

## **“The impact of recent volatility of crude oil price on fiscal policies and upstream investments of the GCC countries”**

**By Daniel Brett**

Lower levels of oil revenue both reduced government revenue and threatened to plunge Gulf economies into recession in 2009. In addition, Gulf states did not escape the effects of the global credit crunch, with the private sector experiencing a severe shortage of credit. Economic rescue programmes intensified after a sharp decline in oil prices because of the plunge in demand following the eruption of the crisis. The traditional policies in which Gulf states drew up massive fiscal surpluses were abandoned in favour of Keynesian pump-priming, even risking the possibility of running up deficits. The policy responses of GCC governments came in three phases.

In the first phase governments sought to shore up the banking and financial sector and inject liquidity into the system, followed by a second phase of mainly fiscal initiatives designed to bolster aggregate demand with a focus on sustaining critically important economic diversification projects and a third phase designed to stimulate regional debt markets to enable corporations to raise funds in order to bolster balance sheets and initiate expansion projects.<sup>1</sup> These expansionary policies included spending on infrastructure projects and downstream industries, seeking to offset the decline in oil's contribution to GDP with growth in non-oil GDP. As a result of rising expenditure at a time of falling oil output, the oil price governments needed to break even rose dramatically and well above levels seen in previous economic downturns.

### **Break-even oil prices**

Oil prices have followed global economic trends, falling sharply from mid-2008 before recovering some momentum in 2009. Crude prices tumbled from around US\$140/b in July 2008 to below US\$40/b by the end of 2008 and averaged US\$58/b in the first 10 months of 2009 and US\$73/b in October 2009.<sup>2</sup> While the dip in oil price was significant, many analysts noted that it did not fall to levels seen in previous recessions when it has dropped as low as US\$10/b and a projected average of US\$60/b for 2009.<sup>3</sup> This was supported by OPEC-induced cuts in output. Following a sharp decline in oil prices from above US\$145/bbl in July 2008, an OPEC conference convened in Oran, Algeria, agreed to tighten supply by cutting 4.2mn b/d from 1 January 2009 over the OPEC-11 production of 29.05mn b/d in September 2008. Nevertheless, a fall in output led to a decline in oil revenue, despite the apparent steadying and improvement of prices.

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<sup>1</sup> “GCC Economic Monthly”, NCB Capital, November 2009

<sup>2</sup> Monthly Oil Market Report, OPEC, November 2009

<sup>3</sup> “Resilience Of Oil Keeps The Gulf Afloat”, Wall Street Journal, November 24, 2009

Invariably, the stimulus measures during a time of reduced oil revenue meant that the break-even oil price for 2009 budgets would rise. Estimates for the average GCC break-even level rose throughout 2009. As the crisis was unfolding in September 2008, the average GCC break-even oil price according to the IMF was US\$46.8/b and according to Fitch was US\$47.4/b.<sup>4,5</sup> In December 2008, Yvan Mamalet, a senior economist with Société Générale Asset Management in London, claimed that the break-even point for GCC states would be US\$45-55/b in 2009 and that only if prices fell below US\$50/b would there be cause for concern. The only reason this would happen is if China slowed more than expected, he said.<sup>6</sup> This was the range in which GCC governments based their budgets for 2009, which the Emirates Investment Bank (EIB) claimed would lead to small deficits that could be easily covered by the previous year's surplus.<sup>7</sup>

