Reform momentum survives Covid

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- **The new wave of reforms in Saudi Arabia reflects commitment to cultivating an attractive investment environment. More work will be needed in improving FDI appeal, and in employment generation.**
- **Significant strides have been made on the geopolitical front, with an interim government now in place in Libya and Iran's dialogue with the US slowly taking shape. Stability on both fronts, however, still remains a long way off.**
- **Sudan's newly formed cabinet has already begun making bold decisions, as the Central Bank of Sudan announced a long-expected devaluation of the Sudanese pound.**
- **While volatility in oil prices is declining, the Biden administration's environmental policies and US-China tensions will remain key downside risks to the energy market's trajectory going forward.**

Table 1 – MENA Dashboard[1]

MENA Oil Exporters	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2020	2021f	2020	2021f
Algeria	-5.5	3.2	-16.4	-16.4
Bahrain	-4.9	2.3	-13.1	-9.2
Iran	-5.0	3.2	-9.6	-6.8
Iraq	-12.1	2.5	-17.5	-13.1
Saudi Arabia	-5.4	2.6	-10.6	-6.0
Kuwait	-8.1	2.5	-8.5	-10.7
Libya	-66.7	76.0	-102.9	-43.2
Oman	-10.0	-0.5	-18.3	-16.9
Qatar	-4.5	2.5	3.0	3.3
UAE	-6.6	1.3	-9.9	-5.1
Yemen	-5.0	0.5	-9.2	-6.0
Average	-12.2	8.0	-19.4	-11.8
Average Ex-Yemen	-12.9	9.6	-20.4	-12.4

MENA Oil Importers	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2020	2021f	2020	2021f
Djibouti	-1.0	7.0	-1.5	-3.0
Egypt	3.5	2.8	-7.5	-8.2
Jordan	-5.0	3.4	-9.1	-7.4
Lebanon	-25.0	…	-16.5	…
Mauritania	-3.2	2.0	-3.8	-0.8
Morocco	-7.0	4.9	-7.8	-6.0
Palestine	-12.0	8.2	-15.4	-12.7
Somalia	-1.5	2.9	…	…
Sudan	-8.4	0.8	-6.9	-4.3
Syria	…	…	…	…
Tunisia	-7.0	4.0	-8.1	-5.1
Average Ex-Yemen	-6.7	4.0	-9.4	-6.4

Iran: First mover fallacy

Since the Biden administration took office, establishing a pathway to diplomacy between the US and Iran has been a priority, however, a return to a nuclear deal is not on the cards just yet.

- The process will take much longer than anticipated, even with the latest Biden administration State Department briefing on Iran formally announcing their desire for a meeting with the Iranian administration.
  - This is not a surprise and the Iranian regime, in line with expectations, reacted coolly.
- The Iranian administration will maintain that sanctions need to be lifted before a return to compliance and the US will stand firm in the counter stance, but compliance from either side is unlikely to come before a meeting.
  - Iran has been piling on the pressure for the US to lift sanctions first, with parliament's decision to partially ban IAEA access to Iran's sites coming into effect this week, and the recent announcement of the development of uranium metals which could be used to develop a weapon. Tehran is walking a fine line.
  - Iran was initially set to cut off IAEA access, however, after inspector general Rafael Grossi's visit to Tehran this weekend, Iran changed tack and instead is "limiting" access and will still give the organisation access to key production sites.
    - Despite the violation of the additional protocol, Foreign Minister Javad Zarif announced that Iran will remain in the JCPOA.
- The International Community, including the EU and Qatar, have been trying to facilitate talks between the US and Iran, stepping in as mediators.
  - The EU has long had a crucial role, acting as an intermediary between the US and Iran, but in 2012 and 2013 it was Iran's Gulf neighbour Oman who facilitated secret talks.
    - It looks like Qatar is now looking to play a similar role, with support from the US.
  - Qatari Foreign Minister Sheikh Mohammed bin Abdulrahman Al Thani spoke with Iran envoy Robert Malley and National Security advisor Jake Sullivan before he led a Qatari delegation this month, meeting President Hassan Rouhani and Foreign Minister Mohammad Javad Zarif.
    - Rouhani doubled down on his message that Iran would return to compliance only once sanctions were lifted, with Qatar urging the US to do so.
- While international support may bring additional pressure for Iran to return to the table, unlike the first deal, Iranian and American officials are well-aware and in contact with their counterparts.
  - This bypasses the need for the introductions that were previously required and limits the need for external mediators to help facilitate talks.
  - While this helps shorten the road to negotiations, Iran's regional neighbours and international stakeholders will still want to have a say in the terms of the deal, meaning that a pathway to a final deal will still be long-winded and bumpy with various parties chiming in.
  - The big question is whether from the international regional community's perspective, the new deal will be

[1] Arabia Monitor; IMF.

the same, better or worse than the previous deal, which was by no means complete, in terms of Iran's role in the world.

