Building a bridge to recovery

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- **Saudi Arabia might need to further diversify its sources of finance going forward, including a more prominent domestic role for the Public Investment Fund (PIF).**
- **Oman receiving a support package from Qatar was expected. We believe more will follow from its neighbours to protect against currency devaluation contagion across the GCC. There was weak investor demand for Oman's recent bond issuance.**
- **With governments in the Maghreb facing renewed fighting in Western Sahara and a fragile ceasefire in Libya, the region is becoming more volatile.**
- **As the Biden administration reengages with Iran, critical choices will be made given the impact on oil markets and potentially on Iranian presidential elections next summer. This is also an opportunity to tackle Iran's thorny regional policies.**

Table 1 – MENA Dashboard[1]

MENA Oil Exporters	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2020	2021	2020	2021
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
KSA	-5.4	3.1	-10.6	-6
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	8.1	-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	2021	2020	2021
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-Syria	-6.7	4.0	-9.4	-6.4

Saudi Arabia: The going gets tough

Regardless of whether OPEC+ decides in the coming weeks to delay the easing of oil production, Saudi Arabia will need to expand its sources for finance and accelerate its commitment to diversification. This is particularly the case as Saudi Aramco's recent bond issue has added concerns over the kingdom's rising contingent liabilities.

- ➢ Persistently low oil prices are causing Saudi Arabia's economic recovery to lose momentum. Data from Saudi Arabia's General Authority for Statistics (GaStat) show that the economy contracted for a fifth consecutive quarter on a YoY basis, declining by 4.2% in Q3 compared with the same period last year.
  - This is the first time the GaStat has released a 'flash' estimate with two months of the period covered. In the past, it has typically been around six months.
  - Data showed that GDP expanded by 1.2% QoQ in Q3 from a contraction of 4.9% in the previous quarter. While the rebound comes off a low base, it was the fastest growth for the kingdom since early 2018.
  - GaStat did not provide a breakdown by sector, but we believe the recovery is primarily fuelled by revenue generated from the non-oil sector following the relaxation of lockdown measures and the 15% VAT increase in July. An easing in the oil price plunge is a contributing factor as well.
    - The average price of crude oil in Q3 reached USD 43.3 pb. This was 30% higher than in the previous quarter. But the recovery will remain slow-going, particularly with the rising probability that current oil production cuts will be extended to March 2021.
  - Non-oil revenue in Q3 grew by around 64% YoY to reach USD 30B. In contrast, oil revenue fell by 50% YoY during the same period, accounting to 43% of total revenue at USD 24B.
  - This was the first time in Saudi Arabia's modern history that non-oil revenue to outstripped oil revenue.
  - For this year, we expect overall non-oil GDP to contract by 5% versus 3.3% growth last year, before expanding again in 2021 by 3%. Oil GDP is set to contract by around 6% versus a 3.6% contraction in 2019.
- ➢ This slow growth suggests that Saudi Arabia's focus on fiscal consolidation will remain its chosen policy for the coming quarters. It is highly unlikely to seek a currency devaluation to adjust for low oil prices.
  - If interest rates remain low -- our base case -- and inflation declines starting in 2021, the kingdom could also be saved from the revaluation pressure it has experienced on previous occasions.
  - For now, subdued oil prices will continue to put pressure on the fiscal and current account deficits; the former is forecast to reach a deficit of 12% of GDP this year from 4.5% of GDP last year, before recovering to 5% of GDP in 2021.
  - While the possible three-month extension of production cuts by OPEC+ will take a toll on the

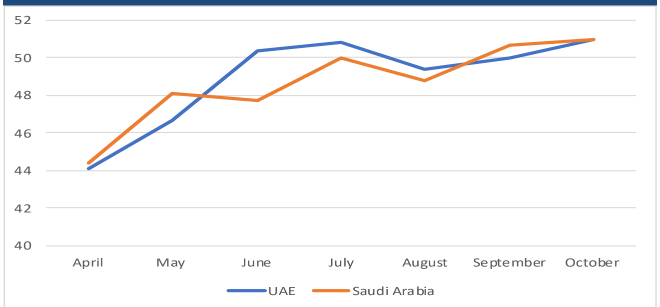
[1] Arabia Monitor; IMF.

recovery early next year, the deficit will start to narrow again as oil prices gradually recover, pandemic effects subside, and the full year of the VAT increase takes effect.