By Q309, analysts appeared to be in consensus that the average break-even oil price was over US\$50/b, reflecting the increased burden of spending related to attempts to stimulate the non-oil economy. The Institute of International Finance (IIF) estimated the level at US\$52.8/b while EFG-Hermes estimated US\$58.2/b.<sup>8</sup> Nevertheless, according to a study by Egypt-based EFG-Hermes, Gulf states would report better than expected budget figures in 2009 due to higher crude prices offsetting the effects of the global credit crunch.<sup>9</sup> The investment bank forecast crude prices averaging US\$60/b in 2009, which suggests that Kuwait, Qatar and the UAE with break-even prices set at below US\$50/b would be in surplus while Saudi Arabia, with a break-even price of just under US\$60/b, could register a small budget surplus equivalent to 0.6% GDP, compared with a 33.6% surplus in 2008 and government projections of a deficit of 8.0%.<sup>10</sup> EIA data for the first 47 weeks of 2009 showed that the average oil price for GCC states was US\$57.41/b<sup>11</sup>, which was close EFG-Hermes' estimated break-even price and well above 2009 estimates by IIF and Fitch.<sup>12</sup>

### **Country-by-country fiscal performance**

GCC governments have saved much of the oil price windfall in recent years, but they have also increased spending, pushing up breakeven oil prices. GCC states' breakeven oil prices vary, depending on their oil wealth and how much oil revenue they choose to spend. Balance sheets have strengthened over the past decade and debt is very low, while assets held by sovereign wealth funds (SWFs) such as Abu Dhabi

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<sup>4</sup> Regional Economic Outlook-Middle East and Central Asia, IMF, October 2008

<sup>5</sup> "GCC Public Finances and Oil Prices", Fitch, November 2008

<sup>6</sup> "Best Laid Plans", Global Finance, December 2008

<sup>7</sup> "GCC may face fiscal deficit for first time in five years", Emirates Business 24/7, April 13, 2009

<sup>8</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

<sup>9</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

<sup>10</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

<sup>11</sup> Energy Information Administration, US Department of Energy, Weekly average spot prices for Abu Dhabi Murban, Kuwait, Qatar Durkhan, Saudi Heavy, Saudi Light, Saudi Medium and Oman blends.

<sup>12</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

Investment Authority (ADIA), Qatar Investment Authority (QIA) and the Kuwait Investment Authority (KIA) have risen markedly on the back of oil revenue windfalls. Governments can draw on part of these holdings if necessary, although Bahrain has relatively small domestic government deposits and no publicly disclosed non-reserve external assets, so has less of a cushion than the larger oil producers. On the downside, poorly performing regional bourses have undermined the value of SWFs' equity holdings, limiting room for manoeuvre.

There is a wide divergence within the estimates for the break-even price. Both Bahrain and Oman have, according to the IMF, IFF and ratings agencies, have the region's highest break-even prices. However, surveys suggest that the level has declined in both countries, falling from US\$74-77/b estimated by Fitch and the IMF in late 2008 to US\$70-75/b by the IFF and EFG-Hermes in late 2009.<sup>13,14,15,16</sup> This decline is in part due to higher than forecast oil revenues as prices staged a recovery, but the regional average price was still 15-17% below break-even prices and only approached these two countries' break-even levels in mid-October.<sup>17</sup> Consequently, they were expected to post fiscal shortfalls.

Bahrain's total revenue as a proportion of GDP was projected to decline from 33.7% of GDP in 2008 to 24.0% in 2009, in large part due to the fall in the contribution of oil revenue from 28.8% to 19.2%.<sup>18</sup> Bahrain's oil wealth is smaller than that of its neighbours, but its budget dependence on oil is similar. As a proportion of total revenues, oil revenue was to decline from 85.0% to 80.0%. The Bahraini government itself has projected a deficit of BD190mn in 2009 and BD239mn in 2010, based on an oil price assumption of US\$60/b in each year.<sup>19</sup> Revenue was set to rise by 29.6% in 2009-10 over the previous two years, while expenditure would rise 9.8% y-o-y. Based on an average oil price of US\$55/b and GDP growth of -0.1%, Business Monitor International projected a budget deficit of 3.1% of GDP in 2009 down from a surplus of 7.5% in 2008.<sup>20</sup> The IMF was more pessimistic, projecting a fiscal deficit of 8.7% of GDP in 2009, from a surplus of 4.9% in 2008, as a result of a fall in oil revenue from 28.8% GDP to 19.2%, despite a more optimistic assessment of real GDP growth at 2.6% (including real oil GDP growth of 0.1%).<sup>21</sup>

