

Middle East Economies Adjusting to the New Oil Normal

Keynote at SuperReturn Middle East 2016

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— & ASSOCIATES —

Agenda

- ✓ **Global & Regional Macroeconomic Overview**
- ✓ **Fiscal consequences of the New oil Normal for the GCC & Implications for SWFs**
- ✓ **Taxation & Privatisation: Key to new Growth Path**
- ✓ **Current state of PE in the region & Investment Opportunities**

Global growth: outlook & underlying risks; 2016-17 *anni horribiles*

Outlook

- IMF: **Global real GDP** growth to stay flat at 3.1% in 2016; EMEs: 4.2%
- **Productivity growth** is stagnant in advanced economies: secular stagnation?
- Global **trade** & industrial activity sluggish
- **Policy stimulus** supports growth in many **EMEs**; need structural reforms

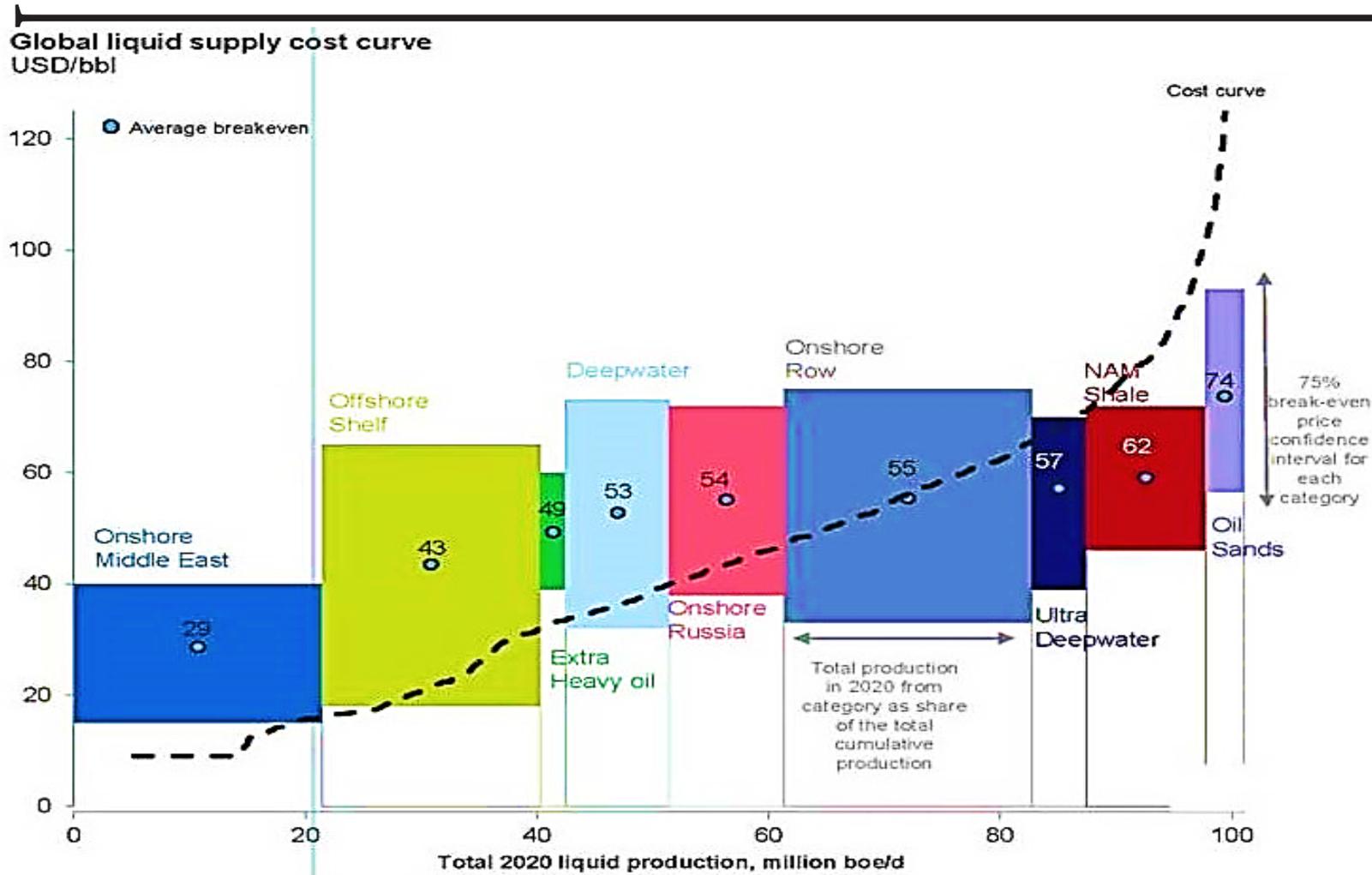
Macroeconomic Risks

- **Low oil prices** => weak investment in commodity exporters => fiscal adjustment
- **Financial sector vulnerabilities** especially in EU banking sector + Greece
- **China** rebalancing
- **Monetary policy**: NIRP, asset markets addiction to low interest rates, EME debt vulnerability, currency wars, stagnant Eurozone

Geo-political risks

- End of **Neoliberalism & anti-globalisation**
- US, France, Germany, Iran **elections** (Trump, Sarkozy?)
- **Brexit** => UK & EU economic, political, policy & institutional uncertainty
- Ongoing **conflicts** in the region & spillovers

“New Oil Normal”: Disruptive tech driving costs down for renewables & shale. Shale now is backstop technology



Source: Rystad Energy research and analysis.

New Oil Normal: downside risk for oil prices & resources

Demand side: cyclical, structural & tech factors imply downward trend in oil demand relative to activity

- Slowdown in EMEs, China
- Greater Energy Efficiency Trend: falling (E/GDP) ratios
- Climate Change & COP21 commitments; changing energy mix

Supply side: tech is making RE, CE, shale more competitive

- Shale: technology & exploitable resources widely available
- Renewable & Clean Energy increasingly competitive
- Return of Iran, Libya, Iraq

Technological innovation affects demand & supply: energy storage, e-cars, flexible capacity, 4th industrial revolution

Zaki Yamani: “The Stone Age did not end for lack of stone, and the Oil Age will end long before the world runs out of oil.” (2002)