- This recovery cycle will be slower than previous ones. We expect that it may take until H2 2022 for the lost private sector output of 2020 to be fully recovered.

- Saudi Aramco issued USD 8B five-part bond last week to meet the target of paying its annual USD 75B dividend this year.
  - Saudi Aramco is the kingdom's largest revenue generator and given its 98.3% ownership, the large pay-out nearly all goes to the government.
  - The loss of over 45% of profits in Q3, following the 73% loss the quarter before, suggests that the company's cash buffers are rapidly eroding.
  - Aramco's recent multi-tranche issuance ranged from 3-to-50-year maturities.
    - So far, investors have placed more than USD 50B in orders.
    - High investor appetite was expected despite the recent downbeat outlook from Fitch Ratings which moved both Saudi Arabia and Aramco to negative from stable.
    - Although both remain rated 'A', the question is whether a credit downgrade is next.
  - In the meantime, Saudi Arabia's U.S. dollar-denominated debt remains competitive. Year-to-date, investors have received yields of about 10%.
    - Saudi Arabia is the second-best performer among emerging markets, after Uruguay (rated BBB- by Fitch) with an average year-to-date yield of 13.3%.
- The kingdom's sovereign wealth fund, the PIF, is likely to support the recovery as well and offset some of the austerity effects as it focuses its investments homeward.
  - Crown Prince Mohammad bin Salman has announced that the fund will be a key driver of growth over the coming two years. New local investments will partly be funded by liquidating existing assets.
  - The PIF plans to inject more than USD 40B into the economy next year and again in 2022. This is expected to rise each year until 2030.
  - This disclosure about how much the PIF is set to pump into the local economy comes as the government embarks on three years of spending cuts to bring the budget deficit to near zero by 2023.
    - From its overall assets of roughly USD 390B, between 75% and 80% are already invested at home.
  - The amount the PIF is set to invest is equivalent to more than 10% of government expenditure in 2021, and nearly equal to what the PIF spent locally in the previous two years combined.
    - In 2019, local investments made by the PIF reached USD 15.5B; it is aiming for USD 25B by the end of this year.
- On the geopolitical front, the recent visit of Secretary of State Mike Pompeo to Saudi Arabia signals a final US push to end the diplomatic blockade between Qatar and the GCC.

Figure 1 – 2020 Purchasing Managers' Index (PMI)[3]



  - While the Saudi government stopped short of offering to end the blockade, stating that Qatar must first address security concerns, we attach a high probability to this spat between Qatar and the Quartet[2] ending before U.S. President Donald Trump leaves office.
  - It is in the US's interest to maintain a close relationship with Qatar as a way of balancing regional power dynamics and ensuring that Qatar does not grow closer to Turkey or Iran; two countries that have provided much needed diplomatic reprieve during the blockade.

UAE: Contracting economy built tensions over OPEC+ production cuts

Despite the private sector showing signs of recovery, the prospect of OPEC+ production cuts until mid 2021 will weigh heavily on the economy. The IMF nearly doubled its forecast for the UAE's GDP contraction to 6.6%, from 3.5% projected in April.

- Government measures have provided a buffer and alleviated some of the economic pressures, but by no means all.
  - Fiscal and monetary stimulus packages currently stand at 17.5% of GDP, but they have not been sufficient to offset the impact of the crisis.
  - Reflecting the worsening outlook, the UAE's Purchasing Managers Index declined to 49.5 in October from September's 51, as the overall level of business confidence hit the weakest level in the series' eight-year history.
    - Taking all this into account, we would not be surprised to see the overall debt burden reach nearly 150% of GDP going into 2021.
- Faced with a likely extension of OPEC+ production cuts until March 2021, the UAE cranked up tensions with its oil-producing allies last week. There has even been speculation that the Emirates would reconsider its membership in the oil grouping.
  - The UAE has now reaffirmed its support for the OPEC+ output reduction accord, but tension has emerged between Riyadh and Abu Dhabi since the

[2] The Quartet includes Saudi Arabia, UAE, Bahrain and Egypt.

