel have now come online, but there have been few new ones since the oil price crash in 2014. Oil producers are now in a much weaker financial position due to the latest price shock, with implications for supplies further down the line.

Impact of Covid-19 on oil economies in the Mena region

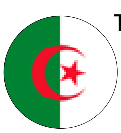


Source: IMF, Opec

INDUSTRY OUTLOOK

Oil and gas producers in the Mena region wrestle price slumps and uncertainty caused by the Covid-19 pandemic

ALGERIA



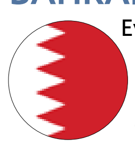
The outlook for the oil and gas sector in Algeria has worsened considerably since January 2019 as a result of civil unrest and the sector's problems are likely to be compounded by global pandemic.

While public spending was cut by 30 per cent in March, state energy firm Sonatrach was ordered to slash its planned investment by 50 per cent to just $7bn to cope with the country's financial pressures.

Algeria's oil and gas exports have dropped in recent years due to growing domestic demand and a lack of foreign investment. Along with the fall in oil prices, this has hit state finances hard.

The timing could not be worse, coming just after a long-overdue hydrocarbons law was finally implemented, which was aimed at boosting foreign upstream investment through improved contract terms and tax rates.

BAHRAIN



Even before the price crash this year, Bahrain had one of the highest breakeven oil prices in the region at $91.8/b. The current low oil price has forced to the kingdom to reassess its investment plans to make sure they are viable. These include bids for a new non-associated gas compression station.

Bahrain has also completed 50 per cent of a multi-billion dollar project to upgrade the Bapco refinery, as per official reports. The refinery upgrade is the biggest active project in Bahrain's oil and gas sector.

EGYPT

Egypt's system of joint ventures with international oil companies means the state shares the burden of costs. With the government's finances already stretched, it did not take much encouragement for oil minister Tarek el Molla to call on its partners to cut spending and production costs.

US-based Apache is the exception, however, and has been notably bullish on the prospects in the country, boosting its Egyptian spending on seismic campaigns. It already accounts for around 185,000 b/d of production, representing almost a third of Egypt's total output. Now it plans to bring onstream a number of discoveries in the Western desert.

IRAN

With the highest number of Covid-19 cases in the Middle East, Iran has been hit particularly hard after it imposed a strict lockdown across the country. As a result, the IMF forecasts the economy to shrink 6 per cent in 2020. A good indicator of the level of reduction is the dramatic fall in domestic gasoline consumption falling 60 per cent compared to last year.

However, Iran has been exempted from Opec's recent production cut agreement, given its oil and gas sector is already suffering under US sanctions which have drastically reduced Iran's oil exports and revenues.

IRAQ

In April, cash-strapped Baghdad requested all its IOC partners cut back their capital expenditure by nearly a third as low oil prices mean that repayments would account for too high a proportion of the country's oil revenues.

Oil export earnings, which in 2019 averaged around $6.6bn each month, have dropped to $1.42bn. This income accounts for more than 90 per cent of Iraq's revenues, but at these levels is not even enough to pay the government's salary bill, let alone for oil company capital spending.

Under these conditions, even relatively straight forward projects will be a challenge.

Iraq's Ministry of Oil has invited contractors to submit technical bids for a section of the crude oil export pipeline between Iraq and Jordan by 2 August. The $4bn package covers a section of the pipeline, between Basra and Haditha.

However, industry sources say that the tender process is likely to be delayed before commercial bids are submitted due to volatility in global oil markets and Covid-19. Furthermore, the project is yet to secure financing.

KUWAIT

Analysts warn Kuwait's deficit could hit $39bn in the 2020-21 financial year, representing 40 per cent of GDP. The state has only budgeted for a $30.3bn deficit this year

Nevertheless, the oil sector will remain the cornerstone of the economy. Kuwait is continuing with plans to increases its production capacity to around 4 million b/d, up from 3 million b/d currently.

After years of delays, Kuwait finally began production from its 60,000 b/d Lower Fars heavy oil field in February, and is targeting as much as 430,000 b/d of heavy crude by 2040.

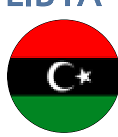
Despite being more energy-intensive and therefore costly to produce than conventional reserves, Kuwait's strategy to invest now will be important in years to come as the transition towards renewable energy sources gathers pace. By then, costly, carbon intensive heavy oil will be much less attractive to develop, making projects inviable and leaving the assets stranded.

Meanwhile, Kuwait and Saudi Arabia have decided to stop oil and gas production from their shared Neutral Zone in June, just months after restarting production.

