

Political Transition: A new normal

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- Lebanon has formed a new government primarily composed of appointees endorsed by Hezbollah-aligned parties and oligarchs. This new cabinet has already met with continued protester strife, and its chances of triggering regional and international backing on the back of a commitment to reform, are limited.
- Despite geopolitical tensions in the region, Saudi Arabia issued USD 5B in bonds that were four-times oversubscribed, signalling investor confidence.
- Forming a government in Tunisia remains elusive with the potential for parliament to dissolve if new Prime Minister Fakhfakh's Cabinet is not approved. Continued delays in government formation are stalling progress on addressing the national debt.
- China is expanding its investments in phosphates in North Africa with a deal between Wengfu Group and Egypt's Phosphate Misr as well as a potential agreement to explore reserves in Tunisia under discussion.

Iran: Internal & external crises

While geopolitical tensions between the US and Iran have levelled out, we expect threats and implicit tit-for-tat attacks (mainly through proxies) to continue. We do not see the two sides heading to the negotiating table in the foreseeable future.

- US President Donald Trump's administration continues to threaten action on Iran, using what it sees as a "maximum pressure" strategy.
 - Since the escalation of tensions between the two countries at the start of the new year -- notably the assassination of Quds Force General Qasem Soleimani -- the US Treasury Department has imposed additional sanctions on Iran's manufacturing, mining and textile sectors, as well as imposing Iran-related sanctions on Hong Kong-based Triliance Petrochemical Co. Ltd and Sage Energy HK Limited, China-based Peakview Industry Co Ltd, and UAE-based Beneathco DMCC.
 - At the World Economic Forum in Davos, US Special Representative for Iran Brian Hook threatened Soleimani's successor Esmail Qaani with the same fate as the general. It is unlikely, however, that the US will follow through in the near future -- if at all -- given the slight easing of tensions.
 - Iran's immediate revenge for the assassination -- a missile attack on a base housing US troops in Iraq -- will not be the final act of retribution for the killing.
 - On 17 January, Supreme Leader Ayatollah Ali Khamenei gave a rare sermon, the first since the protests of the Green Movement in 2012. He praised the attack on US forces and alluded to potential future retribution.
 - The sermon assuaged Khamenei supporters who have been calling on more direct action taken against the US.

MENA Oil Exporters				
	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2019	2020f	2019	2020f
Algeria	2.6	2.4	-13.2	-9.9
Bahrain	2.0	2.1	-8.4	-7.7
Iran	-9.5	0.0	-4.5	-5.1
Iraq	3.4	4.7	-4.1	-3.5
KSA	0.2	2.2	-6.1	-6.6
Kuwait	0.6	3.1	-10.4	-11.6
Libya	4.3	1.4	-10.9	-14.9
Oman	0.0	3.7	-6.7	-8.4
Qatar	2.0	2.8	7.0	6.9
UAE	1.6	3.0	-0.8	-1.7
Yemen	2.1	2.0	-6.9	-7.2

MENA Oil Importers				
	Real GDP Growth (%)		Fiscal Balance (% of GDP)	
	2019	2020f	2019	2020f
Djibouti	6.0	6.0	-1.5	-1.7
Egypt	5.5	5.9	-8.3	-6.7
Jordan	2.2	2.4	-3.4	-3.2
Lebanon	0.2	0.9	-9.8	-11.5
Mauritania	6.9	6.3	2.1	0.3
Morocco	2.7	3.7	-3.7	-3.3
Palestine	-1.6	0.5
Somalia	2.9	3.2	0.1	0.2
Sudan	-2.6	-1.5	-5.4	-11.1
Syria
Tunisia	1.5	2.4	-3.7	-2.8

Country	Scheduled For	Event	Comment
Libya	H1 2019 Postponed	Referendum	No new date has been set yet.
		Presidential & Parliamentary (after referendum)	
Iran	Feb-20	Parliamentary elections	On track
Syria	Apr-20	Parliamentary elections	Date tbc
Jordan	Sep-20	Parliamentary elections	On track
Kuwait	Oct-20	Parliamentary elections	Date tbc
Egypt	Nov-20	Parliamentary elections	On track

- We expect to see further attacks coming at intervals over time. On 26 January, five rockets were fired into Baghdad's international Green Zone with one hitting the US embassy.
 - No one has claimed responsibility, but we suspect it was an Iranian or pro-Iranian paramilitary faction.