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<sup>13</sup> "GCC Public Finances and Oil Prices", Fitch, November 2008

<sup>14</sup> Regional Economic Outlook-Middle East and Central Asia, IMF, October 2008

<sup>15</sup> "GCC Regional Overview", International Institute of Finance, September 28, 2009

<sup>16</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

<sup>17</sup> Energy Information Administration, US Department of Energy, Weekly average spot prices for Abu Dhabi Murban, Kuwait, Qatar Durkhan, Saudi Heavy, Saudi Light, Saudi Medium and Oman blends.

<sup>18</sup> IMF Executive Board Concludes 2009 Article IV Consultation with Bahrain, IMF Public Information Notice No. 09/112, September 9, 2009

<sup>19</sup> "Bahrain Cabinet Approves 2009-10 Budget With 30% Rise In Revenue", Middle East Economic Survey, November 10, 2008

<sup>20</sup> Economic Outlook Q409, Business Monitor International, September 29, 2009

<sup>21</sup> IMF Executive Board Concludes 2009 Article IV Consultation with Bahrain, Public Information Notice (PIN) No. 09/112, September 9, 2009

Both the IMF and the Bank of Muscat, the central bank, had not provided an estimated break-down of oil revenue as a proportion of Oman's government revenue or the pace of real oil GDP growth in 2009. In 2008, oil revenues contributed 67.4% of total government revenue, based on Bank of Muscat data.<sup>22</sup> In the first 47 weeks of 2009, Oman blend spot prices averaged US\$59.8/b<sup>23</sup>, which if spending levels were sustained or increased could overturn the country's fiscal surplus, which stood at just 1.2% of GDP in 2008.<sup>24</sup>

Saudi Arabia's planned slim fiscal surplus of just 0.4% GDP in 2009, from a surplus of 33.0% in 2008, also looked threatened. Saudi Arabia's US\$49.6bn fiscal package amounted to 9.4% of its 2008 GDP.<sup>25</sup> The average price of Saudi blends stood at US\$56.42/b in the first 47 weeks of 2009, which was just under US\$3/b below the break-even level estimated by EFG-Hermes<sup>26</sup>, but 13% above IFF's estimate and 4.4% above Fitch's. Yet, Saudi Arabia is the region's biggest loser in terms of the scale of the loss in oil revenues with real oil GDP dropping by 10.3%, leading to a 0.3% contraction in overall real GDP.<sup>27</sup> As a result, government oil revenue as a proportion of GDP was expected to drop from 55.9% in 2008 to 35.0% in 2009.<sup>28</sup>

The UAE planned for an overall fiscal surplus of 12.1% of GDP in 2009, down from 23.2% in 2008, with expenditure up from 24.9% to 29.0% and revenue down from 48.1% to 41.1%.<sup>29</sup> In 2009, the proportion of oil revenue to total revenue was projected at 73.7%, compared to 82.1% in 2008, representing the highest rate of decline in the GCC.<sup>30</sup> The country has seen the strongest rise in its break-even oil price as the emirates have attempted to inject liquidity and support investment in the non-oil economy. In 2008, the IMF estimated the UAE's break-even price at US\$23/b<sup>31</sup>, while Fitch estimated the price for Abu Dhabi alone at US\$31/b, albeit based on an average oil price 7% below the IMF's estimate.<sup>32</sup> By 2009, Fitch had revised up the Abu Dhabi break-even price to US\$40/b, a level that IFF estimated for the whole of the UAE.<sup>33,34</sup> Later on in the year, as the country's financial woes became

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<sup>22</sup> Derived from data in Annual Report 2008, Bank of Muscat, Jul 2009

<sup>23</sup> Energy Information Administration, US Department of Energy, Weekly average spot prices for Oman blend, January 2 to November 20, 2009.