[3] Arabia Monitor; IHS Markit.

UAE breached its oil output quota during the summer.
- The UAE pumped around 2.7M bpd in August, 103K b/d over its 2.6M bpd quota under the OPEC+ supply accord and a rise of 293K bpd from July.
    - Given that the UAE needs to monetise oil resources, it is increasingly dissatisfied with the allocation of production caps, which it deems unfair.
    - UAE officials suggested that all members should comply with existing production quotas before an extension of cuts is considered.

➢ Tussles in the cartel dissipate, but the Abu Dhabi National Oil Company's recent approval of its USD 122B capital expenditure plan for the next five year has the potential to run the UAE afoul of OPEC+.
- This follows the discovery of 22B barrels of recoverable unconventional oil resources and an additional 2B barrels of conventional oil reserves.
- The company stated it envisions that oil output could rise from around 4M b/d to 5M b/d in 2030.

➢ Meanwhile, the UAE is reinventing itself to speed its recovery; there has been a parallel improvement in certain economic aspects, compounded by government efforts to boost investment.
- To offset the capital outflows, the UAE has introduced new measures to boost the private sector.
- It announced the expansion of its 10-year golden visa to include medical doctors, scientists, data experts and PhD holders, in a bid to drive the country's diversification efforts by attracting high-skilled professionals.
    - This follows the decision on 28 October by the Abu Dhabi Department of Economic Development to allow foreign companies 100% business ownership.
- We expect such liberalisation to encourage long-term private sector investments and accelerate the Emirates' transition to a knowledge-based economy.
- Earlier last month, the UAE also unveiled secular-leaning legal reforms[4].These moves are part of the country's strategy to offer an environment that is more supportive of expatriates, including foreign investors.

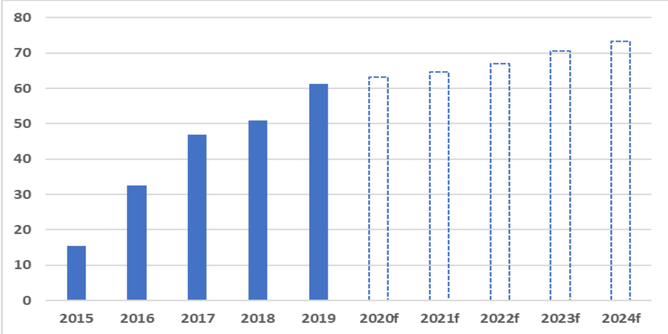
➢ Partly on the back of diversification efforts, the UAE was assigned the fourth-highest investment grade at Fitch Ratings and is now ranked AA-.
- This positive outlook is supported by the country's solid external asset position.
- It is expected to encourage capital flows from foreign investors as the UAE prepares to issue its first federal bond, possibly before the end of the year.

Oman: Thinking out of the box

In line with our previous analysis, we expected Oman to receive a support package from its GCC neighbours. Qatar moved first, at the end of October, with USD 1B in financial aid injected into the Central Bank of Oman.

➢ Since he came to power in January, Sultan Haitham Bin Tariq Al Said has pushed for fiscal adjustments and

Figure 2 – Oman Gross Government Debt[5]



unprecedented economic reforms to offset revenue losses, such as a 15% cut to government spending. But the budget deficit will remain wide over the next three years.
- The deficit is expected to reach over 18% of GDP this year, compared with 7.6% in 2019, and to average 13% of GDP between 2021 and 2023.
- This year's shortfall is the largest since 2016 and is expected to accelerate the deterioration of the already debilitated sovereign and external balance sheets.

➢ As part of its plan to offset fiscal pressures, Oman plans to introduce a 5% VAT in April 2021, and -- by far the boldest measure across the GCC – to tax wealthy individuals starting in 2022.
- Revenue from the income tax will be used to fund social programmes. It remains unclear whether both citizens and expatriates will be subject to the tax.
- These fiscal austerity measures are to be rolled out gradually, to mitigate social discontent.

