ananta centre

West Asia Digest

MONTHLY ....MARCH 2016 | VOL 01 ISSUE 02

Highlights

- Overview
- Energy
- Non-oil Sectors
- India-related News

Overview

The second week of March witnessed a small upswing in oil prices: Brent nearly touched $ 40/barrel for a while and then stabilized at $ 36/barrel.On Tuesday, 8 March, Brent crude futures reached $ 41.84, before declining to $ 40.24. This has been enough for analysts to suggest that prices have now bottomed, and a new price equilibrium of $ 50 could be considered. Gary Ross, of the New York-based consultancy, PIRA, said that $ 50 would become the "new anchor" for global oil prices and that this figure could even be reached by the end of the current year. However, Goldman Sachs believes that these price increases are "not sustainable in the current market environment."

While this latest news is heartening, the last month has generally been marked by pervasive concerns at the sluggish global economic situation, with some commentators even suggesting that the US could experience a recession in six months. The Gulf Cooperation Council [GCC] countries have however continued to project considerable self-confidence, particularly by tendering for and awarding major contracts across the economic value chain.

But, strains are also apparent: according to the Abu Dhabi Commercial Bank [ADCB], in 2016, the GCC's average weighted real non-oil GDP growth will be a modest 2.2% as against 4.1% in 2015, based on oil prices of $ 41 in 2016 and $ 50 in 2017. These growth figures reflect reduced government spending, both capital and current, coupled with high fiscal deficits, mainly in Saudi Arabia, Oman and Bahrain. Standard & Poor have downgraded Saudi Arabia from A+ to A-; Oman has gone from BBB+ to BBB-, while Bahrain has been lowered from BBB- to BB, placing it two levels below investment grade. The outlook for Saudi Arabia remains "stable", affirming confidence that the Kingdom will take measures to stabilize its fiscal position.

Low oil prices have also raised questions about the need for GCC currencies to continue to be pegged to the dollar. Amidst low oil prices, this makes little sense for the GCC: the dollar is getting stronger (due to improving economic performance and prospects of higher interest rates), which is compelling the GCC countries to raise interest rates to keep pace with the dollar, while they should be doing just the opposite to boost their economies.

Thus, GCC central banks have been buying their currencies in the money markets to maintain the parity with the dollar, using up a lot of their valuable foreign exchange reserves. Observers in the region have suggested that the GCC consider a flexible rate of exchange which would allow their currencies to fall against the dollar. However, for now, GCC financiers continue to rubbish all talk of devaluation.

In this gloomy scenario, the UAE presents a happier picture, largely because it is the most diversified economy in the region. Its leaders have committed their country to realizing a share of 81% for the non-hydrocarbon sector in the national GDP over the next five years. Towards this end, the country has focused on improving business competitiveness, promoting foreign investment and funding a number of projects to boost infrastructure and the knowledge economy. In 2016, growth in Abu Dhabi is expected to be 3.1% and 2.5% in Dubai.

Energy

The small boost in oil prices noted above is primarily the result of significant declines in US production. While American producers had projected an upbeat attitude over the last year, the low prices have now taken their toll: US production had peaked in April 2015 at 9.7 million barrels per day (mbd); in November 2015, it had come down to 9.3 mbd, the reduction from pre-June 2014 being 1.6 mbd. The low prices are expected to reduce a further 800,000 b/d from the market at the end of 2016. A number of companies have announced cuts in oil and gas production of between 10-15% in 2016.

The other reason for price buoyancy is the decision of four major oil producers — Saudi Arabia, Russia, Venezuela and Qatar -- to "freeze" their oil production at January levels, the first global oil agreement in 15 years. The global market anticipates that this agreement will be accepted by other major OPEC and non-OPEC producers at a joint meeting in Moscow on 20th March. The UAE oil minister, Suhail Mohammed Faraj Al Mazroui, in public remarks, admitted that a "correction to a sustainable price will take time", and that in the interim it made sense for producers to freeze production. The Russian energy minister has said that 15 countries, producing 73% of world oil production, have agreed to the freeze.

The decision to freeze production has been welcomed by a number of international experts. Daniel Yergin said: "Freeze is the beginning of a process and it is going to take a couple of months to determine… how much [surplus] oil there is in the market. … in autumn we might see markets more in balance."