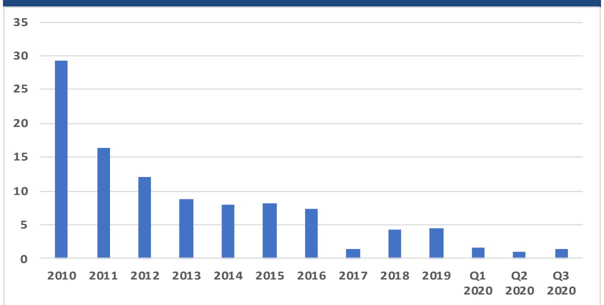
- The same question obviously also applies from Iran's perspective.
    - We see the involvement of Qatar as an important new factor which could help address Iran's thorny regional dossiers in ways that were not tackled by the original JCPOA.
    - Iran's ballistic missile program is another source of angst both regionally and internationally, and the jury is out as to whether this will feature in the new deal in any way.

Saudi Arabia: Ultimatum raises eyebrows

As Saudi Arabia competes to reposition itself strategically as a regional corporate hub, we are witnessing an unprecedented wave of reforms. This is a step in the right direction towards making the kingdom more attractive to investors. More will be needed to balance its risk-reward trade-off.

- Saudi Arabia recently announced that government and state-backed institutions will not award contracts to foreign firms that do not base their regional HQs in Riyadh by 2024.
    - While this decision does not affect firms that wish to do business with the kingdom's private sector, it underscores the kingdom's commitment to pushing through the Vision 2030 plans and attracting FDI inflows.
    - Regulations are set to be formally confirmed later this year. Factors such as reputational risk and ease of doing business could weigh heavily on firms' decisions to relocate.
        - The World Bank's 'Ease of Doing Business' rankings peg the UAE 16th globally, with Saudi Arabia lagging at 62nd.
    - While Saudi Arabia has been actively working to improve its business environment and upgrade its infrastructure to a more expatriate-friendly one, there are no quick fixes.
    - The degree to which this government ultimatum will prove successful in attracting foreign companies, however, remains unclear. Suggesting that Saudi Arabia's assertive stance could possibly be revaluated.
- As part of the push to increase Saudi Arabia appeal as a business and investment hub, under a previous government initiative, "Programme HQ", 24 multinational companies have agreed to relocate their HQs to the kingdom.
    - Given that we are already witnessing a step up in Saudi Arabia's investment plans[2], along with the PIF's new five-year plan which sets to double its assets by USD 1T and contribute around USD 320B to the non-oil GDP by 2025, we expect investor sentiment in the economy to improve.
- Meanwhile, the new judicial reforms announced, which aim to achieve a codified law and address the ambiguities in Saudi Arabia's court rulings are expected to further bolster the kingdom's investment environment.
    - Reforms to four main laws - the Personal Status Law, the Civil Transactions Law, the Penal Code for Discretionary Sanctions, and the Law of Evidence – are set to be announced over the course of 2021. They are

Figure 1 – FDI inflows into Saudi Arabia[3]



expected to represent a significant shift from the current legislative system in place.
- The new laws are part of a programme of structural reforms that Saudi Arabia has been working on in recent years.
    - The development of clear institutional references and regulations, adhering to international judicial practices, is expected to clarify the lines of accountability and improve the kingdom's legislative transparency and overall business competitiveness.
    - Decisions under Saudi Arabia's Sharia law system tend to be at the discretion of the judge. This has historically led to inconsistency in the decisions rendered on similar disputes, in addition to prolonged litigation
    - Previous changes to the legislative system include the launch of e-government services, the establishment of commercial courts and the creation of notary positions for women.

