The Impact of Low Oil Prices on Persian Gulf Producers

Prepared for

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Agenda

- Brief Review of Historical Data;
- General Comments about the Impact of Low Oil Prices on the Persian Gulf Region;
- Focus on three Key Players:
  - Saudi Arabia;
  - Iran;
  - Iraq;
- Outlook for Economic Growth in the Persian Gulf Region.

Historical Perspective

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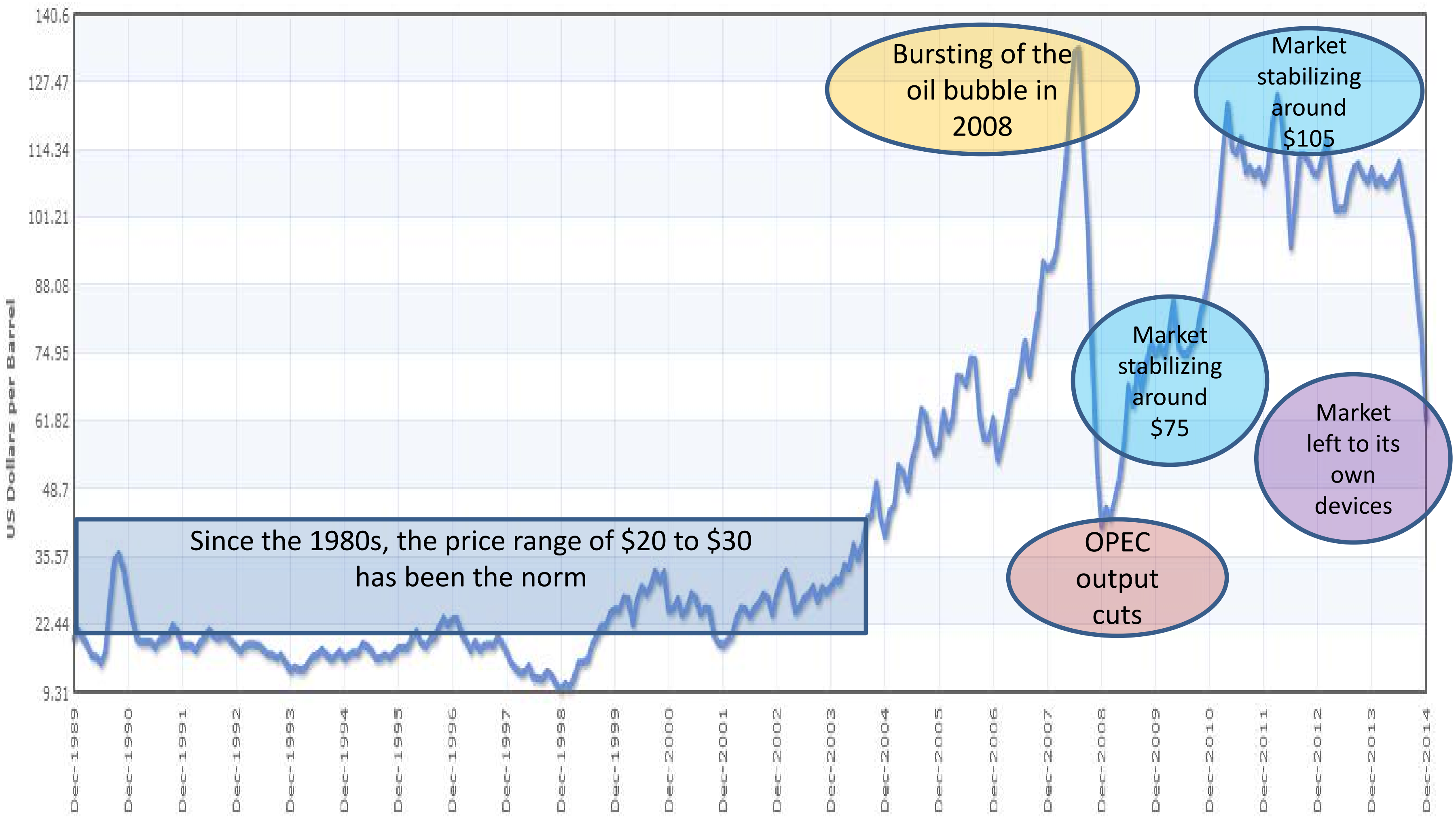