With the US having withdrawn, the JCPOA nuclear deal hangs by a fine thread. Iran is threatening to pull out and Europe is seeking to preserve what remains of the treaty ahead of a meeting on its future next month.

¹ Arabia Monitor; IMF.

- On 14 January, Britain, France and Germany formally accused Iran of violating the JCPOA after Tehran announced it would no longer observe limits on centrifuges. The three signatories triggered the dispute mechanism -- a 15-day timeline for members to resolve issues.
- Joseph Borrell, the EU's top diplomat and nuclear deal guarantor, has since extended the timeline on the dispute mechanism.
- Iranian President Hassan Rouhani asserted his country's commitment to the JCPOA, but threatened the European signatories against taking action over Iran's moves.

Ahead of parliamentary elections on 21 February, Iran's Guardian Council announced that it had disqualified thousands of candidates from running. The disqualifications, mostly of members of reformist and centrist parties, have turned the upcoming election into a race among conservative factions.

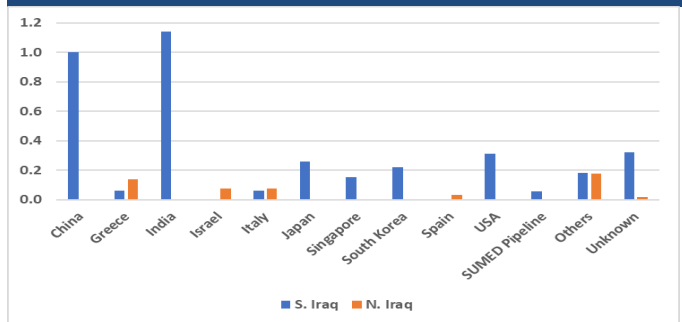
- Conservatives are using the events of the past month to penalise reformists and consolidate control.
- The Guardian Council determines who can run. It consists of six clerics appointed by Supreme Leader Ali Khamenei and six jurists nominated by the judiciary and approved by the parliament (formally the Islamic Consultative Assembly).
 - 14,000 people registered to run in December. Of those just 5,000 qualified.
 - Of the 290 current members of the Assembly, 247 registered to run for re-election, but 90 have been barred and accused of corruption.
 - On 27 January, Rouhani warned that the Council's decisions were a threat to Iran's democracy and sovereignty.
- Public opinion is split in Iran between those who support hardliners and are against opening channels with the US and those who want regime change and are in favour of re-establishing dialogue.
 - The marginalisation and elimination of the reformist candidates will ultimately produce a victory for the hardliners.
 - Tehran's liberal youth have already begun to voice their frustration with Iran's electoral system by refusing to vote, which further strengthens the hand of the conservatives
- Although demonstrations have not yet occurred, it is likely that protests will erupt closer to election time.

Iraq: Impasses over government and US troops

We do not expect a sustainable government to be formed in Iraq by the end of this coming month. Anti-government demonstrations will continue until a new prime minister is chosen who has the protesters' support -- an unlikely outcome for now.

- Protests have been taking place since October, calling for a government that is independent from the country's established political blocs and from both Washington and Tehran.
 - Protesters have continued to block roads in Baghdad and in the south of the country.
 - There have been clashes with security forces and protesters fear casualties will increase after the populist cleric Muqtada al-Sadr withdrew his support from them.

Figure 1 – Iraq Oil Exports by Partner (Mb/d)²



- Sadr led a separate anti-US protest in Baghdad on 24 January dubbed a “million-strong march” (although estimates are that it involved a quarter of that number at the very most).
 - Sadr presented his protests as separate to those occurring concurrently in Baghdad's Tahrir Square. They were, as a result, a demonstration of the power Sadr holds in Iraq.
 - This is important because a new prime minister will need the support of Sadr's Sairoon bloc (as well as the opposing Fatah bloc).
 - But it also creates impasse because other protesters are demanding a prime minister who is outside the influence of such political blocs.
 - This dynamic is not dissimilar to that on the Lebanese street, albeit much more violent.