<sup>24</sup> Derived from data in Annual Report 2008, Bank of Muscat, Jul 2009

<sup>25</sup> "Anti-crisis measures bring about economic stability to GCC states", Business 24/7, November 19, 2009

<sup>26</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

<sup>27</sup> IMF Executive Board Concludes 2009 Article IV Consultation with Saudi Arabia IMF Public Information Notice No. 09/109, August 18, 2009

<sup>28</sup> IMF Executive Board Concludes 2009 Article IV Consultation with Bahrain, IMF Public Information Notice No. 09/109, August 18, 2009

<sup>29</sup> IMF Executive Board Concludes 2009 Article IV Consultation with UAE IMF Public Information Notice No. 09/47, April 13, 2009

<sup>30</sup> Based on data in IMF Executive Board Concludes 2009 Article IV Consultation with UAE IMF Public Information Notice No. 09/47, April 13, 2009

<sup>31</sup> Regional Economic Outlook-Middle East and Central Asia, IMF, October 2008

<sup>32</sup> "GCC Public Finances and Oil Prices", Fitch, November 2008

<sup>33</sup> "GCC Public Finances and Oil Prices", Fitch, November 2008

clearer, EFG-Hermes was estimating US\$50/b as the break-even price.<sup>35</sup> This was marginally lower than the US\$51.58/b average oil price for Abu Dhabi Murban blend,<sup>36</sup> suggesting that the UAE was at risk of running up a fiscal deficit. The EIU projected a small deficit of around 0.3% GDP, well below the government's 12.1% target.<sup>37</sup>

Kuwait's fiscal surplus was projected to decline from 25.8% GDP in 2008 to 8.9% in 2009 with oil's share of revenues declining from 80.0% to 76.5%.<sup>38</sup> The IMF had assumed a breakeven price of US\$33/b,<sup>39</sup> while Fitch estimated US\$42/b (excluding a one-off social security fund payment, it estimated US\$21/b).<sup>40</sup> This was to rise to between US\$47/b (Fitch) to US\$50/b (EMG-Hermes) in 2009.<sup>41,42</sup> With Kuwait blend oil prices averaging US\$58.73/b in 2009,<sup>43</sup> there were grounds for optimism that the government would report an overall surplus. There were signs that Kuwait would out-perform expectations in the first half of FY2009/10 when oil earnings reached US\$28.1bn, 12% above projections for the full-year, while spending was US\$11.2bn, or just 26.6% of the projected expenditure of US\$42.1bn, according to the Ministry of Finance.<sup>44</sup> Oil income accounted for 94.3% of total revenues. This left a provisional healthy surplus of US\$17.5bn against a projected deficit of US\$14bn; in FY2008/09, the surplus was US\$9.6bn after a one-off payment of US\$19bn to the state pension fund. This is fairly typical of trends in Kuwaiti fiscal policy, which has in the past projected shortfalls but always remained in surplus, and largely due to low oil price expectations. The government calculated oil revenues at a conservative price of US\$35/b, down from US\$50/b in the previous year. Nevertheless, revenues were still down 44.6% over H1 FY2008/09. Kuwait transfers its fiscal surpluses to the KIA whose assets are estimated at around US\$230bn.<sup>45</sup>

Qatar, a major gas producer, has been relatively less hit by falling oil prices than its GCC peers given its soaring LNG exports. The long-term nature of gas contracts has supported the value of exports and bolstered investment in infrastructure, petrochemicals and natural gas. Oil revenues accounted for 61.0% of revenues in 2008, the lowest level in the GCC. As such, its oil break-even price has been lower than the rest of the GCC. The IMF and Fitch estimated Qatar's break-even price at US\$24/b and US\$40/b

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<sup>34</sup> "GCC Regional Overview", International Institute of Finance, September 28, 2009

<sup>35</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

<sup>36</sup> Energy Information Administration, US Department of Energy, Weekly average spot prices for Abu Dhabi Murban, Kuwait, Qatar Durkhan, Saudi Heavy, Saudi Light, Saudi Medium and Oman blends.