General Comments

- OPEC’s decision to leave the market to its own devices was unprecedented and market players need to adjust to the new situation;
- Saudi Arabia’s main strategy seems to evolve around securing its market share by pushing out new producers;
- At the same time, one can argue that OPEC has lost control over the international oil market as 70 percent of the supplies are controlled by non-OPEC producers;
- The stated goal of OPEC is to force the high-cost producers, including US shale oil producers out of the global market;
- Saudi Arabia, UAE, Qatar and Kuwait rely on their hard currency reserves to withstand the economic pressure of the current situation. However, this option cannot continue for long;
- Iran, Iraq and Bahrain are the Persian Gulf economies that are undermined most by the low oil price;
- The low price scenario also has other implications, including less investment by Persian Gulf economic on the international scene as well as a cut in their imports, resulting in a fall in international trade exchanges.

Nature of Impacts

- Economic growth in the MENA region in 2015 will be lower than anticipated (downward correction from 3.9% to 3.3%);
- Combined with regional, political and security uncertainties, the current situation is undermining the business climate and also the outlook for public and private investments;
- We need to look at the impacts of low oil price on three different levels, i.e.:
  - Oil company budgets and investments;
  - Consequences for government budgets and its repercussions;
  - Impact on the economy as a whole
- Due to time constraints, in this presentation we will only look at the impact on government budgets and consequent government policies.

Impact on the Region's Treasuries

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- All key economies in the Persian Gulf region will be hit by the lower oil price;
- At the same time, all of the region's governments have significant hard currency reserves to compensate for the shortfalls;

Country	Budget Deficit 2015 (in billion $)	Hard currency reserves (in billion $)	How many budget deficits (2015) can this reserve cover?
Saudi Arabia	39	734	About 19 years
Iran	10	127	About 12 years
Iraq	18	69	About 3.5 years
UAE	0	70	NA
Qatar	0	46	NA

$-based versus €-based Drop

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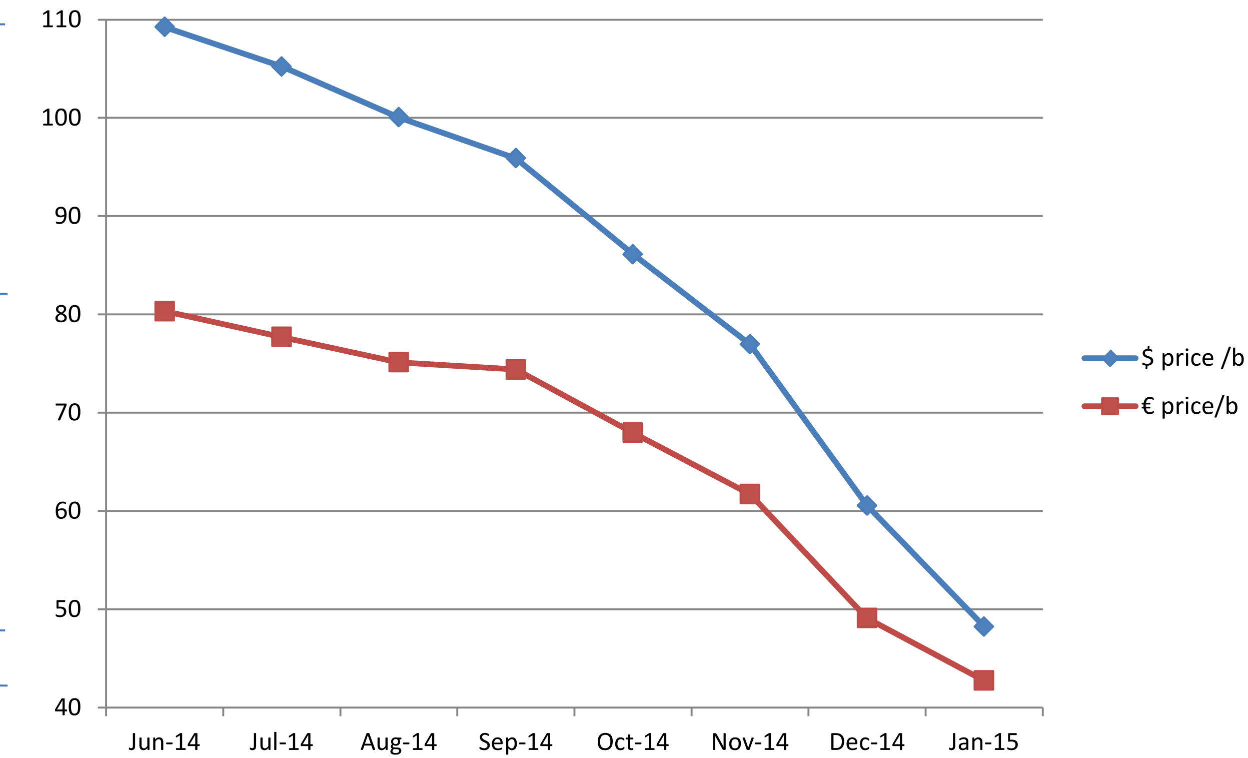
$-based price fall since June 2014: 56%