We expect that Iraq and the US will return to the negotiation table to iron out details of their agreement on the presence of US troops following an Iraqi parliamentary vote calling for their total expulsion.

- While Iraqis and their government are sending a clear message to the US to leave, Washington insists that there will be no troop withdrawal. It is likely that the two nations will manage eventually to renegotiate the number of troops in the country.
- Iraqi President Barham Salih discussed the withdrawal of US troops at a meeting with US President Donald Trump at the World Economic Forum, painting the issue as a matter of national sovereignty.
- There are roughly 5,200 US troops currently stationed in Iraq, a far cry from the 150,000 in 2007.

Lebanon: Debt clock ticks

Lebanon's new government does contain some qualified technocrats, but it is not independent enough from entrenched factions to please the protest movement that brought down the previous leadership. Added to its distinct Hezbollah orbit support, this weakens the government's capacity to convince the international and regional donor communities to unlock the various aid commitments.

- After three months of protests, Prime Minister-designate Hassan Diab announced the formation of a 20-member cabinet of “technocrats”, as opposed to the 30-member political cabinet in the previous government.
- But the new ministers were vetted by the traditional factions, including Diab himself, who since the beginning did not inspire popular support.

² Arabia Monitor; OPEC.

- Amongst the vetting parties were Hezbollah in pole position (including for Diab himself), Amal, the Free Patriotic Movement (FPM), Marada and Druze politician Talal Arslan. As a result, the new Cabinet primarily consists of advisors and appointees representing the main political oligarchs and parties allied with Hezbollah.
- The ministers are unlikely to demonstrate much political independence to speak out on major matters given their sponsors.
 - Diab's share of ministers is four, including himself, Minister of Interior Mohammad Fahmi (a retired major general who works with BLOM Bank), Minister of Education Tarek Majzoub (a judge) and Minister of Environment and Administrative Development Demianos Kattar (former finance minister in Najib Mikati's three-month long government in 2005).
 - The FPM has six ministers, including Minister of Energy Raymond Ghajar (adviser to former FPM energy ministers), Minister of Foreign Affairs Nassif Hitti (a former Lebanese ambassador to the Arab League), Deputy Prime Minister and Minister of Defence Zaina Akar (executive director of Beirut-based research and consultancy firm Information International), Minister of Justice Marie Claude-Najem (director of the Centre of Legal Studies and Research for the Arab World at the University of St. Joseph), Minister of Economy Raul Naame (chairman at ASTROBank and executive general manager at BankMed) and Minister for the Displaced Ghada Shreim (a professor at the Lebanese University).
 - Hezbollah has two seats -- Minister of Health Hammad Hasan (a doctor and former head of the Baalbeck-Hermel union of municipalities) and Minister of Industries Imad Hoballah (who works in telecoms).
 - The pro-Hezbollah Sunni Consultative Gathering named Minister of Telecoms Talal Hawwat (an engineer who has worked in tech/telecom companies, most recently Sandvine).
 - The Amal Movement named Minister of Finance Ghazi Wazni (an economist, and adviser to Amal head and Parliament Speaker, Nabih Berri) and Minister of Agriculture and Culture (newly merged) Abbas Murtada (an Amal official in the Bekaa).
 - The Marada Movement named two ministers, including Minister of Public Works Michel Najjar (the dean of the Faculty of Science and Engineering at Balamand University) and Minister of Labour Lama Yamine (an architect and professor at the Lebanese University in Tripoli).
 - Ramzi Musharafieh, a medical doctor, heads the Ministry of Tourism and Social Affairs and Manale Abdelsamad (a lecturer at the American University of Beirut and at Saint Joseph University) heads the Information Ministry. They were put forward by Druze politician Talal Arslan.
 - Youth and Sports Minister Varte Ohanian was named by the Armenian Tashnag party.

