Energy sector features new financing mechanisms

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- **Recent measures by the Central Bank of Egypt signal a shift in monetary policy toward supporting growth as inflation eases.**
- **In Saudi Arabia, higher expenditure than revenue so far this year pushed H1 2019 accounts into a mild deficit of 0.2% of GDP. The overall deficit forecast for this year as a whole is projected at 4.2% of GDP.**
- **The Lebanese government's slow reform process and inability to pay its bills keep manifesting in mini-crises: the latest is over trash, and credit rating downgrades.**
- **Chinese construction companies continue to win major contracts in MENA -- most recently in the UAE and Iraq -- despite competition from Europe and Asia.**

Algeria: Economic hardship mounts, impasse continues

Protests in Algeria continued through the scorching summer heat and Adha holidays, in a clear message to the regime that the popular protest movement Hirak will not easily go away.

- ➢ The most recent demonstrations called for dismantling the six-member panel set up to oversee a national dialogue and the presidential election, currently planned for October. The election could yet be called off as were the ones scheduled for 18 April and 4 July.
- ➢ Defence chief and de facto leader General Ahmed Gaïd Salah has failed to break Hirak, which has become harder to control.
- ➢ Former Minister of Defence Khaled Nezzar has likewise upped his battle against Gaïd Salah. In a video published on YouTube, Nezzar called on the army to depose Salah, without directly mentioning his name.
- ➢ Neither man has support among the protesting public, both being seen and dismissed as part of the previous regime.
- ➢ In the meantime, there is some confusion over the trials of politicians and oligarchs active under the regime of former President Abdelaziz Bouteflika.
  - An administration report suggested that the trials of Saïd Bouteflika (the ex-president's son), Mohamed Toufik Mediène (former intelligence chief), Athman Bachir Tartag (former deputy to Mediène) and Louisa Hanoune (Algerian Workers' Party president) will begin in the following few weeks.
  - This has been dismissed by their legal adviser who claims that investigations into alleged corruption and the misuse of public funds are still under way.
  - The latest big business names subject to a post-Bouteflika crackdown on alleged corruption are the three Benhamadi brothers, including Abderrahnane Benhamadi, chief executive officer of Condor Electronics group. They have been held in provisional detention.

Table 1 – MENA Dashboard[1]

MENA Oil Exporters	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2018	2019f	2018	2019f
Algeria	2.1	2.3	-6.0	-11.5
Bahrain	1.8	1.8	-11.7	-8.4
Iran	-3.9	-6.0	-4.1	-4.1
Iraq	0.6	2.8	6.2	-5.2
KSA	2.2	1.8	-4.6	-7.9
Kuwait	1.7	2.5	11.3	9.5
Libya	17.9	4.3	-7.4	-10.9
Oman	2.1	1.1	-7.7	-9.9
Qatar	2.2	2.6	5.3	6.1
UAE	1.7	2.8	-1.8	-0.8
Yemen	-2.7	2.1	-4.4	-5.1
Average Ex-Libya & Yemen	**1.2**	**1.3**	**-2.3**	**-4.4**

MENA Oil Importers	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2018	2019f	2018	2019f
Djibouti	6.7	6.7	-4.4	-2.1
Egypt	5.3	5.5	-9.6	-8.6
Jordan	2.0	2.2	-4.6	-4.0
Lebanon	0.2	1.3	-11.0	-11.7
Mauritania	3.0	6.4	1.6	0.6
Morocco	3.1	3.2	-3.7	-3.7
Palestine	5.2	2.9	-8.3	-10.4
Somalia	3.1	3.5	0.0	0.0
Sudan	-2.1	-2.3	-3.1	-2.9
Syria	...	...	...	...
Tunisia	2.5	2.7	-4.6	-3.7