Regional Macroeconomic outlook: budget and current a/c balances turn red

	Real GDP			Budget balance (% of GDP)			Current Account (% of GDP)		
	2015	2016f	2017f	2015	2016f	2017f	2015	2016f	2017f
Oil Exporters	2.3	3.3	2.9	-9.5	-9.2	-6.2	-4.0	-4.4	-1.8
Saudi Arabia	3.5	1.2	2.0	-15.9	-13.0	-9.5	-8.3	-6.6	-2.6
UAE	4.0	2.3	2.5	-2.1	-3.9	-1.9	3.3	1.1	3.2
Iran	0.4	4.5	4.1	-1.7	-1.1	-1.0	2.1	4.2	3.3
Oil Importers	3.8	3.6	4.2	-7.3	-7.0	-5.8	-4.5	-4.8	-4.7
Egypt	4.2	3.8	4.0	-11.5	-12.0	-9.7	-3.7	-5.8	-5.2
Morocco	4.5	1.8	4.8	-4.3	-3.5	-3.0	-1.9	-1.2	-1.4
MENA	2.1	3.2	3.2	-9.3	-9.1	-6.4	-4.4	-5.0	-2.8
Maghreb	2.8	2.3	4.3	-16.2	-15.6	-12.3	-14.4	-13.8	-12.7
GCC	3.1	1.7	2.3	-9.4	-9.8	-6.9	-2.4	-3.7	-0.5

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Oil Exporters' Adjustment to Oil Shock

Commodity Exporters responded to tumbling revenues in a variety of ways; lower spending, higher taxes, depleting/sell assets and/ or borrowing

Cutting current spending: Indonesia, Iran, Mexico

Capital expenditure: Saudi, Mexico

Raising taxes: Iran

Substantial energy price reforms: GCC

Non-oil non-tax revenues: Saudi

Running down financial assets (SWFs), including forex reserves, to finance deficits: Gulf region, Russia, Venezuela

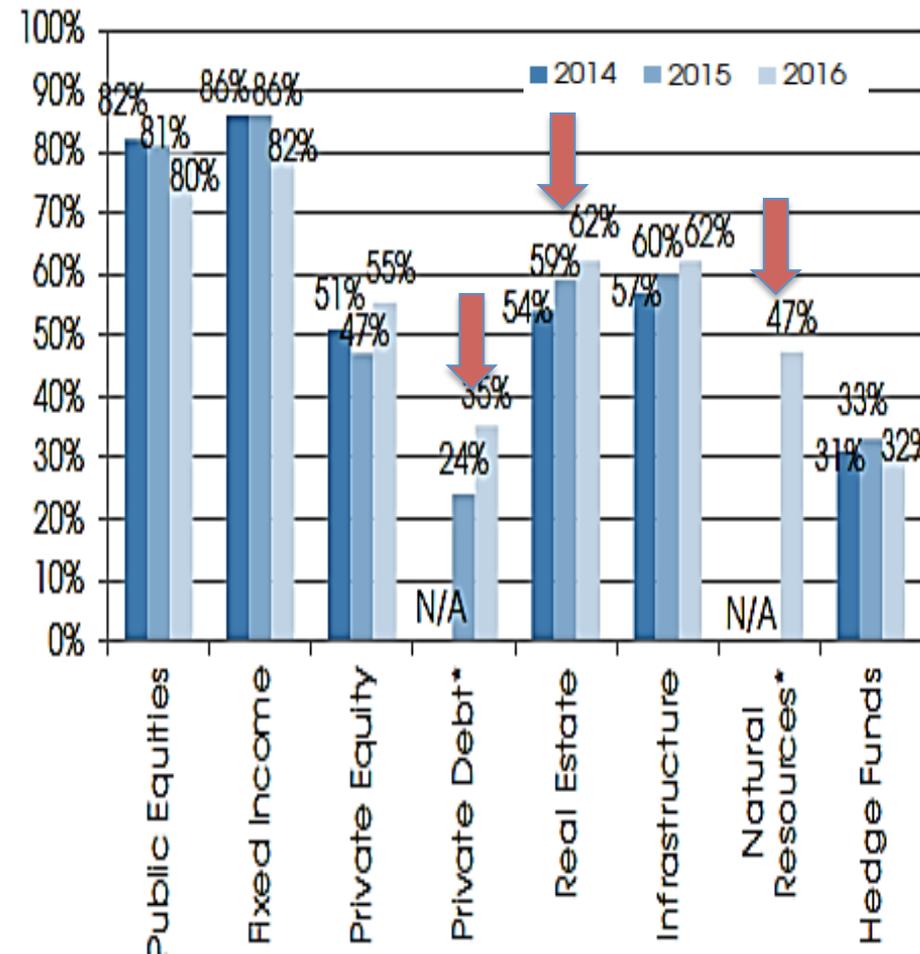
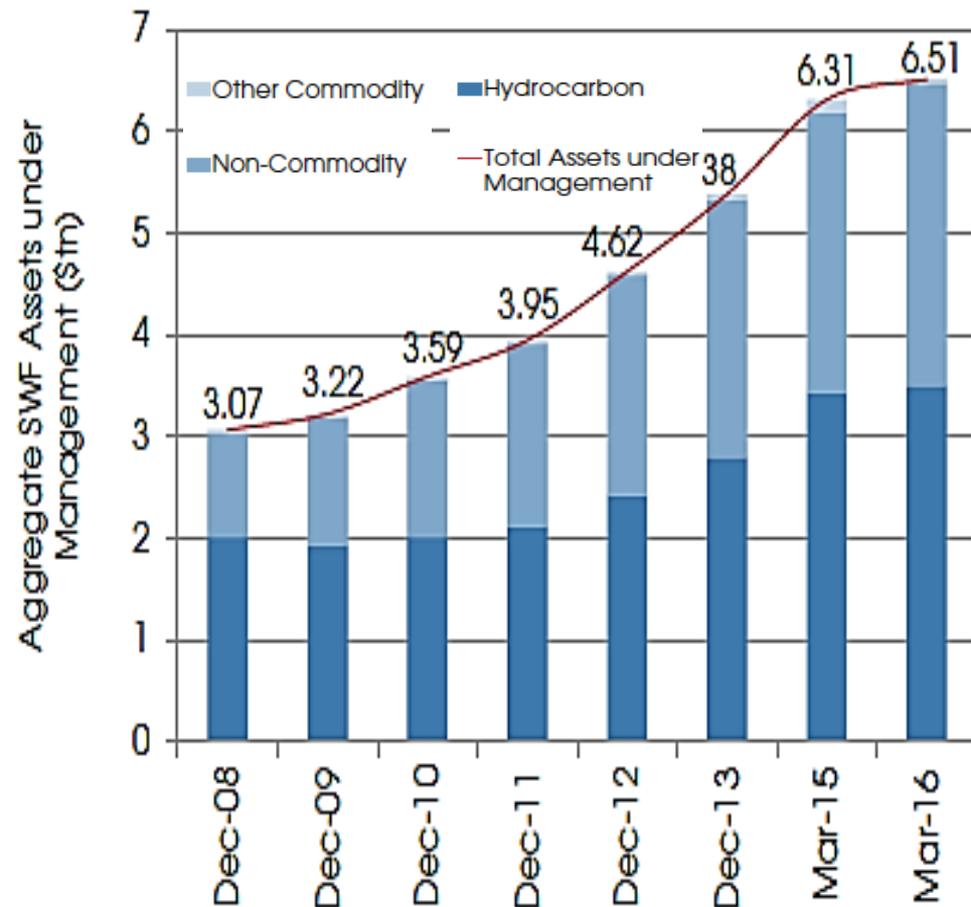
Exchange rate adjustments: Russia, Indonesia