	24/01/2020	17/01/2020	27/12/2019
Average Yield	37.17%	37.56%	29.99%
Z-Spread (Bid in bps)	4,211	4,250	3,045
Yield on US 5-Year Note	1.55%	1.61%	1.71%

With a USD 1.2B debt payment looming large, MPs approved a 2020 budget on 27 January, one with rosy assumptions about the crisis-torn economy.

- The 2020 budget envisages a 6% deficit, a far cry from the unrealistic goal set by the former government to bring it close to zero.
 - It includes no new taxes. A proposed USD 400M one-off levy on banks was dropped.
 - The budget also aims to slash around USD 663M in transfers to state-run electricity provider Électricité du Liban, but does not specify how.
- Parliament's endorsement of the budget will not be enough to win the confidence of the international community or encourage donor countries to provide badly needed soft loans to Lebanon.
- Two issues to watch are:
 1. Will the banking sector pull through this new phase, including payment of the bond maturing in March?
 - One of the first tasks of the new government will be to decide whether to proceed with Banque du Liban's proposal to ask local holders of some of this year's bonds, including the issue maturing in March, to swap them for longer-dated ones to ease pressure on the country's finances.
 - Although practiced many times in the past with minimal impact, this time around such a move would most certainly push Lebanon's credit rating further into junk territory.
 - Growing debt payment concerns have driven CDS spreads to record highs. Lebanon's 5-year CDS spreads reached 3,867 bps on 29 January compared with 710 bps in the same period a year ago, and much higher than the 400 bps after the assassination of then-Prime Minister Rafic Hariri in 2005 and the 600 bps recorded after the July-August 2006 war broke out.
 2. Will the new government be able to handle the protests and social disruption that prompted its appointment in the first place, at a time when unemployment and firm closures are rising rapidly?

Kuwait: Record fiscal deficit in 2020/21 budget

The 2020/21 budget approved by the Kuwaiti government forecasts a budget deficit of USD 30.4B (21% of GDP) after transfers to the Future Generations Fund, the country's sovereign wealth fund. This compares with a USD 25.3B deficit in 2019 (18.4% of GDP).

³ Arabia Monitor; Banque du Liban.

- Spending is budgeted at USD 74B, the same level as the previous fiscal year. Wages and salaries (including subsidies) account for 71% of total expenditure.
- Revenues are expected to be USD 14.8B, 9.8% lower than last year on expectations of lower oil production.
 - Oil revenues account for 87% of Kuwait's total, and the budget assumes the same average oil price of USD 55 pb as the previous year.
 - However, oil production is expected to be lower at 2.7 Mb/d for 2020/21 versus 2.8 Mb/d in 2019/20.
- Funding the deficit will come from the state's ample reserves. Unlike other GCC countries that have been actively raising capital from international debt markets, Kuwait has not tapped the market since 2017 when it issued USD 8B in bonds.
 - The Kuwaiti Parliament is yet to pass a law raising the debt ceiling and allowing the country to issue debt with longer maturities.

Saudi Arabia: Healthy appetite for debt paper

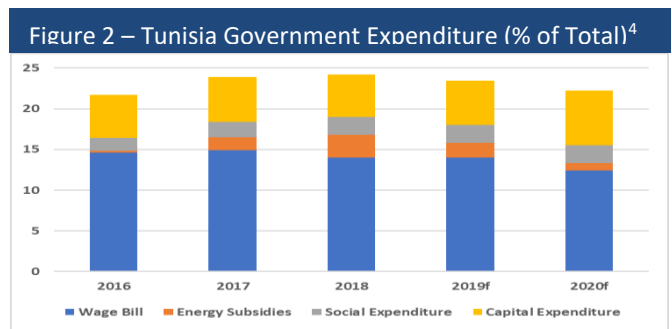
On 21 January, Saudi Arabia issued USD 5B in bonds that were four-times oversubscribed, signalling high investor confidence in the kingdom despite the escalation in geopolitical tensions in the wider region.