Table 2 – MENA Geopolitical Calendar 2019

Country	Scheduled For	Event	Comment
Libya	H1 2019 Postponed	Referendum	Peace talks have been postponed and UN Envoy Ghassan Salame said the conditions are inappropriate to hold elections in Libya yet.
		Presidential & Parliamentary (after referendum)	
Qatar	July 2019 Postponed	Parliamentary elections	Emir Tamim decided to extend the term of the Shura Council Appointed to two years, from July 1st, 2019 to March 30, 2021.
Algeria	Oct-19	Presidential elections	Elections were postponed from July to October. Algeria's interim leader Abdelkader Bensalah's 90-day term that began with the departure of former president Abdelaziz Bouteflika ended on 9 July will remain in place until elections are held.
UAE	Oct-19	Parliamentary elections	On track
Oman	Oct-19	Parliamentary elections	On track
Tunisia	Oct-19	Presidential elections	On track
	Dec-19	Parliamentary elections	On track
Egypt	Q4-2019	Governorate elections	On track

There is growing evidence that a prolonged power struggle could cause a weakening of the economy through higher imports and lower foreign currency reserves.

- ➢ In April, the IMF revised its Algerian economic growth forecast down to 2.3% this year from the 2.7% it predicted in October 2018 (although still up a bit from 2.1% in 2018).

[1] Arabia Monitor; IMF.

- In Q1 2019, the economy grew by 1.5% YoY, the lowest such rate in 20 years, driven by a decline in the real value added of the hydrocarbons sector (-7.7%).
- To cut unemployment (currently around 30%) to a level that reduces the risks of instability, Algeria's economy needs to grow by more than 6% annually over the next few years, according to the World Bank. That is not currently in the cards.

➢ Inflation fell to 3.1% in June from 3.6% the previous month due to lower prices for some food items.
  - But the IMF forecasts that inflation will rise to 5.6% this year from 4.3% in 2018 partly driven by expansionary fiscal policy. The government's target is around 4.5% for this year.

➢ In the first half of the year, the trade deficit stood at USD 3.2B, 12% higher than the same period of the previous year mainly due to 6.3% lower energy revenue.
  - Algeria imports 70% of what its population of 42 million consumes.

➢ Algeria's foreign exchange reserves were USD 72B (14 months of imports) by end-April compared with a peak of USD 177.4B (33.4 months) in 2014.
  - Reserves are forecast to decrease further to USD 55.6B (11.5 months) in 2019 and USD 39.1B (8.3 months) in 2020.

➢ External risks include threats from militant groups in the wider Sahel region as well as instability in Mali.

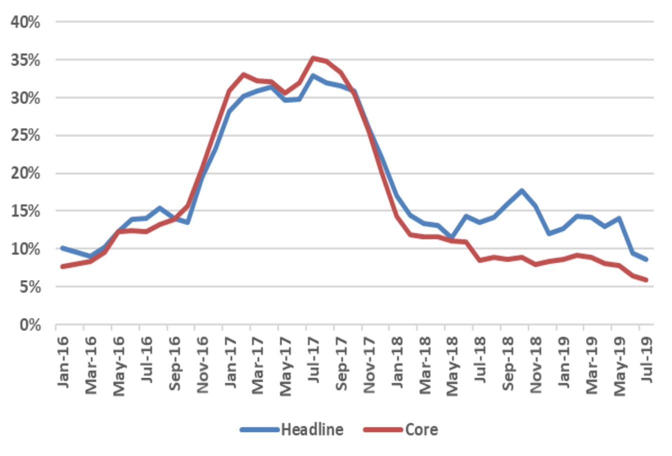
Mauritania: Continuity but with challenges

Following Mohamed Ould Ghazouani's presidential election victory in June, occasional riots have broken out in Nouakchott in protest. As we suggested, the change at the top from President Mohamed Ould Abdelaziz is testing the resilience and adaptability of the power structure over which he presided in a highly personalised manner for more than a decade.

➢ In the 22 June elections, Ghazouani, the candidate for Abdelaziz's ruling Union for the Republic (UPR) party, won with 52% of the vote.
  - At one level, this cements UPR's rule in Mauritania and suggests a continuation of Abdelaziz's policies. Ghazouani, 62, a military man, was a member of Abdelaziz's entourage as far back as 1980. He was interim president in 2012 and served as Minister of Defence from 2018.
  - But at another level, 48% of the voters cast ballots against him, meaning he has strong opposition. Furthermore, the elections had a 62% turnout and were perceived as the country's first democratic transition of power.
  - There will most likely be more demonstrations against Ghazouani's rule over the coming months, but we do not foresee them being large enough to destabilise the government or trigger a sharp deterioration of the security environment.