Borrowing: Saudi, Qatar and Oman

SWFs adjusting to the New Oil Normal: Change in net assets available to GCC SWFs: decline of \$250bn in 2015 & \$750bn over 2015-20

Slow growth of SWF AUM (\$tn)
likely rise in emerging Asia SWFs

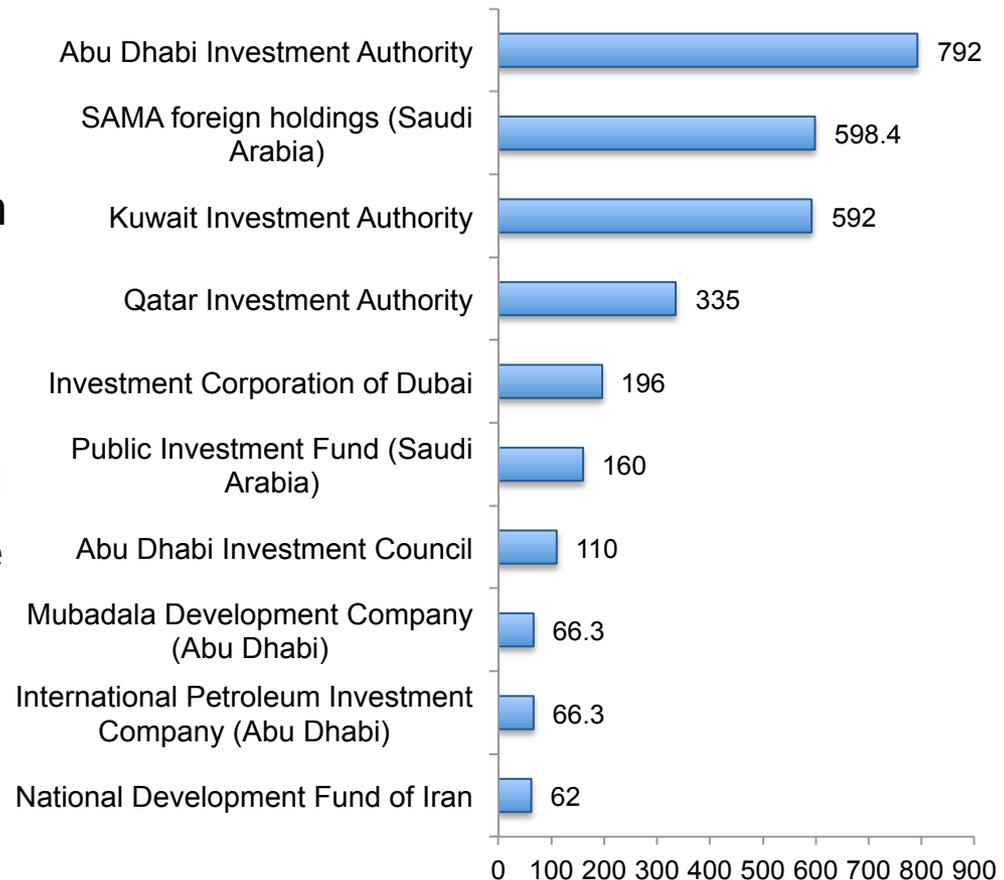
Searching for yield & alternatives



Impact on regional SWFs

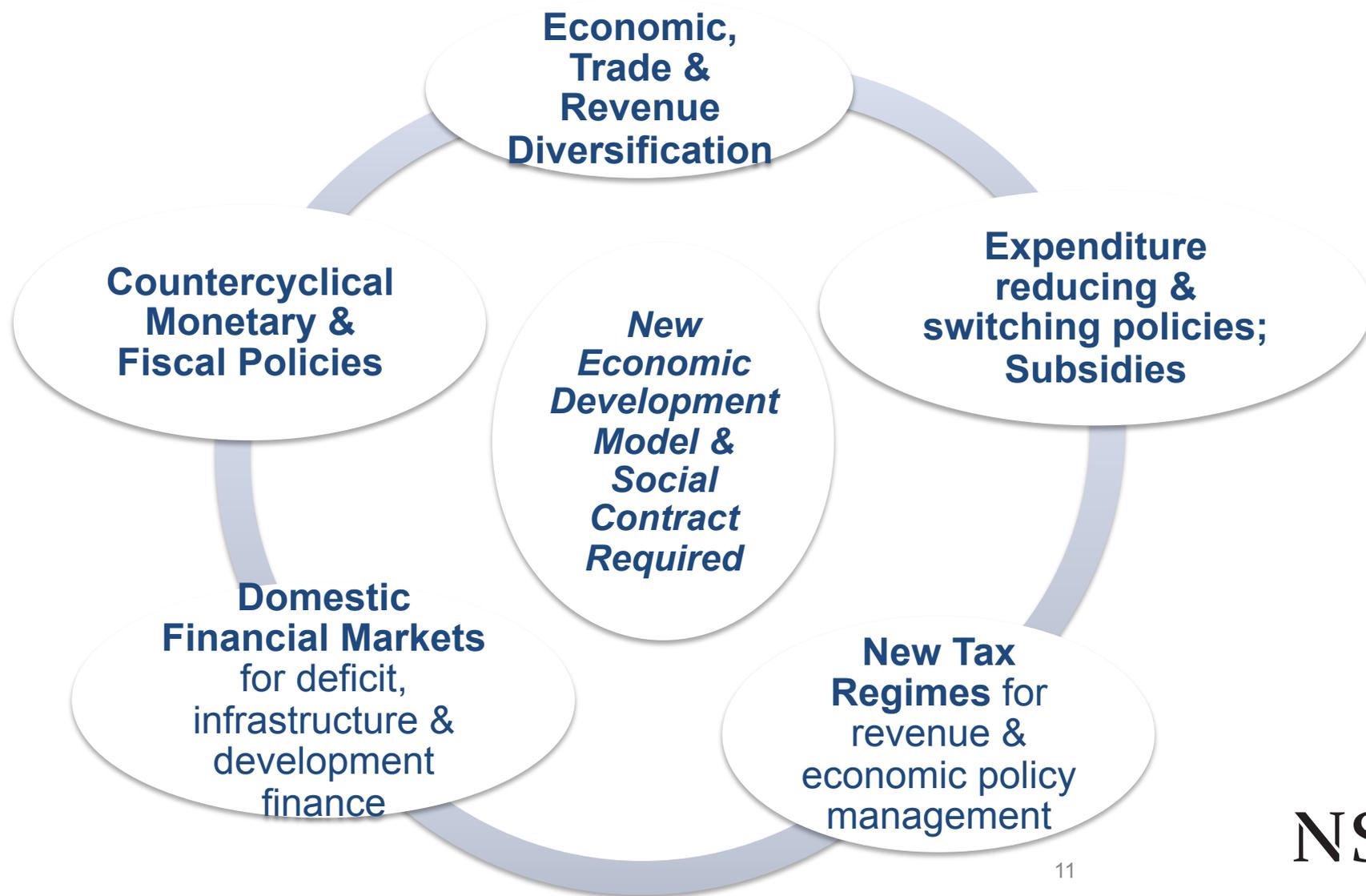
- Gulf SWF assets account for 40% of total SWF Assets & 70% of total Oil & Gas related SWFs (Jun 2016, SWFI)
- SWFs are re-assessing long-term investment strategies favouring local/regional markets vs. Europe/ US/ Canada
- SWFs, such as ADIA, SAGIA and SAMA, have become more active in local PE, real estate and infrastructure opportunities.
- Even GCC pension funds (holding \$ 400-500bn) have become more locally focused
- More mergers/ consolidation