€-based price fall since June 2014: 47%



- It is unclear how the price will behave in the next months, but Persian Gulf producers will still have a good margin compared to their actual production costs;

Focus on Saudi Arabia - 1

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- Despite many conspiracy theories, Riyadh's strategy is more likely based on the desire to increase its global market share;
- Two consequences could be foreseen: More expensive production of oil would be pushed out of the global market. At the same time, cheap fuel prices could increase consumption and make renewable energy and nuclear power, less cost-competitive. All of these factors could pave the way for renewed price increases in the future;
- Although Saudi Arabia has a huge foreign exchange reserve, there will be negative dynamics in many internal financial transactions in the Kingdom;
- The new Saudi King has announced continuity in policies, but it remains to be seen how long the oil price strategy will continue – analysts believe that it would have to continue until 2020 to achieve the above goals;
- It is difficult to assume that the Saudi policies are based on a confident and calculated strategy. It seems to be related to all the current regional, domestic and geostrategic uncertainties;

Focus on Saudi Arabia - 2

- One risk of the Saudi strategy is that both Moscow and Tehran would be compelled to counter the Saudi initiative in the region's complex geostrategic competition;
- There are also domestic risks associated with Riyadh's current strategy. There will be cuts in welfare spending and salaries for government workers which will have social consequences.   Though the hard currency reserves are enough to prevent big budget cuts, the perception by domestic and international investors will lead to lower investment activity and higher unemployment – again with social repercussions;
- Experts have already lowered their expectations for Saudi investments in the period 2015-2019: Projected energy investments have been reduced from originally $175 billion to some $127 billion for the mentioned period.
- The Kingdom's economic growth will also slow down.

Focus on Iran

- Iran’s economy was already under pressure and the psychological impact of the oil price development has further aggravated the conditions;
- Some of the Iranian politicians have framed the current situation as an “oil war” and are pushing for an Iranian response;
- However, the government remains committed to détente;
- The oil price drop has compelled the government and law makers to reduce dependency on oil export revenues – however, adjustments will take effect in the medium term;
- The economy is diverse and resourceful enough to manage the low oil price;
- One of the positive consequences of low oil prices for Iran will be the need to reform the economy to pave the way for greater private sector activity;
- Tax reforms, privatization and a reform of cash handouts are already underway;
- Other reforms including a more investor-friendly approach to oil and gas investments will generate an economic momentum;
- One of the winning cards that Iran possesses is the growing gas production which can compensate for some of the lost oil revenues;