- The bond sale, the first by a GCC government this year, came after the US-Iran attacks. These did not deter investors looking for high returns amid low global rates.
- The bonds issued have maturities of seven, 12 and 35 years (the country's longest to date).
 - The USD 1.25B seven-year tranche was priced at 85 basis points over U.S. Treasuries with a yield of 2.54%; the 12-year offering of USD 1B at a spread of 110 basis points and yield of 2.88%, and the USD 2.75B 35-year tranche, yielding 3.84%.
- Saudi Arabia last sold eurobonds in October 2019, when it raised its third international USD 2.5B sukuk that was 5.6-times oversubscribed.
- The kingdom plans to raise USD 32B this year, with about USD 12B of the total to be used to refinance existing local debt. This would leave USD 20B worth of new funds that Riyadh could raise in the debt markets.

Tunisia: Struggle to form government continues

Forming a government is proving precarious, but the Assembly is likely to approve newly appointed Prime Minister Elyes Fakhfakh's Cabinet nominees.

- On 20 January, President Kais Said designated Fakhfakh to form a new coalition government after Prime Minister Habib Jemil was unable to do so and lost his position in a no-confidence vote on 10 January.
 - Fakhfakh, a former Total employee and finance minister, was an unexpected choice after Said met with Hakim Ben Hammouda and Fadhel Abdelkefi -- candidates who had parliamentary support.
- Fakhfakh, is expected to propose a government composed of technocrats like himself.



- He has announced that his Cabinet will be smaller than those that have come before which would see the elimination of some governmental positions.
- He has 30 days to form his new government and bring it before the Assembly for ratification. If MPs reject his proposal, Said will dissolve the Assembly and call for a new election -- a move which would jeopardise a number of sitting members' seats.
- While the political deliberations continue, we do not expect much progress on legislation necessary to address the country's ailing economy.
 - The IMF projects real GDP growth at 2.4% in 2020, up from 1.5% in 2019. It expects Inflation to fall from 6.6% to 5.4%. However, it projects government gross debt to slightly increase from 74.4% to 78.7%.
 - Whether Fakhfakh's government is approved or not, foreign lenders will continue to push the new government to cut spending.

Libya: Fighting erodes shaky truce

Libya peace remains elusive despite small step in Berlin to broker a deal. With General Khalifa Haftar's Libyan National Army's (LNA) renewed attacks on the Government of National Accord (GNA), we do not expect both sides to participate in near future talks. Resumed tensions are taking a toll on oil production with fears of a complete halt.

- January's peace talks in Berlin ended with no definitive result, although negotiators agreed to uphold a ceasefire and an arms embargo agreed earlier by a dozen foreign countries and several regional organisations -- but not by the warring parties in Libya.
 - Not surprisingly, the ceasefire and arms embargo have not held. The LNA advanced on Misrata, seizing a town on the way that was under GNA control.
 - Misrata is a key stronghold of the GNA with several militias loyal to the government.
- A major direct impact has been on oil. Output has shrunk by almost 80% since the LNA launched a blockade of major ports and fields in mid-January.
 - Among the affected fields were Sharara -- Libya's largest -- and neighbouring El Feel, both contributing almost a third of the country's total output.
 - According to the National Oil Company, production now stands at 262 Kb/d, down from around 1.3 Mb/d before the blockade.

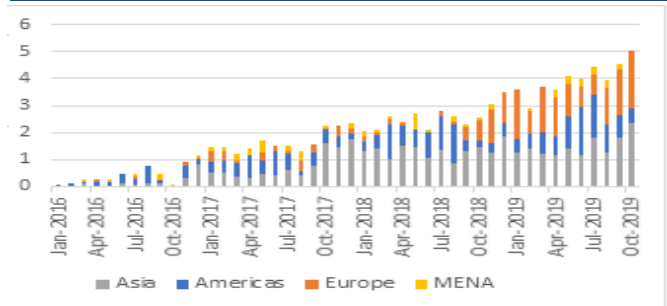
⁴ Arabia Monitor; IMF.

MENA Energy Outlook: An LNG challenge from the US

US LNG exports will continue to expand strongly on the back of abundant US gas supplies and ongoing plant construction.