Top 10 SWFs from the region (AUM, \$bn)



Source: SWF Institute estimates

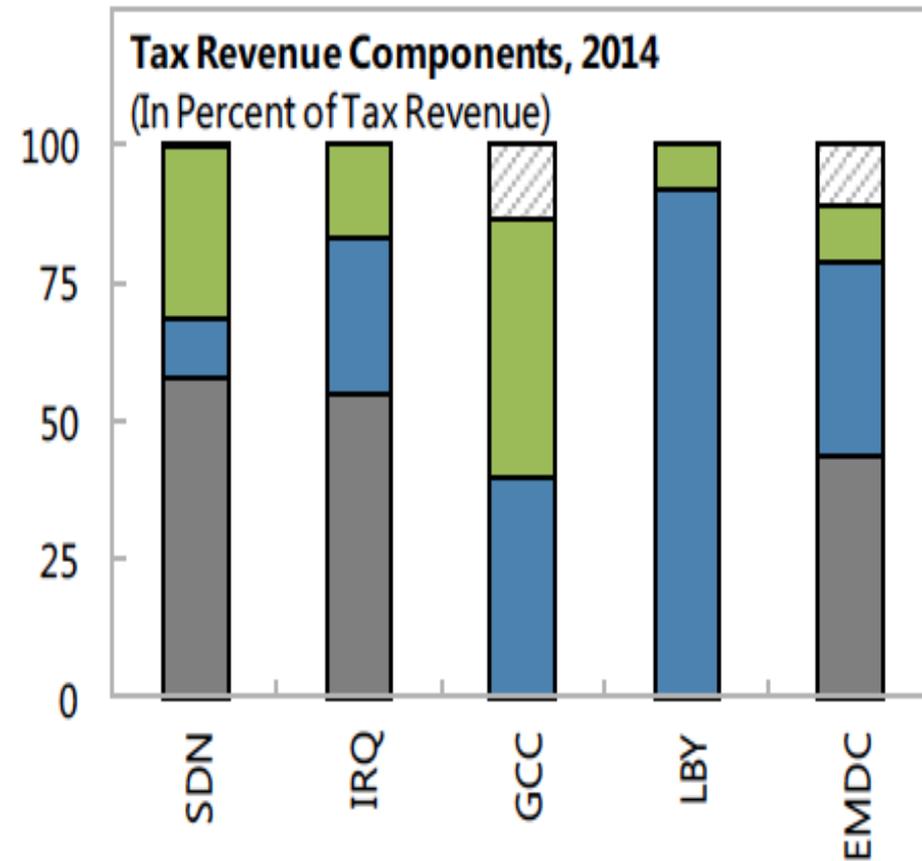
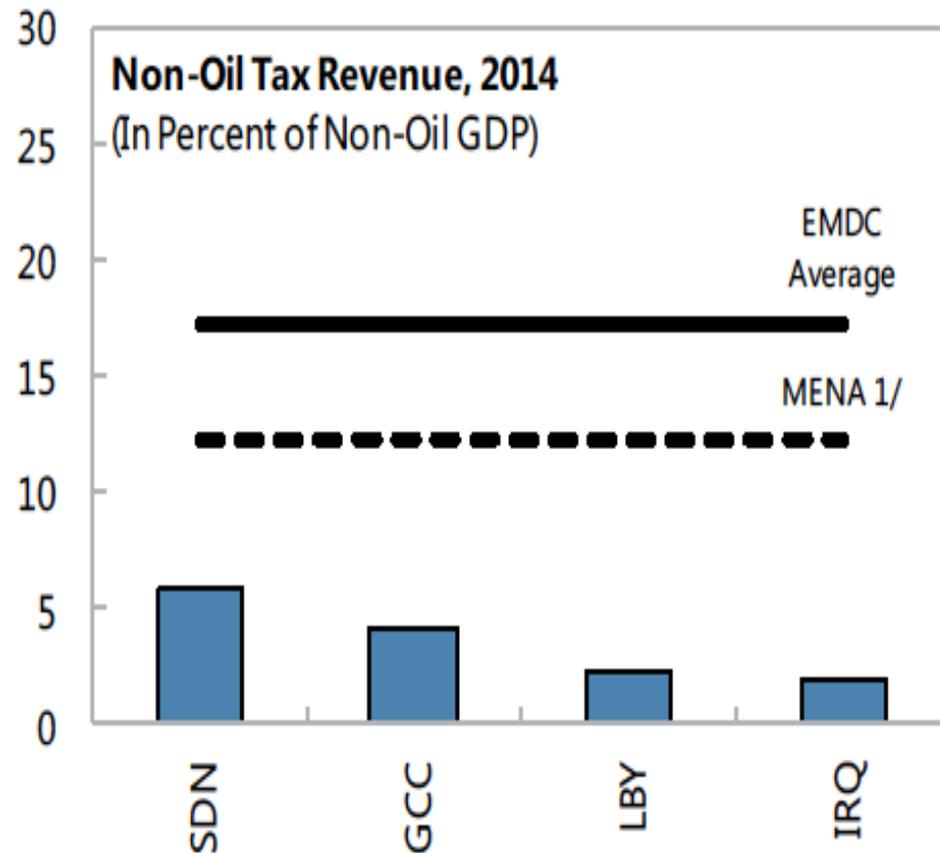
Major economic policy reforms required to adjust to New Oil Normal