➢ We see downside risks persisting until fiscal reforms take effect and oil prices improve. Haitham's strategies to improve Oman's weak fiscal position will be painful and could form a strong headwind against recovery.

➢ To meet its financing gap, Oman tapped the international debt market for the first time since July 2019 with a USD 2B two-tranche bond in October.
- It priced a USD 1.2B seven-year bond at 6.75%, and a USD 750M 12-year bond at around 7.3% -- costly, as expected, given its junk rating by all three major credit agencies. The sultanate halted earlier plans to raise a three-year bond.
- The newly issued debt's secondary market price declined on its first day, with the bonds trading 1.5%-2.5% below their face value.
    - The sultanate has the worst-performing bonds in the region this year.
- More recently, Oman raised an additional USD 500M through a reopening of the two bonds issued in October.
    - Oman has tightened both tranches from its initial price guidance earlier on and priced a USD 200M seven-year bond at 6.3%, and a USD 300M 12-year bond at around 6.9%

➢ Amidst subdued investor appetite, Oman is now discussing a loan of at least USD 1B with international banks yet to be disclosed. The loan is expected to fund heavy debt redemptions due over the next two years.

[4] Reforms focused on decriminalising alcohol, criminalising so-called honour crimes and allowing the cohabitation of unmarried couples

[5] Arabia Monitor; IMF.

- We expect Oman's funding requirement to remain high with further issuance necessary. Access to the international debt market will be crucial.

➢ Creatively, Oman is attempting to diversify its sources of finance while avoiding increasing its overall debt further. The recent decision to use its largest oil-producing area, Block 6, as collateral for new debt is a clear indication that the sultanate is thinking out of the box
  - It is planning to transfer 60% of its stake in Block 6, to a new entity that could then tap international markets.
  - While confirmed details are yet be released, the new entity is expected to issue around USD 3B in bonds during H1 of next year.
  - Block 6 is currently operated by state-backed Petroleum Development Oman, and this contract area is the most significant oil and gas operation in the sultanate. It has the production capacity of 650K bpd and holds more than 75% of total crude oil reserves.

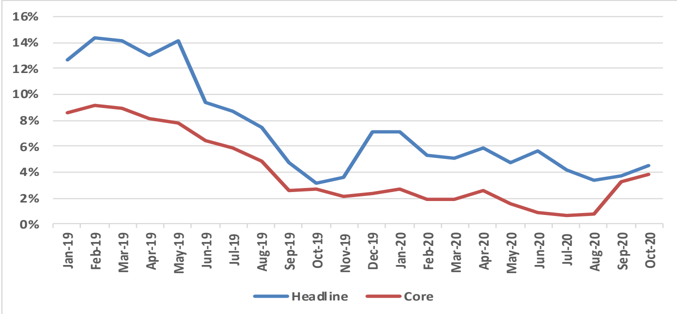
Egypt: Growth brings back investors

The COVID-19 pandemic has not passed Egypt by; it has disrupted reforms, hurt tourism, and slowed private investment. But by managing some growth, diversifying its bond market and with the Central Bank of Egypt's (CBE) commitment to stabilising the economy, the country has lifted investor sentiment.

➢ Despite Egypt aiming to reduce its budget deficit to 6.3% this fiscal year from the 7.2% deficit in FY19/20, we expect its fiscal position to remain under pressure. Total expenditure is expected to increase by 8.9% YoY to reach USD 110B, as per the FY20/21 preliminary budget. This will be the largest budget in the country's history.[7]
  - The government's spending increase is mainly to continue implementing structural reforms, which focus on increasing allocations for investments, infrastructure and expanding its export base.
  - This wider deficit will increase Egypt's public debt and once more pressure its debt servicing costs, due to reach USD 34B this fiscal year.
  - Egypt will continue borrowing on international debt markets.