Nuclear Deal and Oil Revenues

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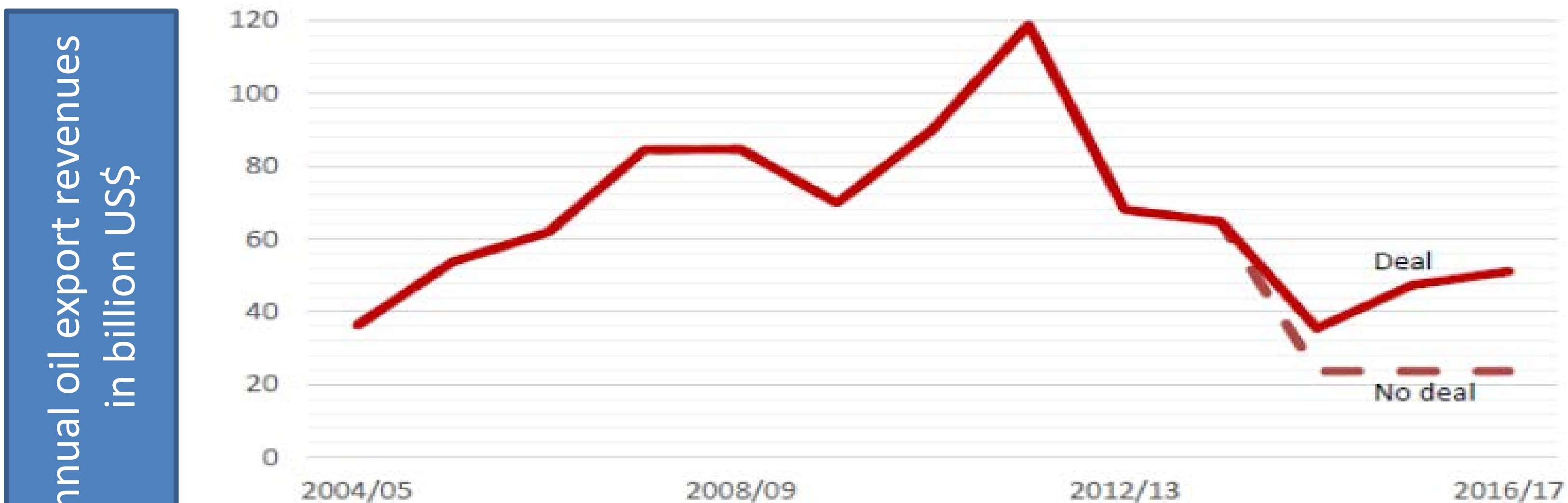
- Iran's economic outlook will strongly depend on the outcome of the nuclear negotiations;
- Lower oil prices today could provide an opportunity for Iran to regain its lost market share in the medium to long term;
- If current prices persist in the medium term and unconventional oil production declines, and if there is a comprehensive nuclear agreement, Iran could restore its pre-sanctions market share by 2017;
- The following chart compares the outlook of oil export revenues in two scenarios:



Source: World Bank Estimates

Iran's Economic Outlook

- According to IMF estimations, Iran's GDP grew about US$20 billion in 2014 and increased to US$406.3 billion.
- IMF predicts that if prices remain at $50 and there is no comprehensive nuclear deal, Iran's economy will decline by about 1% in 2015;
- However, despite the decline of the monetary value of the oil sector, Iran's economy will benefit from the growing gas production - Iran's gas production is expected to increase to the equivalent of 2.78 mbpd in the course of 2015;
- The country's inflation rate has dropped to 15.8% in 2014 and IMF expects the rate would rise to 17.3% in 2015;
- Based on IMF estimations, Iran's overall exports totaled US$94.9 billion in 2014, and are expected to fall to US$80 billion in 2015;
- The country's imports stood at US$82.6 billion in 2014 and are expected to fall to US$77.8 billion in 2015.
- Iran's current account balance was reportedly US$2.2 billion in 2014, but it is expected to fall to zero in 2015.