However, some commentators doubt that the freeze will be universally accepted or would even be effective in boosting prices. Mohammed Al Soomi, writing in GulfNews, has noted that the market is awash with oil estimated at over three million barrels per day [mbd]; even if there is an increase in global demand, it will not exceed 1.5 mbd, thus leaving a huge surplus in the market.

Again, besides non-OPEC producers like the US and Norway, even OPEC members such as Iran and Iraq are not likely to participate in the "freeze" regime. While Iraq needs all the revenue it can generate, Iran, just emerging from sanctions, has made clear its intention to boost production immediately by half a million barrels and by a million by the end of this year. In February, Iran began its first oil shipment to Europe since 2012, with cargoes going to Total of France and Hellenic Petroleum of Greece. Since there are still some sanctions in place that restrict banking transactions, Iran has offered to swap its crude for refined fuel, exchange fuel oil for gasoline, and accept payment in Euros and other currencies.

Non-oil Sectors

The parlous economic situation is compelling the GCC countries to take unprecedented measures to reform their economies. Saudi Arabia is looking at significant spending cuts, reductions in subsidies and even harsh austerity measures. It has also hired the services of the global consultants, McKinsey, to advise on effecting a thorough economic transformation; proposals being examined include raising public and private investment of $ 4 trillion to boost productivity and employment. Specific proposals being pursued are: raising domestic energy prices; privatizing mining; setting up a state-owned mortgage company, and selling stakes in valuable government-owned enterprises, including airports, hospitals, and even theiconic national oil company, ARAMCO.

Bahrain has also announced a 60% hike in premium petrol, significant increases in utility charges, and removal of subsidies on foodstuffs such as meat and chicken. The GCC countries are also looking at introducing taxes: they have already announced that collectively there will be VAT charged at 5% by 2019 at the latest, though they have rejected a personal income tax.

UAE's business leaders continue to affirm in public that their country takes a longterm view in economic matters. At a recent conference, the Group Chief Executive and Managing Director of Mubadala Development Company, Abu Dhabi's development fund, said: "The UAE will continue to think in decades, not months and years." In line with this thinking, Dubai has announced the setting up of Dubai Wholesale City: this $ 8 billion project will in ten years become the world's largest global wholesale hub. It will cover 550 million sq. feet and house 15,000 wholesale traders specializing in: food, construction materials, electrical appliances, electronics, machinery and equipment, vehicles and spare parts, textiles and furniture. It will also have "country pavilions" and is hoping to attract companies from: India, Malaysia, China, Australia, South Korea, Germany, the USA, etc.

The publicity material has highlighted Dubai's advantages: over 800,000 flights passing through every year;

111 million passengers using its airports; 61 million containers handled at its ports, and the connection of its ports with 70 international ports.

India-related News

1. January saw a surge of oil sales to India from the Gulf: Saudi Arabia supplied 940,000 b/d, a 29% increase over January last year, while Iraq supplied 930,000 b/d, a 52% increase over last year. Supplies from Iraq were boosted due to discounts (which knocked off $ 1 per barrel from the oil price) and increased purchases ofBasrah Heavy, which is attractive to Indian refiners who are seeking the cheaper heavy and sour grades after upgrading their plants.

2. This year's Indian budget exempted foreign companies from federal income taxes on approved local sales of oil stored in caverns set up in India for strategic storage. This is likely to attract OPEC producers, the main suppliers to India, to fill up these caverns with commercial oil, thus saving the country the need to spend $ 5 billion to store 130 million barrels. The advantage to OPEC suppliers is that they will get to retain their market share, their principal interest in this period of low oil prices.

3. The Indian budget received praise both from visiting experts and resident business persons in the UAE. At the "Emerging India Forum", organised by Times Now, visiting economists emphasised that India was an attractive destination for global investment, and that the budget was a "decisive step forward" to ensure fiscal consolidation and sustainable growth of over 7%. On similar lines, resident community leaders applauded the budget's focus on the rural and agriculture sectors, and on education, infrastructure, youth and women's empowerment.

4. The Hinduja-owned Ashok Leyland, India's second largest manufacturer of commercial vehicles, announced that it would double the capacity of its manufacturing plant in Ras Al Khaimah, UAE, with an investment of $ 10 million. The expanded plant will include a design and service training centre. After its expansion, the plant will manufacture 24 buses a day.

Author

Ambassador Talmiz Ahmad, Adviser, West Asia & North Africa, Ananta Centre & Former Indian Ambassador to Saudi Arabia, Oman & UAE

(The views expressed are personal)