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Highlights

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Political Developments

1) UN-BROKERED YEMEN PEACE TALKS IN KUWAIT continued to show no progress, with indications at month-end that they might finally be called off. Talks resumed in Kuwait on 21st July after hectic diplomatic interactions by the UN special envoy, Esmail Ould Shaikh Ahmad, in Sanaa, Riyadh and Muscat, with the Hadi camp announcing that it had received a "written response to our demands", which had encouraged the government to re-join the negotiations. The Kuwait government, on its part, set a deadline of two weeks for a final agreement to emerge, adding that failure to meet this deadline should lead to the departure of the two teams from Kuwait.

In the event, the deep divide between the two sides just could not be bridged. On 28th July, the "rebel" side announced that the Houthis and their allies, i.e, the General Peoples' Congress led by former president Ali Abdullah Saleh, had formed a 10-member committee to run affairs in Yemen. This was promptly condemned by the government side as a "coup against the negotiations", which then re-committed itself to liberating the country from Houthi occupation. The UAE government also criticised the move as "a desperate attempt" by the rebels against the legitimate government in Yemen.

Separately, the US military has announced that it will boost its armed presence in Yemen to pursue a more robust campaign against the Al Qaeda in the Arabian Peninsula (AQAP), following up on the successful offensive against the AQAP in Al Mukalla, in south Yemen, in April.

2) Syria: IN A DRAMATIC SHIFT FROM EARLIER POSITIONS, the US has announced that it will work more closely with Russia in its campaign against the ISIS and other terrorist groups. The agreement includes the setting up of a Joint Implementation Group (JIG), with headquarters near Amman, and sharing of information to synchronise targeting of ISIS. The US would also like Russia to pressure the Assad government to avoid bombing the "moderate" rebels and work with the US to promote a political transition in Damascus. The Al Qaeda-affiliated Jabhat Nusra has been closely coordinating its operations with several of the moderate militia, so the US has avoided bombing Nusra targets in recent months; Russia on the other hand has bombed both Jabhat Nusra and other moderate groups as well.

In order to project itself as a "moderate" and a purely Syrian enterprise, Jabhat Nusra declared on 16th July that it had broken its ties with Al Qaeda and had changed its name to "Jabhat Fateh Al Sham" [Syrian Victory Front]. It expressed its gratitude to Al Qaeda leaders "for having understood the need to break ties", and added that it would not have ties with any "foreign parties".

Saudi Arabia has welcomed the Russian role against ISIS, but rejected linking this with keeping Bashar Al Assad in power.

In another unexpected turnaround, Turkey announced that it would be re-engaging with the Al Assad regime in Syria, ending several years of animosity in which it had actively supported Salafi militia seeking regime change and had even set up a "jihadi superhighway" across the Turkish-Syria border to facilitate the movement of young jihadis to Jabhat Nusra and later to the ISIS. The Turkish Prime Minister, Binali Yildirim, said that revival of ties with Syria was important both in the context of a regional counter-terrorism campaign and the overall reset of relations with regional powers. Observers believe that this shift in Turkish policy is due to its concerns relating to the success of the Syrian Kurds in controlling most of the stretch of territory along the Turkey-Syria border, besides their shared threat from ISIS.

3) **The release of 28 pages** of the **US congressional report on the 9/11 attacks** did not reveal any conclusive evidence of links between the hijackers and officials of the Saudi government, though it showed that some of the hijackers might have had contacts with individuals with links to the Saudi government. The Saudi foreign minister quickly expressed the hope that the aspersions cast on the Saudi government over the last 14 years would now end.

The Oil Scenario

1) **Prices: The last fortnight saw** oil prices hovering well below $ 45/ barrel, reaching a low of $ 42 at the end of the month, primarily due to a market glut and slow economic growth. The IEA viewed this over-supply as "persistent" and a cap on oil prices in spite of increasing demand and reduced non-OPEC production. This was reflected in the forward pricing: the Brent contract for September was $ 42.46, while the October contract was $ 43.53. The Energy Information Agency [EIA] of the US Energy Department said that fall in inventories in the second week of July was just 2.34 million barrels, less than the anticipated three million barrels.

Observers believe that this over-supply could continue for some weeks: one consultant has forecast oil prices at $ 39-42 over the next few weeks, after which there could be a balance in the market, with prices reaching $ 50-60/barrel.