➢ Given that the Ministry of Finance is once again shifting its approach to issuing longer-maturity debt to take advantage of lower interest rates, government borrowing costs are expected to fall.
  - Overall debt is expected to remain under the 82.7% debt-to-GDP target as reflected in its FY20/21 draft budget.
  - Pressure on Egypt's foreign reserves has been easing, mainly due to the improvement in investor sentiment and the country's efforts to continue on its reform path and secure more financial buffers.
  - Reserves by the end of October rose by nearly USD 795M to reach USD 39B, a 2% increase MoM.
    - This was the fifth consecutive rise, after USD 10B losses earlier in the year. We expect this growth to continue through the rest of this year.

Figure 3 – Egypt Inflation[6]



➢ Slowing inflation is supporting monetary policy easing; at its most recent meeting (12 November) the CBE cut interest rates by 50 basis points, as it did in September.
  - The overnight lending rate was reduced to 9.25% from 9.75% while the overnight deposit rate dropped to 8.25% from 8.75%.
  - Consumer price inflation reached 4.5% YoY in October from 3.7% in September.
  - Even though it rose, it was the second-lowest inflation rate in over 14 years and well below the official target of 9% (±3%).
  - We expect inflation to rise slightly by end of the year to around 5.5% before it peaks at 7.7% in 2021.

➢ Cutting rates again creates a dilemma for the CBE. Keeping interest rates high attracts portfolio investments, while lowering them supports the recovery of economic activity. We expect the CBE to continue its monetary policy loosening, but cautiously.
  - This is mainly because Egypt is offering some of the highest carry trades among emerging markets, with short-term debt yielding around 13%.

➢ The return of foreign investor confidence in local market paper will partially compensate for the loss in foreign exchange from tourism and remittances.
  - Foreigners now account for 9.4% of total local debt holdings, up from 5.2% at the end of June.

➢ A draft bill was approved by the cabinet earlier this month to exempt tax and fee revenues on bonds offered to overseas investors. If passed, we can expect higher portfolio capital flows in the domestic market.
  - A sovereign sukuk draft law, once approved by parliament, will allow Egypt to issue its first sovereign Islamic bond. This will diversify the country's investor base, deepen the liquidity of its financial markets, and help narrow the deficit in the medium term.

➢ As Egypt works to revitalise its competitiveness in the bond market, we expect international appetite to remain strong, particularly under the current macro management framework, and with the IMF programme as an anchor.

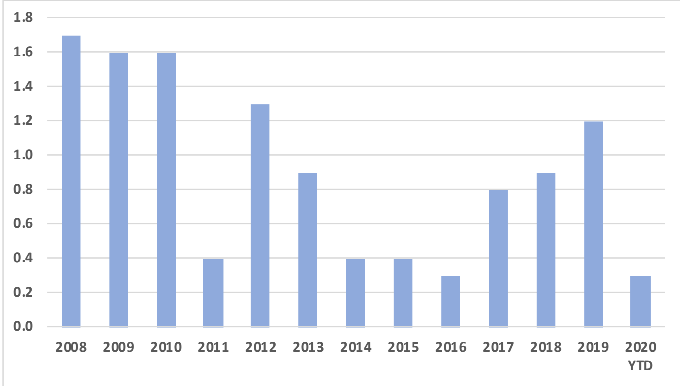
Libya: Still no road to peace

The recent UN-sponsored ceasefire talks in Tunis failed to produce a roadmap for Libyan elections next year. Until an agreement on this is reached, and as long as foreign interference continues, Libya's battered economy and oil industry will suffer.

[6] Arabia Monitor; CBE.
[7] Egypt's fiscal year runs from 1 July to 30 June.