Egypt: Investor interest rallies, again

Economic recovery appears to be gaining traction as investor sentiment continues to turn in Egypt's favour. Optimism around vaccine efficacy and the Central Bank of Egypt's (CBE) ability to stabilise the EGP against the USD have restored confidence and helped reverse the country's two-year-long inverted yield curve.

- The Ministry of Finance is shifting its approach to issuing longer-maturity debt and taking advantage of lower interest rates.
    - This will ease government borrowing costs, with overall debt expected to reach 68.3% of GDP this fiscal year.[4]
- Following an active 2020 in international debt markets, Egypt issued a USD 3.8B three-part tranche bond for the first time this year.
    - The five-year USD 750M note was closed with a yield of 3.9%, a 10-year USD 1.5B bond at 5.9%, and a 40-year USD 1.5B offered at 7.5%.
    - This is the second time Egypt has issued notes with maturity as long as the latter.
- With the market wide open for high-yielding EM issuers, demand from investors resulted in indicative yields on each note declining by 37.5 basis points on average according to the Ministry of Finance.
    - The issuance was more than four times oversubscribed with total bids reaching USD 16.5B.
- Egypt's FY20/21 budget reveals that the government will borrow over USD 7B to meet its financing gap this year. We therefore expect to see a rally in issuance activity in the coming months.

[2] For more on investments, see our Country Views Issue #145, Saudi Arabia: A report card on Vision 2030.
[3] Arabia Monitor; Invest Saudi.
[4] Egypt's fiscal year runs from 1 July to 30 June.

- The sovereign sukuk draft law, which is still under review for approval by parliament, will allow Egypt to issue its first sovereign Islamic bond. This is expected to help deepen the liquidity of its financial markets, and to narrow the deficit in the medium term.

➢ Additionally, because Egypt offers some of the highest carry trades among EMs, with short-term debt yielding around 13%, we expect international appetite for Egypt's bond market to remain strong.
  - Combined with the IMF programme and the CBE providing a stable anchor for inflation expectations and financial stability, this will rebuild Egypt's reserve buffers and contribute to the recovery of last year's private sector output losses.
  - Pressure on Egypt's foreign reserves has been easing, mainly due to the country's efforts to continue its reform path and secure more financial buffers. The USD 2.8B IMF loan that came in May 2020 has also helped.
    - Reserves by the end of January 2021 reached over USD 40B, a 2% increase MoM. This was the tenth consecutive rise, after USD 10B losses in 2020.
    - Reserves now represent 7.7 months of import cover from a low of 2.2 months after the revolution in year 2013.

➢ Meanwhile, at its most recent meeting on February 4, the CBE held interest rates steady once again, with inflation remaining within the new target of 7% (±2%).
  - The overnight lending rate is at 9.25% and the overnight deposit rate is at 8.25%.
  - Consumer price inflation slid to 4.3% in January YoY from 5.4% in December. Inflation came in lower than expected on the back of the decline in food prices by 0.5% YoY and 1.6% MoM.

➢ If inflation figures for February remain below target, the CBE could cut the policy rate at its upcoming meeting on March 18.

➢ This would support the recovery while keeping the real interest rate manageable. High rates are of course key to attracting additional portfolio flows.

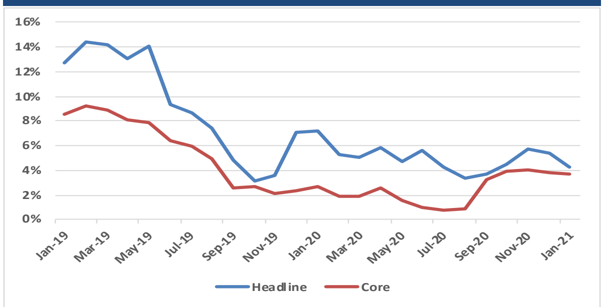
Libya: A decade of woes at dusk

After enduring years of civil war, which battered the country and divided it to the brink of partition, Libya has finally had a breakthrough with the formation of an interim executive authority, which is taking the reins until elections next year.

➢ The latest developments have been a massive breakthrough in the country. However, the situation remains fragile, with the next few months serving as a vital indicator of the medium- and long-term opportunity set.