2) **Iran: In the first six months of this year,** Iran has recovered 80% of the market share it had lost when the US and EU sanctions had placed severe restrictions on its oil exports in 2012. This has been achieved mainly on the back of significant increases in exports to Asian markets: exports to India have gone up by 63% (338, 000 b/d), to Japan by 28% (206,000 b/d), South Korea by 123% (265,000 b/d), and China by 2.5% (603,000 b/d). Iran exports 2 mbd of its total production of 3.8 mbd.

3) **Iraq has announced that it is in negotiations** with Exxon Mobil and Petro China to develop two oil fields in the south of the country, which are together expected to produce 550,000 b/d. Iraq is at present producing 4.78 mbd, making it OPEC's second largest producer after Saudi Arabia: four million b/d produced in the fields are in the south of the country, while 700,000 b/d are produced in the Kurdish region. From the southern fields, 3.19 mbd are exported, which will rise to 3.2 mbd this month and remain at this level till the end of the year.

Non-Oil Economic Developments

1. **The Institute of International Finance (IIF)** has noted that the GCC countries are increasingly **turning to debt markets, both domestic and foreign, to finance their fiscal deficits** rather than dip into their reserves. The GCC countries had a fiscal deficit of $ 35 billion in 2015, which is likely to increase to $ 89 billion this year. This

approach is expected to ease pressures on domestic banking systems. Foreign borrowing is likely to be $ 48 billion this year. The IIF estimates that non-resident capital flows to the GCC countries will rise to $ 110 billion in 2016, as against $ 80 billion last year.

2. **REMITTANCES FROM THE GCC COUNTRIES** have made it the number one remitting region in the world, with remittances amounting to $ 90 billion in 2014, mainly reflecting the money sent home by its 18 million strong expatriate population. According to World Bank figures, worldwide remittances in 2014 were $ 583 billion, with over 15% generated from the GCC countries. The US was the largest source of remittances; Saudi Arabia was second placed with remittances of $ 37 billion, followed by the UAE ($ 19 billion), Kuwait ($ 18 billion) and Qatar ($ 11 billion). About 60% of the remittances are handled by traditional exchange houses.

Given the low oil prices and increasing fiscal deficits, there are suggestions that GCC governments consider a **tax on remittances**. Observers however point out that, while this could provide some quick fiscal relief, it would have an adverse impact on the attractiveness of the GCC for expatriate workers, besides of course encouraging unofficial money transfers. Subsidy reform is perhaps a more attractive way of addressing the issue of fiscal deficit.

3. **IN THE MIDST OF REGIONAL GLOOM, the UAE continues to indicate a positive outlook:** according to the *Middle East Economic Digest* (MEED), its growth is expected to be 4% per year every year till 2020, as against a modest growth of 3.1% this year. This will be facilitated by expectations of oil prices rising to $ 50/barrel in 2017, and increasing by 10% annually till 2020. This will be supported by non-oil activity, particularly the projects for EXPO-2020, enhanced trade with Iran, and its $ 629 billion projects pipeline: in early 2016, projects valued at $ 22.6 billion were awarded, mainly in the real estate, transport, and power sectors.

India-Gulf Ties

1. **IN THE QUARTER ENDING JUNE, Iraq became the number one oil supplier to India**, supplying 847,000 barrels/day, thus obtaining a share of about 20% of India's imports in that quarter. Iraq nudged out Saudi Arabia from first place: the Kingdom supplied 768,000 barrels/day, with its share standing at 18%. Iraq attained its position due to the sale of Basrah heavy crude, which is in considerable demand by Indian refiners who are now able to refine most kinds of heavy grade crude. The Iraqi crude is also used to produce bitumen, used in road construction: this fits in well with the national commitment to build 40 km of roads every day in the current financial year.

2. **INDIA'S LARGEST ENGINEERING AND CONSTRUCTION COMPANY, Larsen and Toubro**, part of a consortium with Singapore-based Emas Chiyoda, has been awarded a $ 1.6 billion gas development contract by Saudi Aramco. The contract is for the expansion of the second phase of the Hasbah offshore gas field in the Gulf. L&T's own share of the contract is about 60%. The project will be completed in three and a half years and will supply 2.5 billion standard cubic feet of gas per day to meet the country's growing gas demand, particularly in the areas of power and water desalination. L&T had earlier been part of consortia that had won the Riyadh metro and Doha metro projects.

Author

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

(The views expressed are personal)