<sup>37</sup> Strong oil prices boost UAE fiscal surplus, Emirates Business 24/7, September 6, 2009

<sup>38</sup> 2009 Article IV Consultation with Kuwait, IMF Country Report No. 09/152, May, 2009

<sup>39</sup> Regional Economic Outlook-Middle East and Central Asia, IMF, October 2008

<sup>40</sup> "GCC Public Finances and Oil Prices", Fitch, November 2008

<sup>41</sup> "GCC Public Finances and Oil Prices", Fitch, November 2008

<sup>42</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

<sup>43</sup> Energy Information Administration, US Department of Energy, Weekly average spot prices for Abu Dhabi Murban, Kuwait, Qatar Durkhan, Saudi Heavy, Saudi Light, Saudi Medium and Oman blends.

<sup>44</sup> Kuwait half-year income surpasses full year target, AFP, November 10

<sup>45</sup> Kuwait half-year income surpasses full year target, AFP, November 10

respectively in 2008.<sup>46,47</sup> In 2009, the IFF estimated it at US\$34/b and EMG-Hermes US\$50/b.<sup>48,49</sup> With the average price of Qatar Dukkhan blend at US\$60.54/b in the first 47 weeks of 2009,<sup>50</sup> it was likely that Qatar retained a healthy fiscal surplus in 2009.

## Investment

Government awards of projects along with increased support to ongoing ones have not only supported private sector activity but also limited the number of project delays and cancellations. According to a report by the IFF in September 2009, of a total US\$2,060bn projects planned in the GCC, 23% were on hold or cancelled.<sup>51</sup> The UAE made up the largest proportion of cancelled projects – 73.7% - followed by Saudi Arabia, which contributed 12.6% of the total. Qatar contributed the lowest proportion of project cancellations, with 7.0% of its project cancelled contributing 2.5% of the regional total. This is in large part due to the fact that most of the value of its projects is in the country's burgeoning gas sector; it represented 8.7% of the GCC's originally planned projects. NCB Capital stated in November 2009 that government involvement accounted for more than half of total project investment in the region. It noted that while project delays and cancellation have been substantial, they have been 'isolated to specific regions and sectors.' It said that 74% of the US\$372bn worth of projects, either on hold or cancelled, are in the UAE construction sector because of the severe correction in the sector. Further, a number of projects that had been shelved are beginning to be revived in a more benign cost environment, it added.<sup>52</sup> Downstream industries reliant on oil and gas, such as refining and petrochemicals, were either left intact or delayed to bring down costs, reflecting the GCC's emphasis on sustaining economic diversification over the more prestige projects, such as Dubai's real estate and office developments.

The reduction in oil prices fed into a decline in the price of naphtha, a feedstock for the petrochemicals industry. The GCC's petrochemicals industry is being developed on the back of massive increases in natural gas extraction in the region. Derived from natural gas, ethane was regarded as a cheaper feedstock to crack than naphtha at a time when oil prices exceeded US\$100/b. But as oil prices fell, the differential began to diminish, particularly by Q109, thereby eroding the competitive advantage of the principle feedstock being utilised by the region's new ethylene crackers that supply the region's new petrochemicals capacity. Nevertheless, the subsequent recovery in oil prices and the low-cost of gas extraction have turned the market back more in favour of ethane feedstock.

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<sup>46</sup> Regional Economic Outlook-Middle East and Central Asia, IMF, October 2008

<sup>47</sup> "GCC Public Finances and Oil Prices", Fitch, November 2008

<sup>48</sup> "GCC Regional Overview", International Institute of Finance, September 28, 2009

<sup>49</sup> EFG Hermes revises upward Gulf macro economic forecasts, Business Intelligence Middle East, August 9, 2009

<sup>50</sup> Energy Information Administration, US Department of Energy, Weekly average spot prices for Abu Dhabi Murban, Kuwait, Qatar Durkhan, Saudi Heavy, Saudi Light, Saudi Medium and Oman blends.