➢ Following the informal October ceasefire, the Libyan Political Dialogue Forum (LPDF) put forward a roadmap which helped to facilitate the unification of the country's institutions, as well as outline the process which was used to select the executive authority that would be in charge of the country until the December 2021 elections.
  - A unified budget was also established for the first time since 2014.
  - Additionally, a permanent UN envoy to the country, Jan Kubis, was selected to fill the role of temporary envoy Stephanie Williams.

Figure 2 – Egypt Inflation[5]



    - Williams has been in the role since Ghassan Salame's departure in March of last year.
  - The close attention from the UN and other international organisations ensures that momentum on progress is maintained.

➢ Abdul Hamid Dbeibah, a businessman-turned-politician, has been chosen as Libya's new interim prime minister
  - Dbeibah was appointed along with a three-man Presidential Council comprised of one member to represent each of Libya's historic territories.
    - Mohammad Younes Menfi, a former diplomat hailing from Eastern Libya, is serving as the head of the council.
    - Dbeibah has a close association with Libya's former ruler Muammar Gaddafi, as he was charged with running the state-owned Libyan Investment and Development Company (LIDCO), making his appointment a surprise to many.
  - The Interim Prime Minister has until 26 February to form his government. The country's House of Representatives then gets 21 days to endorse it, meaning 16 March is the final deadline for this process.

➢ If the House of Representatives fails to express confidence in Dbeibah's cabinet, the matter then returns to the delegates of the UN-led LPDF, which, in turn, improves the chances of Dbeibah passing a cabinet the first time around.

➢ It seems clear that Libya is moving in a positive direction, although we remain wary as long as foreign mercenaries maintain a presence in the country.
  - Even though leaders of Turkey, the UAE, and Russia - countries known for sending mercenaries into Libya - have endorsed the peace process, foreign troops have remained in the country.
  - The 5+5 security talks' 23 January deadline of withdrawal expired with the terms yet to be met.
  - The UN will continue to double down on mercenaries, but without foreign leaders buttressing the UN's initiative, these players will remain, posing an ongoing risk to the stability of the ceasefire.

Sudan: New cabinet but same old issues

Following months of technocratic rule, on 8 February Sudanese Prime Minister Abdalla Hamdok named a more diverse and expanded 25-member transitional cabinet. The new government is facing myriad challenges, as Sudan is still reeling from 30 years of al-Bashir rule, which decimated the economy and security of the country.

➢ The new cabinet, which took months to form, includes members of different rebel groups, including the Sudan

[5] Arabia Monitor; CBE.

[6] Arabia Monitor; CBS.

Revolutionary Front, in a bid to fulfil the peace agreement signed last October.

- Prime Minister Hamdok was forced to reshuffle as he struggled to push through much-needed reforms and secure foreign funding, as the situation was still strained between the different factions of the country.
- Only five members of the previous cabinet were retained by Hamdok, most importantly the Minister of defence, and other positions were awarded to a variety of organisations – including the Umma Party, the National Ba'ath Party and the Beja Congress – to present a united front.
    - One of the most ambitious appointments was that of Darfur rebel leader Gibril Ibrahim as Minister of Finance, which shows that the once-warring groups are putting their differences aside.

➢ The new cabinet will now shift its focus to the peace agreement, which aims to end the conflict in Darfur.

- The conflict has been ongoing since 2003 and has left an estimated 300,000 people dead and 2.5 million displaced, according to UN numbers.
- We believe the reshuffle will be crucial in easing the country's transition to democracy and putting an end to years of civil unrest.

➢ In addition to the precarious security situation, the cabinet faces another immediate challenge in the form of the desperate economic situation.

- Rising inflation, which has reached nearly 270% in December 2020, up from 254% in November, is putting a strain on living conditions for millions in the country.
- Higher living costs are threatening to create a food security crisis, as cautioned by the Famine Early Warning Systems Network.[7]
- This is causing further unrest in the country, as seven states in Sudan have declared a state of emergency following the violent protests against rising food prices with curfews and school shutdowns announced in 10 cities.

➢ A third threat the government will have to manage is the escalation of tensions with neighbouring Ethiopia.