- Significant US LNG exports began in February 2016 with shipments from Cheniere’s facility in Louisiana. They have now expanded to reach up to 5 billion cubic metres (BCM) per month, with six operating terminals: Sabine Pass in Louisiana, Cove Point in Maryland, Corpus Christi in Texas, Cameron in Louisiana, Elba Island in Georgia and Freeport in Texas. Several others are under construction and more are proposed.
- MENA has not been a major direct market for US LNG. The MENA LNG import market is relatively small, and geographically distant from the US.
 - Egypt was briefly a significant importer but has returned to export status on the back of domestic gas expansion, while UAE imports have also dropped.
 - However, US exports have continued to come to the UAE because of its halt on importing Qatari LNG, and low LNG prices have also been favourable for Jordan which imports virtually all of its oil and gas. US supplies have mainly gone to Asia, with a steady amount to the Americas, and a rising quantity from 2018 onwards to Europe due to oversupply elsewhere.
 - US LNG sales to China have been severely constrained by the trade war, though the ‘Phase 1’ deal may relax this.
- Nevertheless, the rise of US LNG has had a major impact on MENA exporters. LNG prices have fallen sharply because of strong supply, with the US joined by new projects in Australia and Russia.
 - ‘JKM’ (east Asian spot) prices fell from around USD 16 per million British thermal units (MMBtu) in 2014, to as low as USD 4 last year.
 - This limits the earnings of Qatar (and to a lesser extent, the UAE and Oman). Qatar has diverted gas to Europe to avoid cutting prices too much in its core Asian markets.
 - Egypt has reduced LNG exports as realised prices have fallen below the top tier of prices it pays to domestic producers. However, if prices fall much further, some US exports may be shut-in temporarily.
- The long-term market impacts may be more important. US LNG, sold on flexible conditions with new price benchmarks not linked to oil, has encouraged a more varied and liquid world LNG market.
 - Oil-linked pricing is challenged by links to Henry Hub (US gas), JKM and European benchmarks. This, along with other developments such as Japanese market liberalisation, limits the scope for premium pricing to traditional Asian customers.
 - It has also opened up new markets, even if many are relatively small. These include Bangladesh, Pakistan, Lithuania, Panama, and Malta, with new entrants to follow in the next few years such as Bahrain and possibly Morocco, Saudi Arabia, Lebanon and Cyprus.

Figure 3 – US LNG Exports by Country⁵



- US and other new LNG is a competitive challenge for Qatar. Doha has had to compete hard in markets such as India by cutting prices in return for increased volumetric sales. If China ramps up US LNG purchases, that will further challenge MENA’s market share in the country.
 - Qatar’s planned LNG expansion to 110 million tonnes per annum in 2024 and 126 Mtpa by 2027, from 78 Mtpa today, will demand aggressive marketing to compete with US supplies.

Sino-MENA: Chinese appetite for phosphates continues to rise in North Africa

China State Construction Engineering Corporation and Wengfu Group signed a USD 848M deal with Egypt’s state-run Phosphate Mirs Company to build and operate a phosphoric acid plant in southwestern Egypt.

- The Abu Tartour plant project is the largest phosphorous chemical project contracted by a Chinese company overseas so far. It is planned to have the combined annual production capacity of 500K tonnes of phosphoric acid products and 1.6M tonnes of sulfuric acid products.
- Wengfu Group, the largest phosphorus and chemicals manufacturer in Guizhou, has been eyeing overseas opportunities under the Belt & Road Initiative, including in Algeria, where a USD 6B phosphate plan will be built in partnership with Algeria’s Sonatrach, state-run fertiliser manufacturer Semidal-Manal and China’s CITIC.
 - Projected output capacity of 6M tonnes per year will begin in 2022. The project cost also covers a railway connecting the site to the port of Annaba.

China’s appetite for phosphates in North Africa is also evident in Tunisia where investors submitted an official request to carry out investments in phosphate residues.

- This is more controversial compared with the developments in Egypt and Algeria. Previously, Tunisian companies have been barred from investing in this field, as authorities considered phosphate residues, estimated at minimum of 24M tonnes annually, as “strategic” stock.
 - It remains to be seen whether the Tunisian government will grant the Chinese request, but we expect to see phosphates companies such as Wengfu Group, together with other Chinese financiers and contractors, pushing for more production capacity in North Africa as a whole.

⁵ Qamar Energy; EIA.

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