GCC needs greater revenue diversification

current reliance on trade taxes which will have to be phased out

Existing Taxes focus on CIT (on non-nationals) and Trade

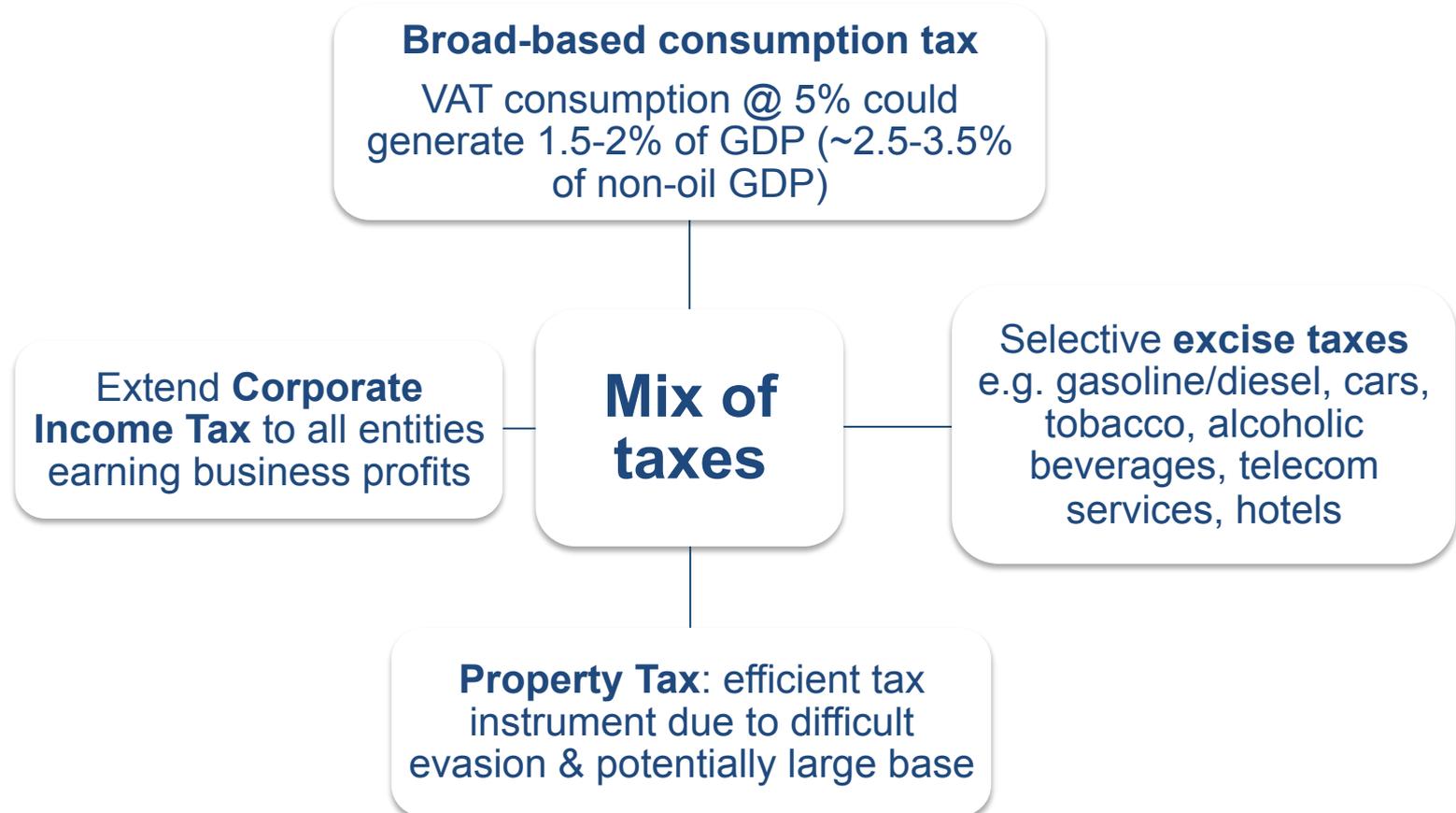


Sources: National authorities; and IMF staff calculations.

■ Goods and Services ■ Income ■ Trade ■ Other

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Main elements of a new GCC Tax Regime



***Caveats: Importance of communication & sequencing;
reforms will take time: develop institutional capacity*** NS

Reforms to encourage development of an active private sector

- Enable Structural shift to private sector through **Privatization Programs (Saudi, Kuwait, Oman)**. **Aramco** example: NPV of future oil revenues about 350–700% of GDP; private participation in both the upstream and downstream sectors is likely to reduce rent seeking, enhance transparency, & clarify fiscal linkages

=> likely to change the PE space, but requires policy reforms:

- **Public Private Partnerships (PPPs)** frameworks. Opportunity in major projects: ‘Saudi New Cities’, Expo 2020, Qatar’s World Cup
- **100% foreign ownership** / removal of the “sponsor” system
- **Labour market policies and reforms** to favour private sector employment
- Foster **Access to Finance & Financial Inclusion** to support entrepreneurs, growth companies & market participation, especially by women

The “dark side” of existing PPP projects/ structures

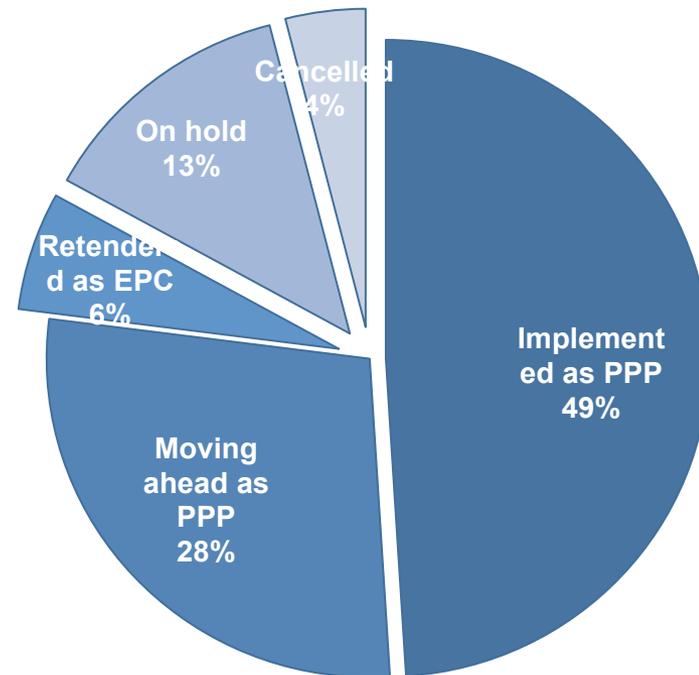
23% of the 80 PPP projects in MENA since 1996 have failed (no deal signed): MEED

Why?