<sup>51</sup> "GCC Regional Overview", International Institute of Finance, September 28, 2009

<sup>52</sup> "GCC Economic Monthly", NCB Capital, November 2009

In downstream segments, the credit crisis proved to be a greater impact on investment than oil price considerations, although the two were intertwined. Oil remains fundamental to the development of the non-oil economy, which is financed by the petrodollars flowing into the banking system. Hydrocarbon revenues have swollen bank balances across the Gulf region, with significant amounts of capital and liquidity from oil windfalls ploughed into economic diversification and asset acquisition. With an end to stellar oil prices, the outlook for the region is far less positive, although not catastrophic. Gulf banks have remained well capitalised thanks to the years of energy windfalls and government support, in spite of the collapse in oil prices from late 2008.

#### **Table: Notable fiscal measures in Saudi Arabia and the UAE**

##### **Saudi Arabia**

- As a share of 2008 GDP at 9.4%, the US\$49.6bn stimulus is the highest among G20 nations
- A deficit budget of SAR65bn for 2009 was passed; 55% of revenues to be spent on human resources, social welfare and communications
- US\$400bn five-year investment and development program announced; stalled projects got SAR20bn from the Public Investment Fund
- With USD580bn of total projects in the pipeline over the next 5-7 years, the Kingdom is also looking to take advantage of lower construction costs
- Continued public funding for the six economic cities in the Kingdom is critical due to restricted bank lending and outflow of foreign funds as a result of the financial crisis

##### **United Arab Emirates**

- Federal budget for 2009 had a 21% planned increase in spending; focus was on human capital and diversification
- Dubai increased budgeted spending by 11% to AED135bn in 2009; the Dubai Metro launch reflects focus on infrastructure
- Dubai raised US\$10bn bonds to fund diversification and restructure government-linked business entities
- Funding in Abu Dhabi for USD400bn of infrastructure projects over 2030 continues under the Abu Dhabi Economic Vision
- Abu Dhabi has also guaranteed funds for projects like the zero-carbon USD22bn Masdar City

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Source: *NCBC Research*<sup>53</sup>

By late 2009, Gulf states had overcome the worst effects of the global credit crisis and started to stabilise due to the unprecedented financial stimulus measures, according to the Saudi-based NCB Capital.<sup>54</sup> However, it stated that while project delays and cancellations were substantial, they were isolated to specific regions and sectors, estimating that nearly three-quarters of the US\$372bn of projects either on hold or cancelled were in the UAE construction sector. This was, in large part, due to a correction following years of rapid growth. Many projects were also delayed in anticipation of lower costs.

The pace of investment and supply growth are slowing in the face of lower oil prices, leading to pessimistic demand growth forecasts, with projects set for significant delays, particularly those where investment costs are high and where there is a threat of medium-term global over-capacity. Lower oil

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<sup>53</sup> "GCC Economic Monthly", NCB Capital, November 2009

<sup>54</sup> "Anti-crisis measures bring about economic stability to GCC states", *Emirates Business* 24/7, November 19, 2009

revenues were always going to reduce liquidity in the GCC banking sector, but the situation has been compounded by the global credit crisis, which has limited financing for private sector projects. On the upside, the global recession has given investors the chance to negotiate down construction costs, which were ramped up in 2008 before the onset of the financial crisis.

Aside from the slump in markets, some projects were delayed to take advantage of the crash in the regional construction boom, which has brought down building costs. In the electricity and desalination sector, the Dubai Electricity and Water Authority (DEWA) postponed the bidding of the US\$8.6bn Hassyan Power Generation and Desalination Plant from 2008 to October 2009, with the winner announced in January 2010. This will enable it to take advantage of lower costs, but the delay in awarding contracts could put back completion from 2012 to 2013.

