GCC Crude Realities

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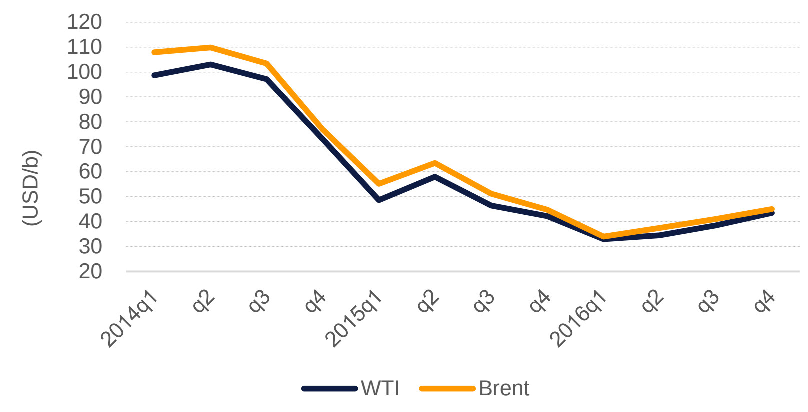
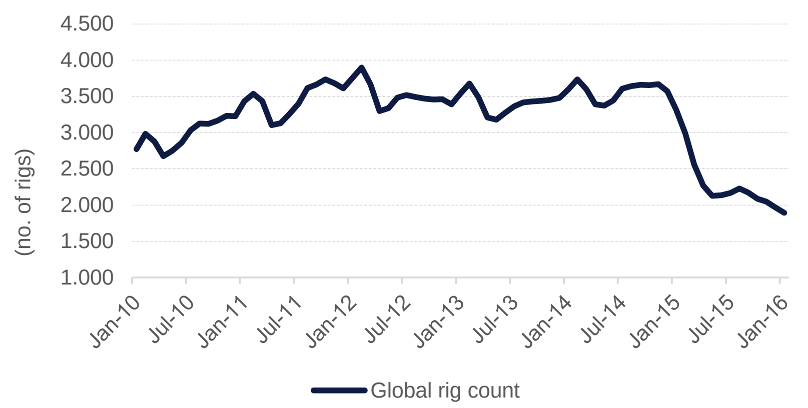
Emirates NBD Research oil price assumptions

- **Oil prices will remain under considerable pressure in 2016** but ultimately a rebalancing in fundamentals will exert limited upward pressure.
- **WTI futures will average more than USD 37/b**
  - Prices 23% lower on average yoy
  - Year highs will be in Q4 – average of USD 43.50/b
- **Brent futures will average over USD 39/b in 2016 (-27% yoy)**
  - Prices 27% lower yoy
  - Prices will move to USD 45/b on average in Q4
- **High-cost production will begin to contract** as producers are less hedged and more vulnerable to cashflow constraints under the current forward curve
- A repeat of 2015's strong demand gains are unlikely but we are confident that **consumers won't think twice about filling their tanks**.
- The degree of **slack in the oil market is very low** and delayed maintenance or cost-cutting at existing wells will slow down production in the near term
- Pace of rally from mid-February has been too strong, too soon and may encourage higher cost producers to hedge if prices stay reasonably elevated

Emirates NBD Research oil price forecasts



Price slide is affecting investment globally

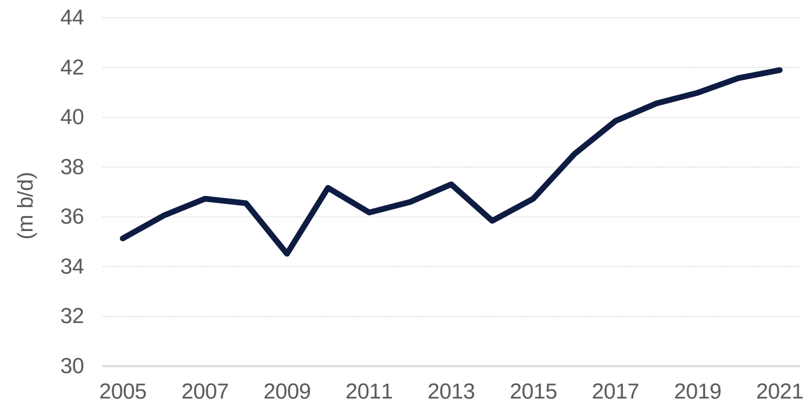


Source: Emirates NBD Research, Bloomberg.