- An enduring ceasefire will require the rival parties -- the UN-backed Government of National Accord (GNA) and the opposing Libyan National Army (LNA) -- to arrive at a formal agreement on how to conduct an election and/or share power in the interim.
- The informal ceasefire signed in October has managed to cool tensions and has provided a pathway for Libya to return to the international oil market. But it all remains volatile without a firmer pact.
- The National Oil Corporation (NOC) is piling on the pressure calling on decisive action to also reach a clear agreement as to how oil revenues will be distributed across the country.
  - The NOC has now opted to abstain from depositing oil revenues via the Libyan Central Bank (CBL) instead transferring funds to the Libyan Foreign Bank.
  - The NOC is taking a political stance against the CBL which it accuses of mismanaging revenues and is asking for an audit of the bank's activities.
- The latest move from the NOC delays the distribution of much needed revenues to Libyans and adds volatility to the peace-making process.
- Oil output from the NOC has surpassed the OPEC+ target of just over 1M bpd following the resumption of production in October. However, renewed government instability could result in a decline or halt in production again
- The UN is currently trying to form a transitional government with LNA and GNA officials until elections are held, it hopes, in December 2021.
- The LNA and GNA have agreed to use a paramilitary group to conduct joint patrols of Libya's petroleum facilities, an important collaboration between the feuding parties which would support sustained production output.
  - Apart from the lack of an election roadmap, foreign interests in Libya continue to stymie a resolution to the civil war; both the GNA and LNA receive foreign financial and military support.
  - Turkey continues to be the most visible foreign power involved in Libya, maintaining its role as the predominant supporter of the UN-backed GNA.
    - Unlike Russia, which has used mercenaries to provide military support to the LNA, Turkish President Recep Tayyip Erdogan has repeatedly sent Turkish troops to Libya to provide military assistance.
  - Similarly, Russia continues to provide assistance to the LNA to counter the GNA's foreign support, using mercenaries and aircraft to expand LNA leader Khalifa Haftar's military strength.
- With the current UN-brokered ceasefire failing to address the role of foreign-funded mercenaries, little traction will be made in reducing foreign influence in Libya.
  - A permanent end to volatility now relies more on Turkey and Russia than on Haftar and GNA Prime Minister Fayez al-Sarraj.

Figure 4 - Libyan Oil Production (Mb/d)[8]



Morocco: Renewed hostilities in the west

In Western Sahara, the Polisario Front independence movement has declared a "state of war" with Morocco, breaking the 29-year ceasefire and bringing additional volatility to the Maghreb. With Morocco's economy already battered by COVID-19, a war with the Polisario could complicate recovery as well as deepen its rift with Polisario supporter and neighbour Algeria.

- The Polisario Front, formed after Spain abandoned its colonial claim to Western Sahara, has fought for independence from Morocco and for Sahrawi self-determination.
  - Fighting between Morocco and the Polisario took place between 1975 and 1991 before a UN-brokered ceasefire was signed, and Morocco agreed to hold a referendum that has yet to take place.
  - Fighting resumed after Moroccan Armed Forces intervened in the El-Guergarat passage, as Polisario members were blocking the movement of goods at the crossing.
    - The passage is part of a buffer zone between the Moroccan-controlled territory and the self-declared Sahrawi Arab Democratic Republic. The latter interpreted Moroccan intervention as casus belli.
    - Morocco currently controls 80% of the contested territory.
  - Should fighting be renewed, there is potential to destabilise the region and divert valuable resources away from Morocco as the country faces an economic downturn caused by the COVID-19 pandemic.
- Morocco's economy is expected to contract by 7% this year, but grow by 4.5% in 2021, assuming the drought that has badly hit agriculture ends.
  - Defence spending has increased by 29% this year, so any full-scale military operation would be costly and complicate economic recovery further.
    - Morocco has increased defence spending to solidify Moroccan control of Western Sahara territory as tensions rose but stopped short of pre-emptive military action.

[8] Arabia Monitor; National Oil Cooperation.