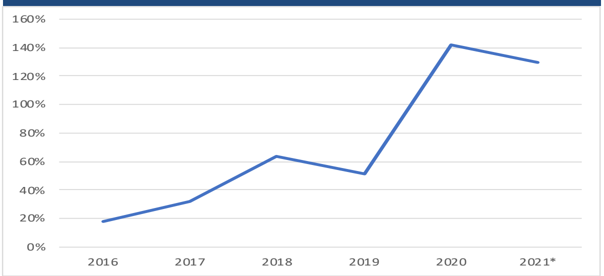
- The Sudanese Irrigation and Water Resources Minister Yasser Abbas has expressed fears of Ethiopia's actions regarding the Renaissance dam. This threatens the country's national security.
- As with previous negotiations, the latest three-way talks held with observers from the African Union and European Union, failed to make headway.

➢ In order to break the deadlock, Sudan is proposing a mediation role for the US, as well as boosting cooperation with Egypt to put pressure on Ethiopia.

- The rapprochement includes military exercises and talks to strengthen economic ties between the two countries, including establishing an Egyptian industrial zone in Sudan.
- The emergence of new allies will come as a relief for the new cabinet, as Sudan was up until recently isolated from the rest of the world.
- But the urgency of finding a solution for the numerous internal and external challenges faced by the country remains.

[7] The Famine Early Warning Systems Network is a leading provider of analysis of acute food insecurity established in 1985 by the USAID.

Figure 3 – Sudan Inflation[6]



Energy Outlook: Toward a new baseline[8]

A slow pace toward a new deal with Iran is encouraging for oil markets, with forecasts now expecting a steady price recovery over 2021 to possibly hit the USD 70 range.

➢ With Saudi Arabia still holding the million-barrel joker card, we feel this recovery has legs, despite a likely release of a further 500k bpd at the upcoming OPEC+ meeting on March 4th.

➢ During what has been an exceptionally trying year in oil markets, Saudi Arabia has certainly demonstrated continued leadership in the OPEC+ grouping.

While the oil and gas industry had grown accustomed to shocks since the 1970s, 2020 provided a glimpse of what a new baseline could look like.

➢ The pandemic led to an unprecedented collapse in oil demand in 2020, with after-effects carrying forward into 2021.

- The instantaneous falls were sharper than the 2009 financial crisis or even the Great Depression, with almost all global economies registering negative GDP growth.

➢ Oil and coal have been the most affected, followed by gas, with renewables the least impacted.

- Several legacy coal-fired power plants were mothballed or completely shut down in Europe and North America, while numerous projects in their pre-construction phase were cancelled, especially in China.
- A weakening competitive position versus gas and renewables, along with increasing adoption of environmental policies on the back of significantly lower carbon dioxide emissions in 2020, will continue to reduce coal-fired electricity generation in 2021.

➢ Oil producers will remain under pressure in 2021, even as volatility surrounding prices has reduced.

- Shell cut its dividend for the first time since WWII, while US producers shut-in some 1.6M bpd of output by June as it had become uneconomic.

➢ With the realisation that returns on investments in development projects are not guaranteed, investment in unconventional and long-cycle challenging environments such as deep water and/or Arctic locations have been reduced dramatically.

- In the downstream, reduced capital spending, deferral of refinery enhancement projects, delaying refinery turnarounds, and closure of several older OECD refineries are expected to continue well into the first half of 2021.

➢ Natural gas demand fell by 120 BCM in 2020, the largest annual drop on record. Still, it was less impacted than its oil and coal counterparts.

[8] This section is a guest author contribution courtesy of Robin Mills & Maryam Salman, Energy Analysts.

- Most of the decline took place in mature markets across Europe, North America and Asia, which collectively account for 80% of the estimated drop in global natural gas demand for 2020.
- LNG continued to play a central role in balancing global gas markets and at the same time creating flexibility to match fluctuations in demand.
- Already in oversupply, spot LNG prices slumped in mid-year to record lows but reached record highs in January 2021 as supply outages and logistical constraints coincided with cold weather in east Asia.

➢ Renewables-based power, meanwhile, increased by 7%, making it the least impacted energy sector.
  - Because renewables have minimal variable costs and typically have priority grid access, their output tends to be unaffected by demand.
  - Renewables-based generation increased mainly due to double-digit percentage growth for wind power and an increase in solar PV output from new projects, and higher residential power demand (due to work-from-home policies) with the share of electricity supply nearing 28% in Q1 2020. This is a 26% increase from 2019 levels.