➢ Ghazouani is expected to come under international pressure to combat the practice of slavery, which continues to affect around 90,000 people in Mauritania, according to the Global Slavery Index.

Figure 1 – Egypt Headline vs. Core Inflation 2016-Year-to-July[2]



Egypt: Inflationary pressures contained

For the first time in six months, the Central Bank of Egypt (CBE) on 22 August cut key policy rates by 150 basis points. It was a response to inflation sinking to its lowest levels in at least a year.

➢ The overnight deposit and lending rates and the rate of the main operation were lowered to 14.25% and 15.25%, respectively. The discount rate was also cut to 14.75%.

➢ The cuts were supported relatively lower monthly inflation figures, and by favourable base effects.
  - Annual headline and core inflation (which strips out volatile items like food) declined to 8.7% and 5.9% in July 2019, respectively, the lowest rates in almost four years, notwithstanding the recently implemented fiscal consolidation measures.
    - The decline in July, the same month as a fresh round of energy-subsidy cuts were introduced, suggests that the rise in energy price may have had a smaller effect than many anticipated.
    - But inflation in most other price categories eased too, suggesting that underscoring price pressures were weakening.
    - Price increases on food and beverages posted only 0.5% MoM rise in July, compared with more than 2% after the previous subsidy cut.
  - Core inflation peaked at 35.3% in July 2017, and is expected to drop to 10.7% by the end of 2019/20, compared with 14.5% for 2018/19 and 20.8% in 2017/18.

➢ As well as easing inflationary pressure, recent global developments may have also paved the way for the CBE to resume its easing cycle (which began in February 2018).
  - These include cuts by the US Federal Reserve, the European Central Bank, and various emerging markets including Turkey and India.

[2] Arabia Monitor; Central Bank of Egypt.

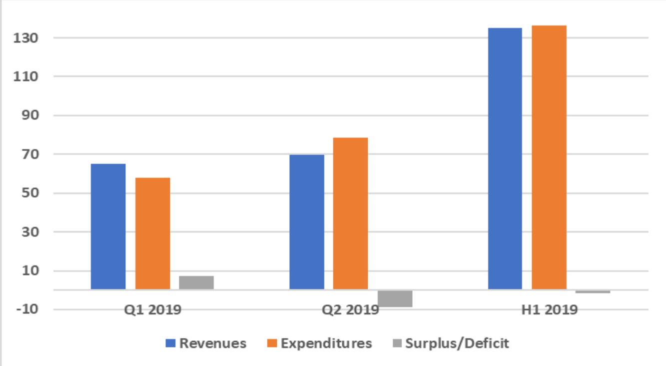
- The Monetary Policy Committee reiterated after its August meeting that its moves were consistent with achieving the inflation target of 9% (±3 percentage points) in Q4 2020, and price stability over the medium term.

Saudi Arabia: Boosting job-creating capital expenditure

Saudi Arabia has budgeted 7% higher state spending this year to an all-time high of USD 295B, reflecting the government's commitment to supporting the economy and jobs through its Vision 2030 initiatives.

- The kingdom posted a budget deficit of USD 8.9B (1.1% of GDP) in Q2 2019 compared with a surplus of USD 7.4B (0.9% of GDP) in Q1 (its first since 2014).
  - Expenditures were up 5% YoY in Q2 to USD 78.5B, driven by 27% higher capital spending, while current expenditure (the more rigid part of expenditure) was flat on a YoY basis with the largest component of this segment, Compensation of Employees, also showing no rise.
  - This level of capital spending is a clear sign that the government is focusing on raising growth and boosting the private sector, contributing to lifting non-oil economic activity within the kingdom.
  - The PMI averaged a high-growth 56.8 from January-July, against a 53.8 average for the whole of 2018. It was driven by a rise in new export orders that came in at their highest pace in two years.
- Total revenue for 2019 is forecast at USD 260B, with 68% derived from oil. In 2018, revenue was estimated at USD 239B.
  - In Q2 2019, revenue totalled USD 69.6B, down 5% YoY, driven by both lower oil and non-oil revenue. Oil revenue declined by 5% YoY, in-line with slightly lower yearly Brent oil prices (down 7%) during the quarter.
  - Meanwhile, declines in Other Revenues (by 37% YoY) pushed non-oil revenue down marginally by 4% YoY in Q2. It is not quite clear from Saudi releases what caused the decline in Other Revenues, although this segment has tended to be volatile on a quarterly basis. We believe, for example, that this segment has in the past included ad hoc budget line items such as windfalls from privatisation, or proceeds such as from the corruption probe.
  - That said, tax revenue was up 20% YoY and an increase in expat dependency fees will mean this segment will continue showing rises during the rest of 2019.
- The overall 2019 budget deficit forecast for this year as a whole is projected at a slimmer 4.2% of GDP, despite the higher spending.
  - The higher expenditure than revenue so far this year pushed H1 2019 accounts into a mild deficit of USD 1.4B (0.2% of GDP). It was 87% lower than that of H1 2018.