In Saudi Arabia, the EPC bidding process for Aramco's joint venture with ConocoPhillips to build a 400,000b/d export-oriented refinery at Yanbu was delayed due to the impact of the recession on the financial markets and the world oil markets, thereby pushing back the completion date to 2014. In June 2009, the two partners reaffirmed their commitment to the US\$6bn project, with improved market conditions prompting them to invite bids from prequalified local and international contractors.

The contract awards for the Saudi Aramco Total Refinery and Petrochemical Company (Satorp) petrochemical complex at Jubail (62.5% Saudi Aramco, 37.5% Total) were delayed by several months as the partners used the global economic slowdown to leverage price reductions from bidders. The final contracts were about 20% down on the highest original estimates to US\$9.6bn.<sup>55,56</sup> The complex will include a refinery processing Arabian heavy crude with a capacity of 400,000b/d and downstream plants with total petrochemicals capacities of over 1mn tpa.

Ras Tanura, Saudi Aramco's US\$27bn JV with Dow Chemical, also saw a six-month delay in its EPC contract. It was due to complete the EPC by end-2009, but due to the financial crisis and rising costs delayed it until mid-2010 with operations starting in 2015.<sup>57</sup> Saudi Aramco vowed to continue to invest in new petrochemical projects, despite the economic downturn, producing a broad range of basic and derivative petrochemicals products.<sup>58</sup>

The massive offshore North Field is the main focus of developments in the Qatari gas sector. In 2009, the development of the US\$5bn Barzan gas project, which is being developed by a joint venture between QP and ExxonMobil in the North Field, was delayed for up to a year in order to cut costs. When Exxon and the state-owned Qatar Petroleum (QP) in 2007 agreed to develop the project, Exxon stated that the initial phase of the Barzan Project would generate an annual 15.3bcm of gas, with start-up having been

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<sup>55</sup> *Aramco and Total Sign Contracts for Jubail Refinery-Aromatics Complex*, Chemical Week, July 8, 2009

<sup>56</sup> *Aramco and Total Sign Contracts for Jubail Refinery-Aromatics Complex*, Chemical Week, July 8, 2009

<sup>57</sup> *Bids for Ras Tanura contracts expected in early 2010*, MEED, February 3, 2009

<sup>58</sup> chemicals-technology.com

scheduled for 2012.<sup>59</sup> It will now begin production in 2013. Meanwhile, Qatargas III has been delayed from 2009 to 2010 and Qatargas IV from 2010 to 2012. Industry shortages and causing rising costs were blamed for the postponements.<sup>60</sup>

Despite its large gas reserves and downstream potential, Qatar Petroleum's subsidiary Qatar Intermediate Industries Holdings and South Korea's Honam Petrochemical announced that their 70:30 US\$2.6bn petrochemical joint venture planned for Mesaieed would be delayed from its original date of 2011 to 2013, leaving many wondering whether it would ever be built.<sup>61</sup> However, in July 2009, the partners indicated that they would not only revive the project but also enlarge it. The original budget of US\$2.6bn will probably be revised upwards, given the scale of the increases, suggesting that Qatar was confident of a sufficient upturn in financing.<sup>62</sup>

The UAE's oil industry has not escaped the effect of the global financial crisis. The start-up of International Petroleum Investment Company's (IPIC) planned 320km 1.5mn b/d oil pipeline from the Habshan fields to the port of Fujairah has been delayed from 2009 to 2011 due to 'market conditions'. The pipeline was to be constructed to bypass the Strait of Hormuz, which is a shipping chokepoint that could be vulnerable to political events, notably any conflict involving Iran. IPIC had also mooted a refinery in Fujairah using oil from the pipeline, but plans are unlikely to be confirmed until an upturn in the market and pipeline construction begins.