The offshore Khafji oil field partially resumed production in March following a five-year pause due to disputes between the two countries.

The decision to halt production puts future contract awards worth billions of dollars in doubt.

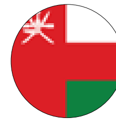
LIBYA



Uncertainty clouds the revival of Libya's oil industry, caught in the midst of a prolonged political strife.

Oil output in Libya, which stood at 1.2 million b/d at the end of 2019, has plunged since 18 January due to a blockade of ports and fields by groups loyal to Libyan National Army leader Khalifa Haftar. On 28 May, the National Oil Corporation of Libya announced nearly $5bn in economic losses due to the oil blockade and drop in exports. Libya was exempted from the voluntary Opec cuts and production averaged 100,000 bpd in May 2020.

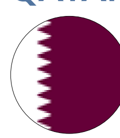
OMAN



Oman hopes to maintain oil production levels, despite rolling out a cost-cutting program across its oil and gas sector. Producing around 1 million b/d of oil and significant quantities of liquefied natural gas (LNG) for export, the sector remains the engine of the Sultanate's economy.

To maintain this balance, the ministry of oil and gas is looking at ways to slash non-essential spending in areas that are not generating revenue, such as roads and infrastructure. Exploration and seismic activity will also be delayed. Major projects look like they have been spared for now. One of the biggest planned projects is a LNG bunkering facility with France's Total, which is expected to reach a final investment decision at the end of 2020.

QATAR

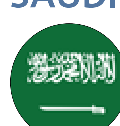


At just $45.70/b, Qatar has one of the lowest breakeven oil prices in the region. Its financial strength will help it as it pursues a multi-billion dollar LNG output expansion campaign despite the collapse in global gas prices.

Qatar plans to raise its LNG production from 77.5 million tonnes a year (t/y) to 126 million t/y, with six new LNG trains by 2027. This will allow Qatar to reclaim its spot as the world's largest LNG exporter, after it was unseated by Australia late last year.

However, state-owned Qatar Petroleum has decided to delay the projects by six months, to take into account the impact of low oil and gas prices on the medium to-long-term outlook of gas and LNG demand.

SAUDI ARABIA



In its first quarterly financial report since going public, state oil giant Aramco announced a 25 per cent lower income compared to last year, due to lower crude oil prices. The rapid fall in prices has sent shockwaves across Saudi Arabia, prompting the government to take the drastic step of raising value added tax from 5 per cent to 15 per cent as a way to shore up the state's finances.

The government has also instructed Aramco to reduce its oil production in June by an extra 1 million b/d to 7.5 million b/d to speed up the rebalancing of the oil market.

Despite this, the kingdom is still pressing ahead with plans to increase its maximum sustainable capacity from to 13 million b/d, up from 12 million b/d currently.

No timeframe for the expansion has been announced but the increased capacity will leave the kingdom well placed to gain from any increased demand, capturing market share from higher-cost producers.

Aramco has kept its capex budget between $25bn and $30bn for the whole of 2020 but will review spending plans for 2021 and beyond. It remains to be seen whether Saudi Arabia will also continue with plans to invest around $35bn in Chinese petrochemicals ventures investments.

Both Aramco and Saudi Basic Industries Corporation (Sabic) have plans in China, which will add nearly 7.5 million t/y of new chemicals production capacity.

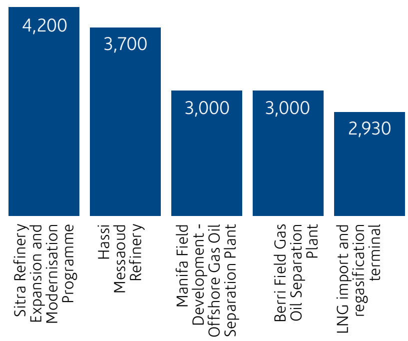
Before the pandemic, demand for these products was rising fast and the kingdom was pinning much of its hopes on crude oil demand being driven by petrochemicals.

Sabic has suspended most of its capital spending plans, as the ongoing economic crisis puts further pressure on prices and margins.

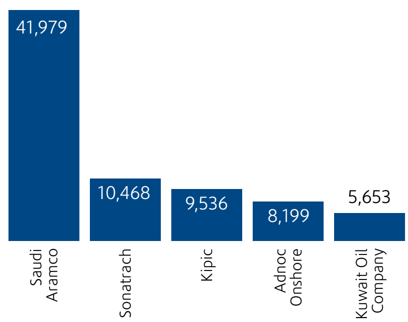
Aramco is undertaking due diligence for its planned 20 per cent stake purchase in India's Reliance Industries. The $15bn investment will allow Aramco access to one of the fastest-growing global markets and increase its refining and petrochemical capacity.