Figure 2 – Saudi Arabia Budget Performance (USD, B)[3]



Bahrain: Fiscal pressures persist

The Ministry of Finance (MoF) says the kingdom is "well ahead of its projected deficit reduction schedule". But keeping it going will be tricky, particularly implementing the Fiscal Balance Programme's (FBP) goal of lowering subsidies. The second half of 2019 will provide a better opportunity to evaluate progress as reforms take shape.

- Bahrain's budget deficit narrowed to USD 1.1B (2.8% of GDP) in H1, 35% lower than the same period a year ago.
- Total revenue for H1 2019 rose by 19% YoY to USD 3.3B, while expenditure for the period was USD 4.4B, 2.5% lower YoY.
  - This follows on, the MoF says, from a full year 2018 budget deficit of USD 2.3B (6% of GDP), 34% lower than the government's previously forecasted deficit.
  - The 2019-2020 national budget was approved by the Shura Council in May, with deficits for the two years forecast at 4.6% and 4% of GDP, respectively.
  - We estimate, however, that deficits this year and next will be closer to the IMF forecasts of 8.4% and 7.7% of GDP, respectively, given that the FBP is expected to weigh on the non-oil economy, which comprises over 80% of total economic activity.
- Introduced in October 2018, the FBP aims to balance state finances by 2022, while reducing existing pubic debt. Key to this is lowering government spending, largely through a voluntary retirement scheme for public sector employees.
- Non-oil growth is forecast at 2.2% for this year from 2.5% in 2018 and 4.9% in 2017.
  - Overall GDP growth is expected at 1.8% this year, on par with 2018, but slower than 2017's 3.8%.
  - Growth should be supported by the launch of Aluminium Bahrain's Line 6 Expansion Project, which could make the company the world's largest aluminium smelter.
  - Also boosting growth will be infrastructure projects, such as the Bapco Modernization Program to allow for expanded refined oil output, and the Khalij al Bahrain oil field development.

[3] Arabia Monitor; Ministry of Finance, Saudi Arabia.

Lebanon: Another crisis over waste

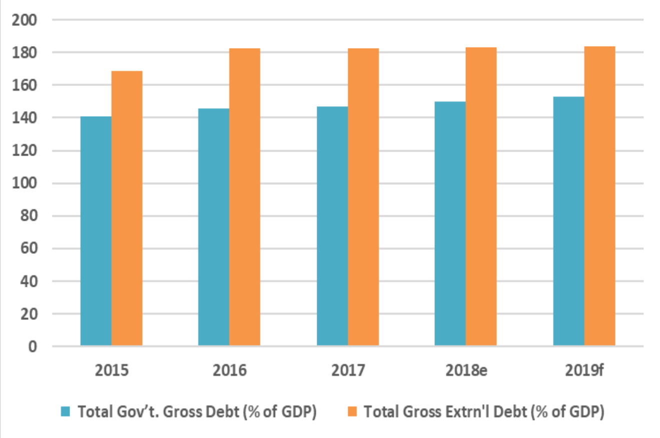
The Lebanese government's slow reform process and inability to pay its bills keep manifesting themselves in mini-crises: the latest is over trash, four years after the last waste-management problem.