## Outlook

The situation as the world comes out of recession is delicately balanced, with OPEC forecasting growth in world oil demand of 800,000b/d in 2010, following a contraction of 1.4mn b/d in 2009.<sup>63</sup> Crucial for GCC members is maintaining a tight supply situation via OPEC quotas amid a weak recovery in order to sustain oil prices at desirable levels. However, the ability to influence prices is compromised by weak compliance by Iran and Venezuela as well as increased non-OPEC supply, which OPEC forecasts will rise by 360,000b/d to 51.2mn b/d in 2010, spurred on by rising output from Brazil, Azerbaijan, Kazakhstan and North America.<sup>64</sup> In late 2009, futures markets suggested that oil prices will stabilize at around US\$75/b in 2010,<sup>65</sup> suggesting that over-supply will not be a problem in the short-term outlook.

The improvement in oil prices should inject liquidity into the GCC's banking sector as well as boosting public finances, thereby bolstering investment programmes. Housing markets appeared to stabilize by end-2009 as lending began growing again, while the region's financial markets began to recover some of

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<sup>59</sup> ExxonMobil corporate website

<sup>60</sup> *Qatar to supply 30% of world's LNG needs*, Emirates Business 24-7, May 26, 2009

<sup>61</sup> *Honam and Qatari Partners Enlarge Scope of Mesaieed Project*, Chemical Week, July 14, 2009

<sup>62</sup> *Honam and Qatari Partners Enlarge Scope of Mesaieed Project*, Chemical Week, July 14, 2009

<sup>63</sup> Monthly Oil Market Report, OPEC, November 2009

<sup>64</sup> Monthly Oil Market Report, OPEC, November 2009

<sup>65</sup> Regional Economic Outlook: Middle East and Central Asia, IMF, October 2009

the losses they reported in the two quarters that followed the September 2008 credit crisis. In mid-2009, Shuaa Capital suggested that the return of international investors would not happen until oil reached US\$75/b,<sup>66</sup> a level that is a realistic expectation amid a global economic upturn. Business Monitor International has forecast global oil prices averaging US\$83/b in 2010, US\$85/b in 2011 and US\$90/b in the long-term. Meanwhile, Bank of America-Merrill Lynch has forecast oil prices of US\$75/b in 2010 based on global GDP growth of 4.3%, but suggested the level could exceed US\$100/b by late 2010 or early 2011.<sup>67</sup> These levels are encouraging, but a double-dip global recession or a lacklustre performance of the Chinese economy could yet dent hopes in the GCC of an imminent return to growth.

Another concern is that while some progress has been made on putting the region's financial infrastructure on a more sustainable footing in recent years, it is still far too dependent upon oil revenues, and there are few drivers of either economic or commercial banking growth outside the natural resources sector. According a recent report by Cambridge Energy Research Associates (CERA) entitled 'The Long Aftershock', low oil prices could result in a 50% reduction in future oil supply growth from what would have been expected if prices had been maintained at mid-2008 highs of US\$90-100/b.<sup>68</sup> CERA claims this would mean around 7.6mn b/d of the 14.5mn b/d of capacity growth due in 2009-14 is at risk, particularly if there is no recovery in oil demand from 2010 and the industry endures years of surplus capacity. Consequently, a prolonged period of lower oil prices is a major risk for future oil supply with under-investment in capacity causing a supply crunch that could lead to price spikes as seen in mid-2008. OPEC producers are intent on keeping prices at a level that covers the costs of production and ensure the necessary levels of investment to build capacity and meet future global demand.

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<sup>66</sup> "\$75 oil key to Gulf stock market rebound – Shuaa", Arabian Business, June 7, 2009

<sup>67</sup> Gold could push oil above \$100 in 2010 or early 2011, Emirates Business 24/7, November 25, 2009

<sup>68</sup> "The Long Aftershock: Potential Project Deferral Puts 7.6mbd of Production Capacity Growth at Risk by 2014", CERA, March 2009