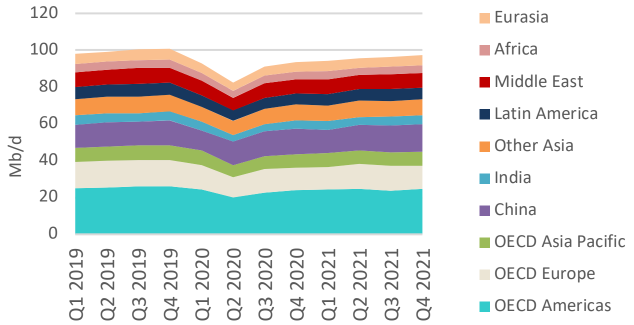
➢ Two major geopolitical events will determine the pandemic's legacy in world energy markets in 2021.
  - First, for the new US administration, the climate emergency will be prioritised through sweeping regulation, reducing greenhouse gas emissions, investment in low-carbon energy and bans on drilling across federal lands and waters, in addition to returning to the Paris Agreement.
  - Second, US relations with China appear set to remain negative in the near-term, meaning both will look to exploit their indigenous fossil fuel resources fully.
  - China will continue to dominate the manufacturing of renewable energy technology, while the US shall seek to gain in areas such as advanced batteries, autonomous vehicles and EVs.
    - This will provide a significant boost to these sectors, while at the same time using coal and natural gas as key playing cards in the trade dispute.

➢ Additionally, other countries will be drawn into the US-China face-off, giving a new flavour to the energy transition.
  - Europe will be drawn in as a third pole of clean energy technology development and deployment.
  - Japan, a Chinese rival, a US ally and a key potential hydrogen market is also important to watch.
  - Australia, as a politically exposed source of coal, LNG, iron ore and other key commodities to China, is expected to be drawn in.
  - Russia, as an important but subordinate energy partner to Beijing, is expected to provide gas and oil through secure land and marine routes, while having rivalries in Central Asia.

➢ Overall, however, the energy market has shown remarkable resilience under such unprecedented stress.

➢ With the exception of the brief WTI negative excursion, oil and gas prices dropped but remained in reasonable ranges.
  - There were no serious shortages of energy products, or blackouts. Most major energy companies survived, despite the financial strain.
  - The action of OPEC+ was crucial in supporting the recovery of oil prices during 2020 and avoiding a complete filling of global storage.

Figure 4 – Global Oil Demand[9]



➢ COVID-19, however, will prove to have accelerated and reshaped existing trends more than creating new ones.
  - The drop in oil demand has likely brought forward the date of peak oil demand, which could occur during the 2020s.
  - That will require major producers to concentrate on cost-competitiveness and the best strategies to cope in a shrinking market.

Sino-MENA: Iraq landmark deal on hold

Iraq's State Organization for Marketing of Oil (SOMO) is pausing a high-profile supply deal with China's Zhenhua Oil.

➢ SOMO had signed a deal with Zhenhua to supply 130k bpd - about 4M barrels a month - over the next 5 years, starting July 2021.
  - Under the terms of the deal, China would advance a one-year upfront payment for the supply, amounting to USD 2B (approximately 2% of 2021 budget).
  - This was to be the first time the Iraqi government would have taken prepayment and it would have been one of the largest contracts with oil effectively being used as security for a loan in the MENA region.

➢ However, optimism over rising oil prices has led Iraq to put the deal on hold, as the government is still trying to consolidate its fiscal position.

➢ The impact of the suspended deal on China and Iraq's energy relations remains to be seen but is unlikely to be severed.
  - Recently, Iraq has announced that it is in advanced talks with state-run Chinese companies to discuss building crude oil storage facilities in China, as part a plan to boost oil sales to Asia.

➢ While the names of the Chinese companies have not been disclosed, we expect them to be the Norinco Group, of which Zhenhua oil is a subsidiary.

➢ We also believe the location to be in Panjin, where Aramco previously signed a deal to build a USD 10B oil refinery, before also putting the investment on hold due to the collapse in the prices of oil on the back of the pandemic.

➢ Iraq is the third largest supplier - after Saudi Arabia and Russia - with about 1.2M bpd sold to China in 2020, but its exports saw the largest rise among the top three oil suppliers in 2020 (up by 190k bpd).

➢ While we do not think the paused deal will seriously disrupt China-Iraq energy relations, it may delay projects such as the oil storage facilities, which, in turn, could slow the growth of Iraqi exports to China.

[9] Arabia Monitor; Qamar Energy, OPEC.

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