- Unattractive deal structures due to lack of detail in the project scope, or inadequate guarantees over revenues
- Politics, governance & conflicts
- Lack of transparency & inadequate institutional architecture
- Fragmented legal and regulatory framework
- Distortionary subsidies
- No frameworks for private sector investments & involvement

Bottom line: as PPP market matures & more formal laws introduced => success rate for project closures will improve

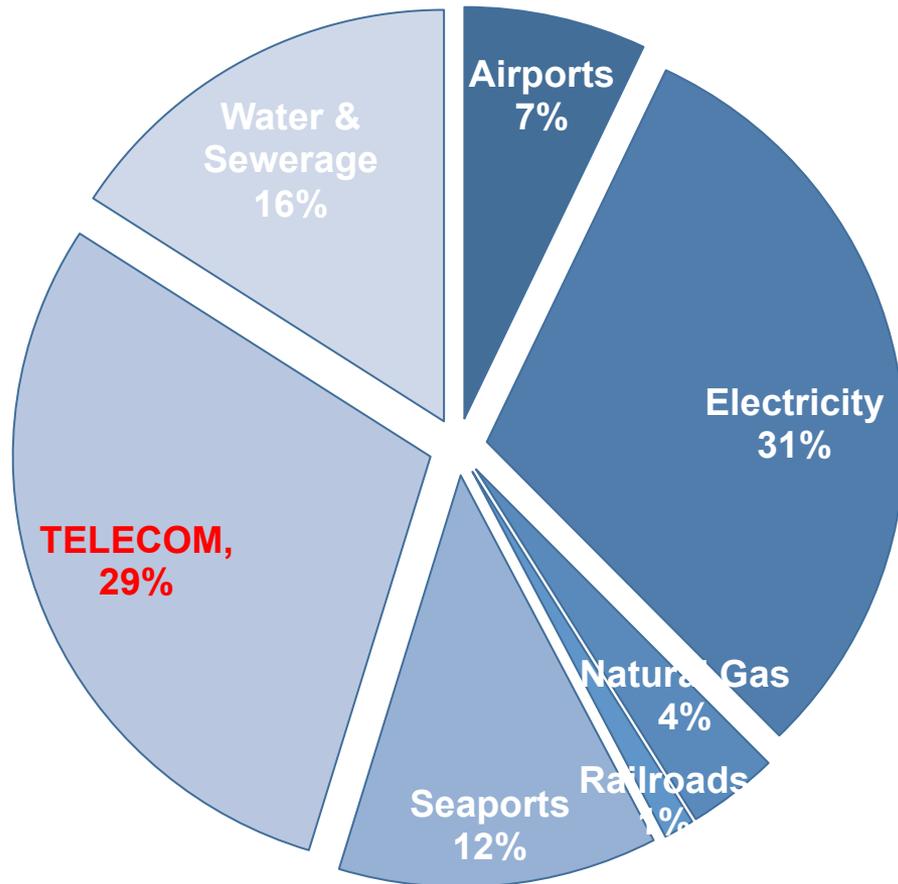
MENA PPP project success rates



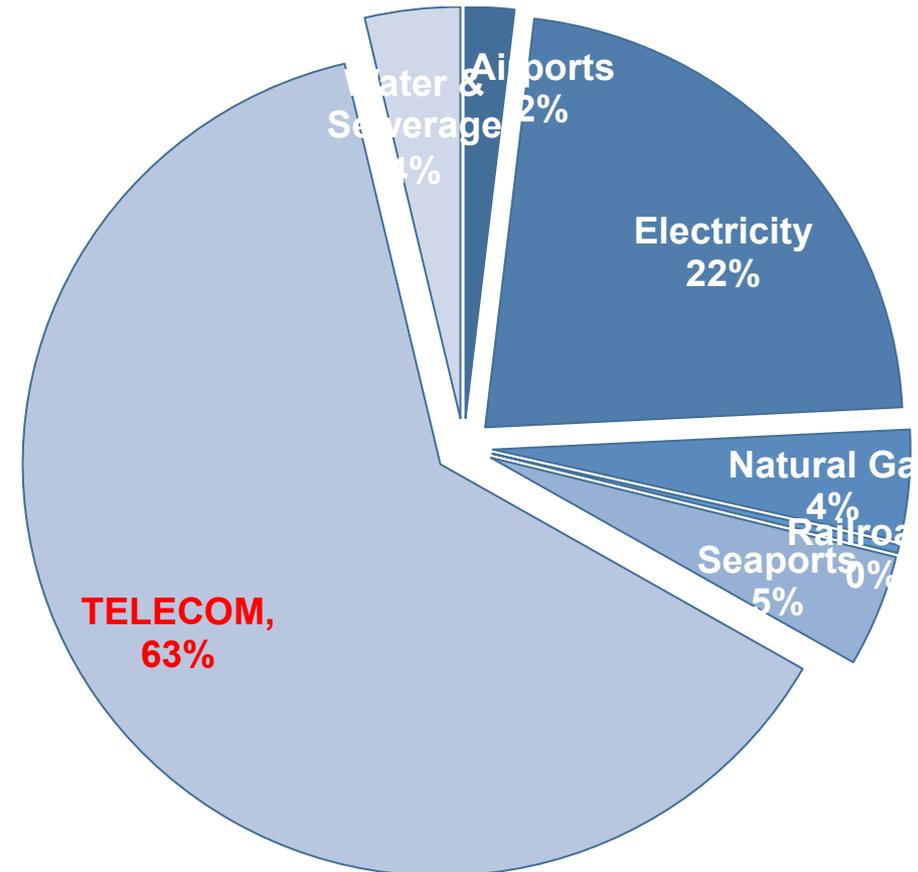
Source: MEED. According to survey of 80 PPP projects and concessions that began developer pre-qualification. Does not include IPPs, IWPs, IWPPs or land for housing real estate schemes in Egypt