- The Borj Hammoud landfill, one of two major landfills serving Beirut, reached capacity at the end of July, but no steps have been taken to provide an alternative site. The government had initially estimated that the landfill would be in operation until 2020.
- Further south, Sidon Municipality has accused the workers at its waste-treatment plant of "blackmail" after they shut the facility down in a pay protest. The workers say they have not been paid by the state for 13 months.
- Dealing with the Beirut waste-management crisis has been on the government's agenda for many months, but the Cabinet cannot agree a new landfill location.
  - In September 2018, the Ministry of Environment (MoE) drafted a waste management strategy, but it is still being finalised in line with the comments from civil society and other stakeholders.
- In June, a 13-page plan was submitted by the MoE to a ministerial committee for review. It proposed Borj Hammoud's expansion without an environmental impact assessment, which is required by both Lebanese legislation and international standards
  - The proposed expansion is broadly considered a temporary solution until the broader waste strategy is implemented.
  - But the initial establishment of the landfill was a supposedly temporary solution to the 2015 waste crisis, pending a more sustainable solution.
  - The 2015 trash crisis was caused by closing the Naameh landfill which was shut down because of increasing complaints from nearby residents about health and environmental risks.
  - The landfill had also exceeded its pre-set maximum capacity of 2 million tonnes. It was opened in 1997 but closed within 10 years.

Meanwhile, Lebanon's economy is facing more credit ratings worries. Fitch downgraded Lebanon to CCC from B- on 23 August, while S&P affirmed Lebanon's credit rating at B-/B with a negative outlook.

- Moody's downgraded Lebanon's credit rating to Caa1 in January but changed the outlook to stable from negative.
- The downgrades have mainly been attributed to the view that the government could take measures that would involve debt restructuring.
  - The decision by Fitch and Moody's also reflected Lebanon's high debt burden (estimated at 150% in 2018) and debt servicing costs (almost 50% of revenues).
  - In addition, wages and pensions account for over a third of total spending and subsidies to Electricité du Liban are running at about 10% of total spending.

Figure 2 – Lebanon Gross Gov't & External Debt[4]



- We believe the likelihood of debt restructuring in 2019 remains low, thanks to still-available liquidity buffers and several policy options still in the toolkit of Banque du Liban (BDL) and the Ministry of Finance.[4]
  - It is also worth noting that Lebanon has never defaulted on payments of maturing debts.
- The S&P ratings affirmation also reflects our view that, despite a significant decline in investor confidence, BDL's FX reserves, estimated at about USD 19B at end-2019 (9.7 months of imports), remain sufficient to finance the USD 1.5 eurobond maturity and about USD 1B of coupon payments in November.
- Lebanon's rating could be upgraded if the new government does as promised and starts to implement structural reforms needed to secure funds from the international donor conference CEDRE (Conférence économique pour le développement, par les réformes et avec les entreprises).
  - Recent government measures include the approval of a fiscal deficit reduction plan in 2019, a roadmap to reform the electricity sector, and plans to finalise the 2020 budget before the end of this year.
  - The authorities have indicated that the 2020 budget will incorporate major changes to the pension system and public sector, as well as new procurement, customs, and tax evasion laws.
  - While the historical track record on reforming these areas remains mixed, even partial implementation could support the disbursement of some donor funds.

MENA Energy Outlook: Spreading the net - financing regional energy developments

Financing MENA energy developments is becoming more innovative, with USD 960B required in the next 5 years.

- The innovation is driven by fiscal pressures from low oil prices, the burden of raising investment for fast-growing domestic demand, and the goal of making state energy organisations more commercially adept.
- Funding methods gaining popularity include bonds, IPOs, the sale of strategic stakes, and independent power producers (IPPs).

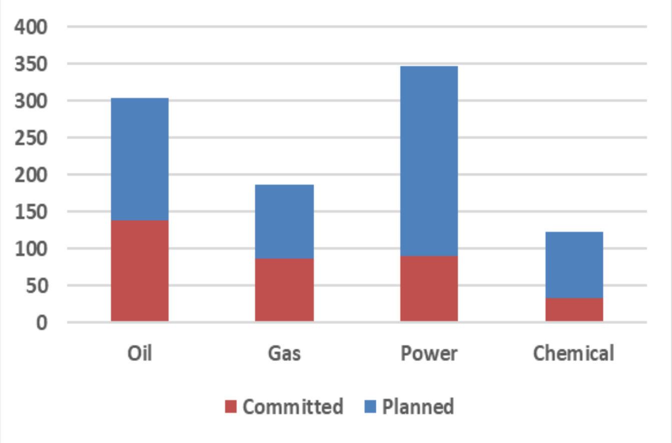
[4] Arabia Monitor; IMF.