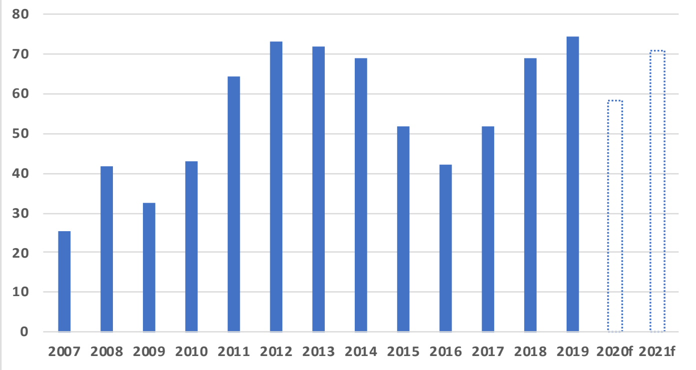
- If the conflict continues, it will impact Morocco's already strained relations with neighbouring Algeria, which continues to be the Polisario's only foreign ally.
  - Algeria has continually used its support of the Polisario as a way of countering Moroccan influence in the Maghreb.
  - Otherwise, Morocco enjoys the support of most of the MENA region, including the GCC, as well as France, giving it the upper hand in the conflict.
- With the UN pre-occupied with other regional conflicts -- such as in Libya and Syria -- bringing both parties to the negotiating table could be delayed until 2021.
  - The Polisario's UN envoy, Omar Sidi, has been stern about the determination to form an independent state, largely going against the international community.
  - The main danger is that the conflict could "drift" and bring in proxy players -- such as from Libya and Syria -- if it continues without intervention from international bodies.

Sino-MENA: Saudi shrimp meet China's COVID police

While bilateral trade and investment chugged along amidst the pandemic and lockdowns in China and MENA, few expected a setback over shrimp.

- Saudi shrimp gained direct access to the Chinese market in 2018 and was seen as a potential USD 500M a year business. But coronavirus was found in frozen shrimp imported from Saudi Arabia via Tianjin ports to Lanzhou in early November this year, temporarily halting the trade.
  - Lanzhou trashed the batch and carried out coronavirus tests on 2,270 people and 680 food and environment samples. All returned negative results.
  - This was not the first-time coronavirus has been found in imported frozen goods. Ten other provinces have found similar contamination, including in Norwegian salmon which was taken off shop shelves and destroyed in June.
- This is also not the first time China has temporarily banned Saudi shrimp imports. In September 2019, exports from Saudi Arabia's National Aquaculture Group (NAQUA), the country's largest seafood company, were banned for 20 days, due to alleged white spot syndrome virus in a shipment of shrimp.
  - China is a not a new market for Saudi shrimp, but it used to transit through Vietnam until China opened up to direct Saudi exports two years ago.
- Shrimp is a highly competitive market with Iran, which has China as its largest client.
  - In 2018, China imported all of its Iranian shrimp via Vietnam, but in 2019 it opened up to direct Iranian exports.

Figure 5 - Sino-Saudi Bilateral Trade (USD,B)[9]



The contaminated Saudi shrimp comes at a bad time. It will significantly reduce exports to China and consumer confidence there in the key months leading up to Chinese New Year in early February.

- China imported 19,033 tons of shrimp in January 2019, exceeding industrial expectations and underscoring huge market potential.
  - In contrast, Saudi Arabia only exported 306 tons in June 2019, highlighting the importance of the months leading up to Chinese New Year.
- It was expected that in 2020, Saudi shrimp exports could generate up to USD 500M in revenue – a target now unlikely to be reached.
- The increased demand for shrimp from MENA has also prompted Chinese aqua firms to set up farms in the region, facilitating additional exports to China.
  - China's Guangdong Evergreen Feed Group was in discussion with Saudi Arabia to build a USD 300M aquaculture farm in the desert, having completed a USD 90M integrated tilapia and shrimp farm in Kafr el Sheikh, Egypt, in 2017. There was also interest expressed in a USD 100M project in Kuwait.

MENA Energy Outlook: Rapid return to nuclear deal unlikely

The potential for a US-Iran deal is now the most salient 2021 political risk for the world oil market. The current lame-duck period to Joe Biden's formal inauguration as 46th President of the United States in January is critical for the potential of sanctions removal from Iran's point of view.

- The Trump Administration might try to engage Iran in a new round of hostilities right before its exit, but Iran will prefer to avoid further engagement with the US altogether, banking on President-elect Joe Biden to follow through on his promise of re-joining the Joint Comprehensive Plan of Action (JCPOA) agreement.
- Moving immediately on opening negotiations with Iran presents the US with a window of opportunity on issues outside of the JCPOA.
  - There is a window of opportunity prior to the upcoming Iranian presidential election, which will be held in late May or June next year, and in which current president Hassan Rouhani cannot run.