OIL & GAS PROJECTS IN THE REGION

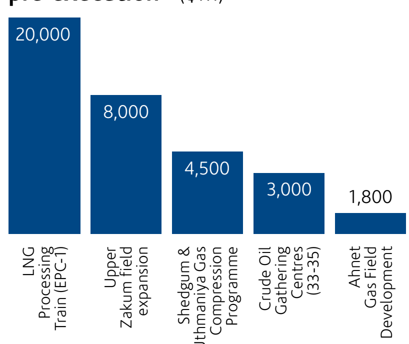
Top projects under execution ($m)



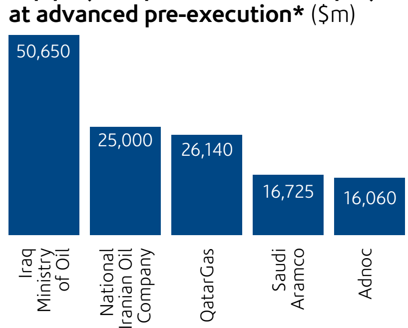
Top project owners based on projects under execution ($m)



Major projects in advanced pre-execution* ($m)



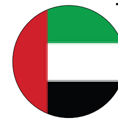
Top project spenders based on projects at advanced pre-execution* ($m)



Source: MEED Projects

*= progressed beyond study

UAE



The UAE has significantly increased its crude oil production capacity in recent years, with production reaching a record high of 3.91 million b/d in May, after the 3.28 million b/d record set in late 2018.

State-owned Abu Dhabi National Oil Company (Adnoc) is also targeting further gains with an ambitious expansion program, hoping to boost capacity to 5 million b/d by 2030.

However, Abu Dhabi's oil income is expected to shrink 30 per cent this year, prompting the government to implement cuts to aid payments, grants and other transfers to reduce the impact on the overall deficit.

The collapse of oil prices has also claimed a major victim in the projects market. As the virus took hold globally, Adnoc terminated a $1.65bn contract awarded in February to a consortium of UK's Petrofac and Malaysia's Sapura for facilities at the Dalma sour gas development.

Subsequent discussions with Petrofac to reprice the contracts failed. Adnoc is now set to retender, having reworked the project scope.

Adnoc has also extended the commercial bid submission date for packages of its estimated $15bn Hail and Ghasha offshore sour gas field development megaproject to 31 July, as it moves forward with a number of brownfield projects to upgrade infrastructure at its key oil and gas-producing field.

On 23 June, Adnoc closed a gas pipeline deal worth $20.7bn, selling a 49 per cent stake in its gas pipelines assets to a consortium of six global investors, and bringing in $10.1bn in direct FDI to the UAE. Adnoc will retain the remaining 51 per cent stake.

This is the second capital inflow into Adnoc's energy infrastructure following $5bn in 2019 from investors including BlackRock and KKR for leasing rights to Adnoc's oil pipelines.

About MEED

MEED has been integral to delivering business information, news, intelligence and analysis on the Middle East economies and activities for over 60 years.

Attracting a key senior management audience through its content and activities, MEED is a media brand, publication and data business that covers a spectrum of services which inform, engage, connect and ultimately support our subscribers and partners in their business development and strategic growth.

Acquired by GlobalData Plc in December 2017, MEED is now part of one of the largest data and insights solution providers in the world with the capacity to build global communities for our clients.

Our purpose is to support the region's companies make better and more timely decisions through our innovative data solutions and grow through our comprehensive and world-class marketing solutions. To find out more email: info@meed.com

About Mashreq

Established in 1967, Mashreq is the oldest bank in the UAE, with award-winning financial solutions and services.

Throughout its 50 years' history, Mashreq has differentiated itself through innovative financial solutions, making it possible for its customers to achieve their aspirations.

Today, Mashreq has a significant presence in 11 countries outside the UAE, with 21 overseas branches and offices across Europe, the US, Asia and Africa.

Mashreq launched its new Vision and Mission recently, outlining its commitment towards its clients, colleagues and the community. In line with its vision to be the region's most progressive bank, Mashreq leverages its leadership position in the banking industry to enable innovative possibilities and solutions for its customers across corporate, retail, international, treasury and Islamic banking.

Mashreq is proud to be the first financial institution in the UAE to be awarded the Gallup Great Workplace Award for four consecutive years from 2014-17.

Mashreq also continues to invest in recruiting, training and developing future generations of UAE national bankers.