- Traditionally, particularly since the 1970s nationalisations of the oil sector, regional energy projects have been funded by government budgets, state company equity, and bank lending.
- International partners have provided equity, usually with minority stakes, and some special-purpose project companies have floated minority stakes on local exchanges, such as the 2008 IPO of PetroRabigh, a Saudi refining and petrochemical joint venture.
  - Examples of bonds include Petroleum Development Oman's USD 3.4B bond in 2016, and a USD 3B bond in 2017 from Abu Dhabi Crude Oil Pipeline a unit of Abu Dhabi National Oil Company unit (ADNOC).
  - The leading IPO would be the offering of 5% of Saudi Aramco to local and international markets, with a likely valuation around USD 1.2B to USD 1.4B, if that renewed plan goes ahead in 2021.
  - ADNOC Distribution sold 10% on the Abu Dhabi exchange for USD 851M in December 2017. Strategic stakes have been sold by ADNOC in its pipeline unit (to a consortium of KKR, Blackrock, an Abu Dhabi pension fund and Singapore's GIC) and in its drilling and refining units to international energy company partners.

➢ IPPs -- non-utility and, hence, generally not state-owned energy producers -- are becoming the investment model of choice for new generation. They have been widely used in the electricity sector for about two decades now, with Abu Dhabi and Oman as early movers.
- Renewable energy IPPs were popularised by Dubai, and have been highly successful. Backed by state offtake guarantees, they have been able to secure limited-recourse funding up to 80% or even 85%, at very low rates.
- So far, few MENA countries have attempted to privatise transmission or distribution. We see considerable scope for privatising specific transmission assets (main power lines), which offer a steady revenue stream similarly to pipelines.

➢ New financing models have not spread everywhere. IPPs and privatisations in Iran have been limited to domestic companies and quasi-state entities, because of sanctions and insider dealing.
- IPPs in the federally-administered part of Iraq have made limited progress, and most oil-sector investment has come from fairly traditional contracts with international energy firms.
- Growing fiscal pressures have not yet compelled Algeria to rethink its near-total dependence on budgetary funding. Despite ambitious privatisation plans in Oman, Egypt and Kuwait, almost nothing has proceeded.
- But if oil prices drop again, it is likely that privatisation of non-core assets such as refineries, oil service firms, desalination, electricity and water distribution, will rise up the agenda.

Figure 3 – MENA Energy Investment 2019-23[5]



Sino-MENA: Keep on building

Chinese construction companies continue to win major contracts in MENA, despite competition from Europe and Asia.

➢ Imkan, an Abu Dhabi-based developer, has awarded its 18-hectare Pixel waterfront project on Al Reem Island to Nantong Sanjian Construction Group.
- The Chinese company is scheduled to start building Pixel's seven towers immediately and complete them in Q4 2021. The development includes 525 residential units as well as retail and food and beverage amenities and co-working spaces.
- Al Reem is a natural island -- 600 metres off the north-eastern coast of Abu Dhabi -- and an increasingly popular residential area.

➢ In Iraq, the China Construction Third Engineering Bureau signed a USD 1.3B contract to build residential, medical and educational buildings in Najaf, Karbala and Basra, the southern governorates of the country.
- The project is expected to take three years to complete once it starts, and will cover low-cost housing, education, healthcare, and tourism facilities.
- China State Construction is also eying Iraq for contracts, albeit with some caution. Its Middle East HQ has expressed interest in pipeline, oilfield and other infrastructure projects, having previously won groundworks and civil engineering contracts before the conflict.
- But the company is unlikely to become active until Iraq's efforts to rebuild after years of conflict bring in stability and safety, according to its CEO.

➢ Chinese contractors are not without competition in Iraq.
- For example, at least two bidders are competing with China Petroleum Engineering & Construction Corporation for the Basra Oil Company's planned USD 250M sour gas treatment facility at Iraq's Majnoon oil field.
- The non-Chinese bidders are UK-based oilfield services group Petrofac and South Korea's Hyundai Engineering & Construction.

[5] Apicorp

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