MENA PPP in liberalised sectors like Energy & Telecom highlights importance of policy reform

Number of PPP projects by sector(1990-2015)

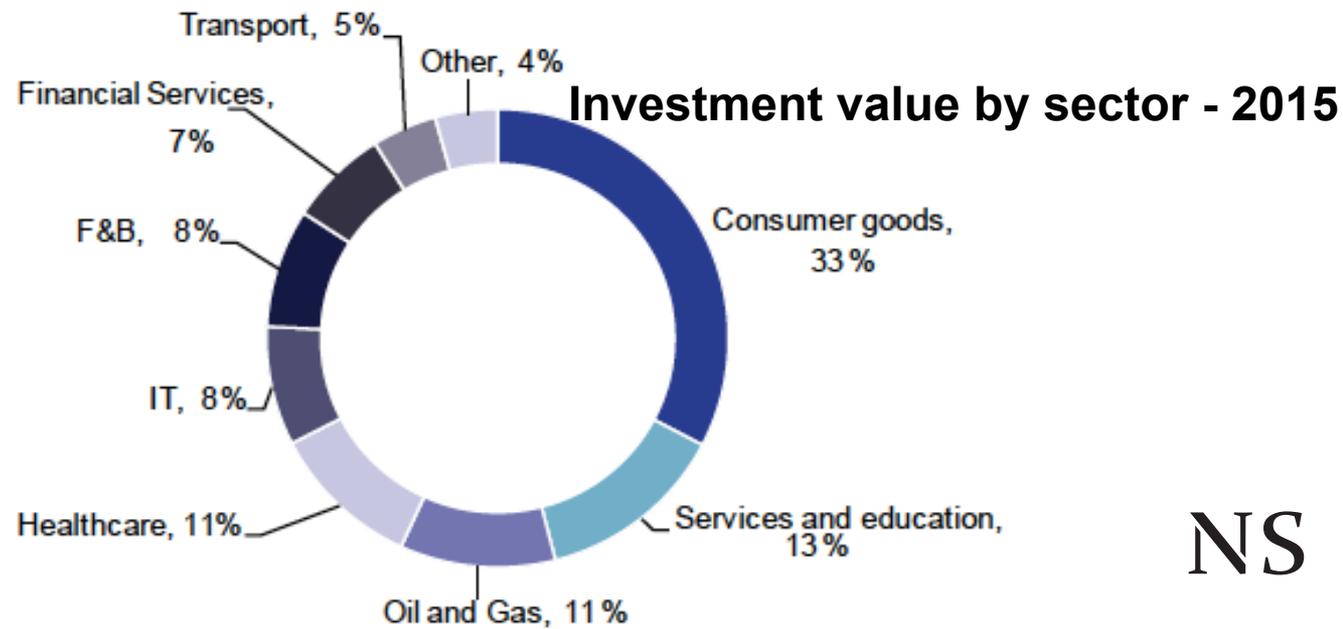
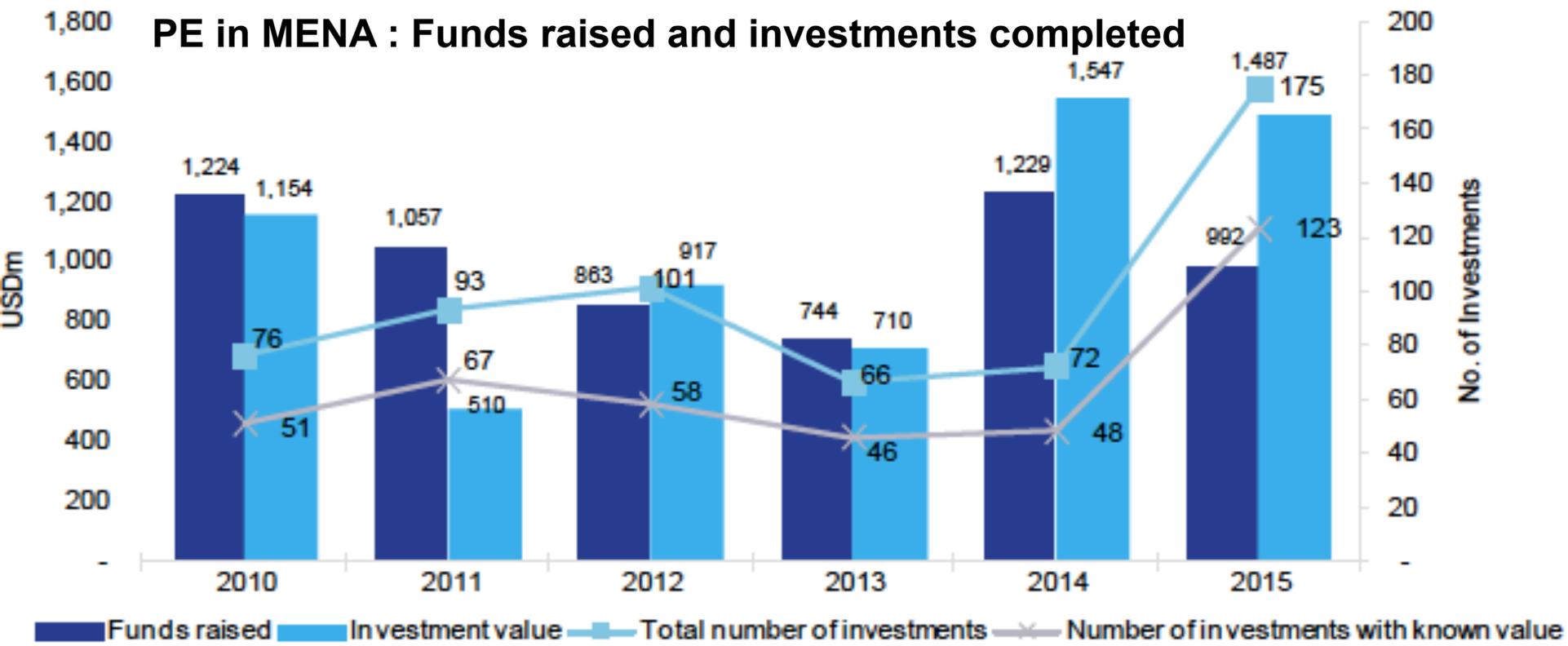