[9] Arabia Monitor; IMF Direction of Trade Statistics.

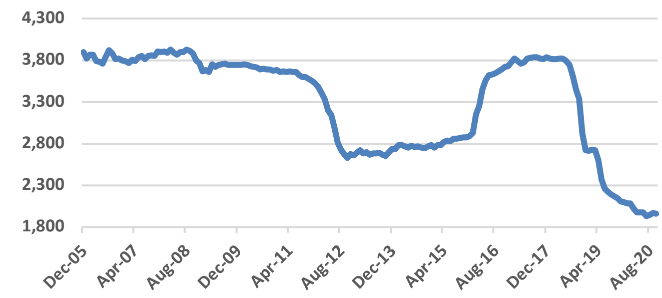
- It would allow many of the same Obama-era officials to re-enter talks with Iranian officials they already know, particularly Foreign Minister Javad Zarif.
- The US could offer significant sanctions relief in return for making some of the restrictions on nuclear activity permanent, addressing ballistic missile development and possibly tackling some of Iran's regional behaviour that the US and its Middle East partners object to, as part of a "more for more" deal.

➢ A waivers-for-compliance approach might be Biden's initial plan as part of the Iran strategy.
  - Biden's choice for National Security Advisor Jake Sullivan has hinted at a scenario where "we provide sanctions relief to Iran in 2021 in exchange for them returning to a number of their commitments."
  - The wording is noteworthy for leaving open a space for a preliminary "less for less" interim deal next year.
  - The "less for less" deal would include waivers for a limited volume of Iranian oil exports to its main Asian customers in return for Iran shipping out its low enriched uranium (LEU) in excess of the JCPOA limit to Russia and ceasing to utilise the more advanced enrichment centrifuges it has recently added.

➢ This will present OPEC with a new challenge in the New Year. With Biden in the driver's seat peeling away Trump's sanctions under a "less for less" deal, at least 0.5 Mb/d of Iranian crude could hit the market in a matter of months, a significant strain for OPEC.
  - Already the surprise revival in Libyan production and renewed pandemic lockdowns in Europe and elsewhere have caused the cartel to consider reassessing its plans of tapering Phase-2 cuts in January.
  - A surge in shipments from Iran could strain the OPEC+ agreement once again and cause prices to face another plunge.

➢ The "less for less" interim deal could transform into a "more for more" deal post Iranian elections.
  - Enforcement of the interim deal shall be less than zealous by the Biden Administration which has most immediately to grapple with the pandemic and economic sustenance. When it can turn to the Iranian file more attentively, it will be post-Iranian elections.
  - Deeper negotiations on a "more for more" deal could open up the Iranian oil sector and economy, in return for curbs not just on the nuclear programme, but on weapons development and regional conflicts. A fully renewed accord would be reached only late next year at best, or early-2022.

Figure 6 - Iranian Historical Oil Production (Kb/d)[10]



➢ A rapid return to market for Iran's full oil capacity yet seems unlikely.
  - Iran's JCPOA production of almost 4 Mb/d, plus about 0.8 Mb/d of condensate, fell to 3.1 Mb/d in September 2018, then to 2 Mb/d as the most intensive phase of the Trump administration's "maximum pressure" campaign took effect.
  - Technically, production could be restored within a few months, as happened at the start of the JCPOA.
  - Renewing long-term contract agreements with its traditional customers, even for waiver-administered volumes, albeit would be a tough ask, as many countries now seem hesitant to engage with the "high-risk" Islamic Republic.

➢ A new approach to Iran would surely face opposition in Congress, driving a much harder bargain with the Iranians. This could push back the timing for the removal of sanctions.

➢ The longer it takes to reach a deal, the less of an impact the full return of Iran's exports would have on oil prices or on OPEC's deliberations.

[10] Arabia Monitor; Qamar Energy.

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