Focus on Iraq

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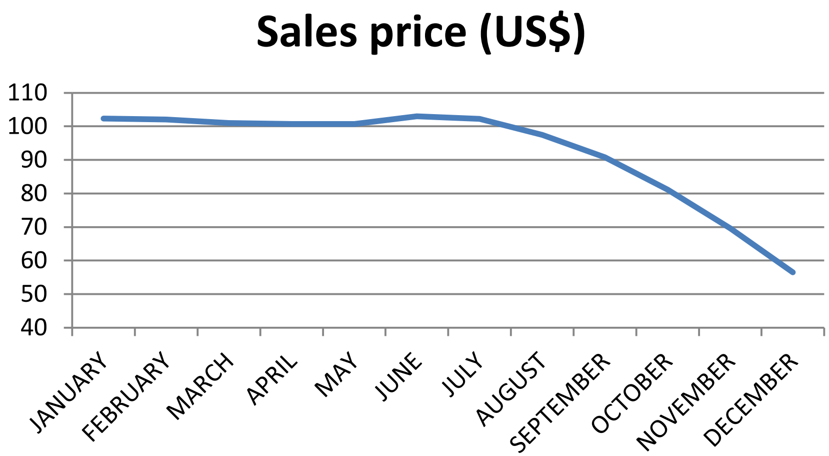
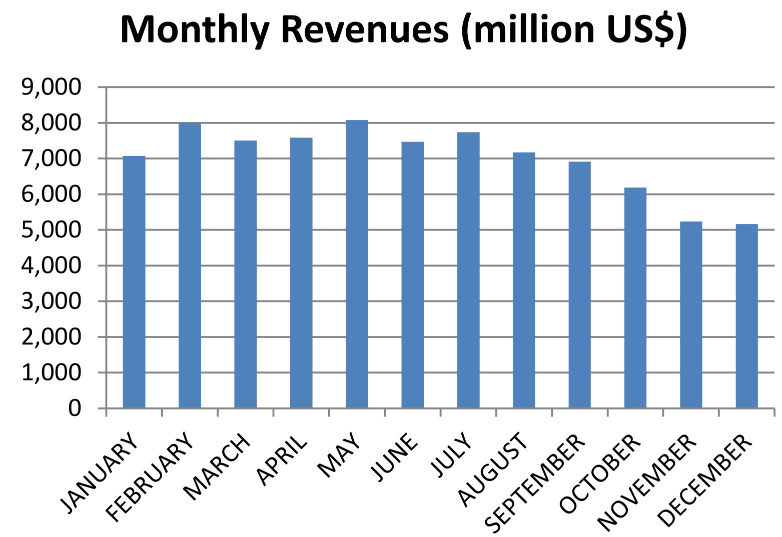
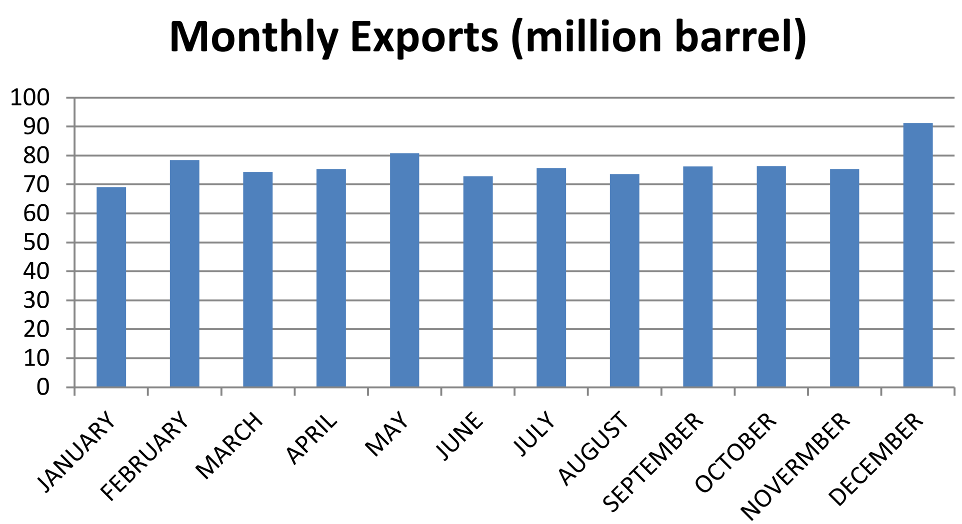
- Iraq continues to suffer as a result of its multi-faceted problems;
- Current domestic issues, especially ISIL have overshadowed the negative economic impact of low oil prices in Iraq;
- The Iraqi situation will also depend on the overall security situation and the actual level of exports;
- In 2015, Iraq is planning to export 3.3 mbpd including 550k from KRG;
- At a projected price of $55 per barrel, it will lead to a $18 billion budget deficit which will be filled by the Iraqi reserves;
- However, Iraq does not have as much financial cushion as the other big players and it will have to come up with a new approach to financing state expenditures;
- Baghdad has already created a committee to look at potential austerity measures to prepare for the government's limited capacity to invest in infrastructure and spend on welfare;

Fact Sheet: Iraqi Exports







Iraq can undo some of the negative impact by increasing production and hence exports, but that is only a short-term remedy.

Source: Ministry of Oil of Iraq

Conclusions

- Eventually, all Persian Gulf producers will suffer financially as they increased their expenditure in line with higher oil prices since 2010. Some even expanded their domestic welfare commitments in order to manage social discontent;
- The so-called "rich" countries within in the region could fill the gap in their budgets by utilizing their reserves;
- Consequently, the low price scenario translates into diverse challenges for different Persian Gulf producers;
- There are threats and opportunities to all of the producers, especially Saudi Arabia and Iran;
- At a time, when the region desperately needs cooperation and win-win initiatives, the oil price situation has paved the way for lose-lose scenarios;
- So many of the strategic parameters are still fluid (outcome of the nuclear negotiations, dynamics of the fight against ISIL, international economic developments etc.) to predict the final outcome of the current price situation;