Investments in PPP projects



Source: WB PPI database

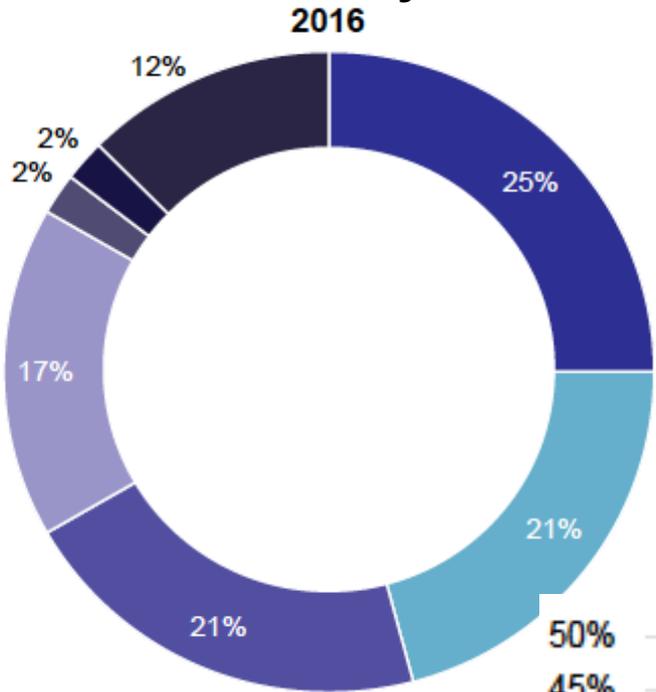
PE in MENA : Funds raised and investments completed



Source: 10th MENA Private Equity Association Annual Report 2015, published Jun 2016

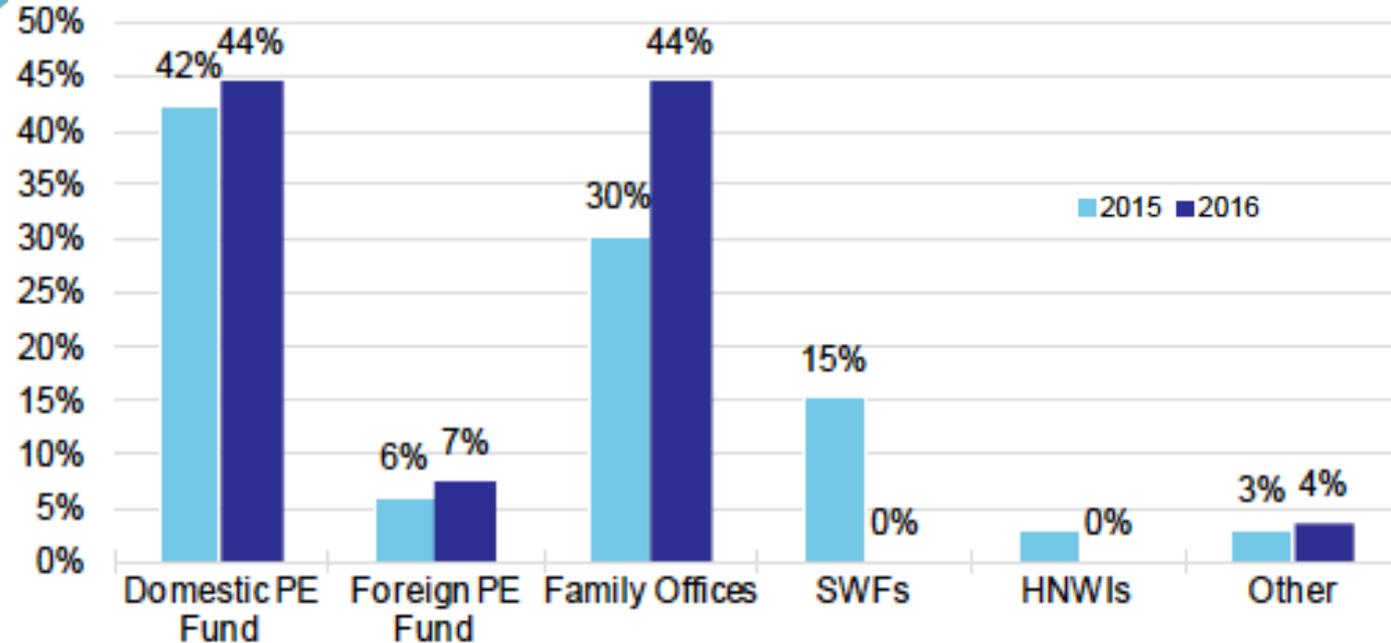
Which industry sectors do you expect most deal activity?

Results of General Partners (GP's) Confidence Survey



- Healthcare
- Consumer/Retail
- Education
- Food
- Power/Oil & Gas/Mining
- Infrastructure
- Other

Which type of investors do you expect to be most active?



Source: 10th MENA Private Equity Association Annual Report 2015, published Jun 2016

Investment Opportunities, 2015-2020

- **Demographics driven:** urbanisation, Smart cities, health, education, retail, hospitality
- **Leverage assets:** Infrastructure, Transport, Logistics to serve region (COMESA, CA, South Asia). Integrate into New Silk Road & GVC emerging from Asia
- **Reconstruction**
- **New Oil Normal driven:** privatisation (Aramco, airports, public utilities) & PPP; **Decarbonisation:** Energy Efficiency, Renewables, Clean Tech; **Global New Energy Finance Hub**
- **Digital economy & knowledge based innovation; FinTech**

MENA/ GCC: Burdened by Water Stress & Energy In-Efficiency

- **MENA: lowest available renewable freshwater resources + highest water stress levels**
- **GCC's growing water crisis:** growing pop., urbanisation, incomes, subsidies
- **Energy efficiency** in OECD countries is 2x GCC & wider MENA; 14% rise in regional **energy intensity** since 2000
- **GCC consume more primary energy than all of Africa**, with just 1/20th of the population!
- **High energy use path unsustainable** >3% of GDP for energy infrastructure investment by 2030

GCC should implement a decarbonisation & climate change strategy

Removal of Fossil Fuel & Water Subsidies

Efficient pricing of public utilities: transport, water, power

Energy Efficiency Investments

Carbon Tax

RE & CT investments

Takeaways

- ME region remains in the throes of the 3 T's: Turmoil, Transition & Transformation
- New Oil Normal requires new economic development model, New Social Contract & deep structural reform agenda => also implies lower growth in flows to SWFs
- Region's SWFs rethink long-term strategy to focus on regional/local investments & economic development role
- Favourable demographics, geographical location, and the New Oil Normal => multiple investment opportunities
- GCC is focus of MENA economic growth + regional economic & financial integration
- PE deal trends imply strong preference for consumer driven, defensive sectors. Prepare for infrastructure PPP

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Thank you

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