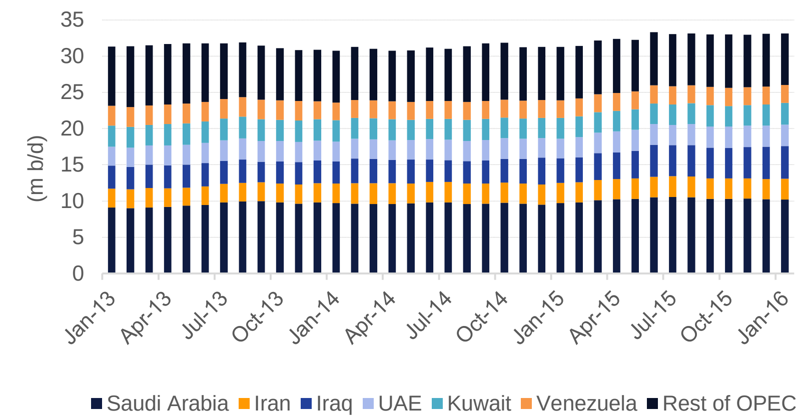
How has OPEC responded?

- **OPEC has added 1.8m b/d of supply since 2013** with the bulk of the addition coming from Iraq and Saudi Arabia.
- The strategic decision to **target market share, rather than prices**, has been a major contributor to the persistence of the oil market surplus but room for expansion beyond current levels is now limited.
- In aggregate, **OPEC is producing at over 90% of its total capacity** with nearly 2/3rds of the excess held by Saudi Arabia.
- **Production cuts from the bloc—or individual members—are highly unlikely**.
  - Prices are unlikely to rally as much as needed for fiscal positions.
  - Damage to domestic economies could be severe at a time when non-oil sectors are already strained.
  - Would undo 18 months of pain felt by higher cost producers and open up market share to competitors.
- **Oil market has moved beyond 'dialogue' and 'cooperation'**. There is no counterparty for OPEC to engage with in the US.

Demand for OPEC oil will expand



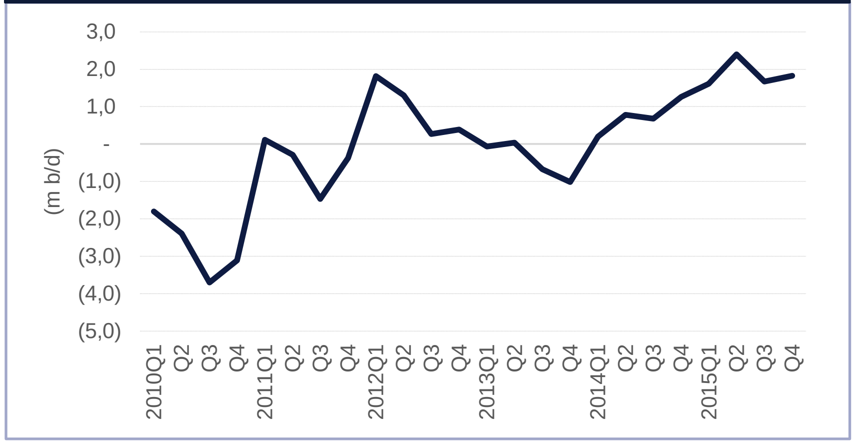
OPEC is targeting market share not prices



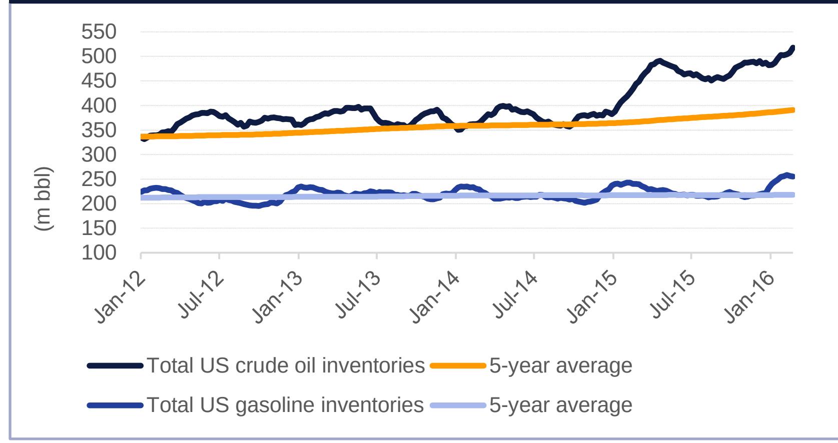
Source: Bloomberg, Emirates NBD Research. IEA MTOMR 2016.

Oversupply is putting greater emphasis on inventories and storage availabilities

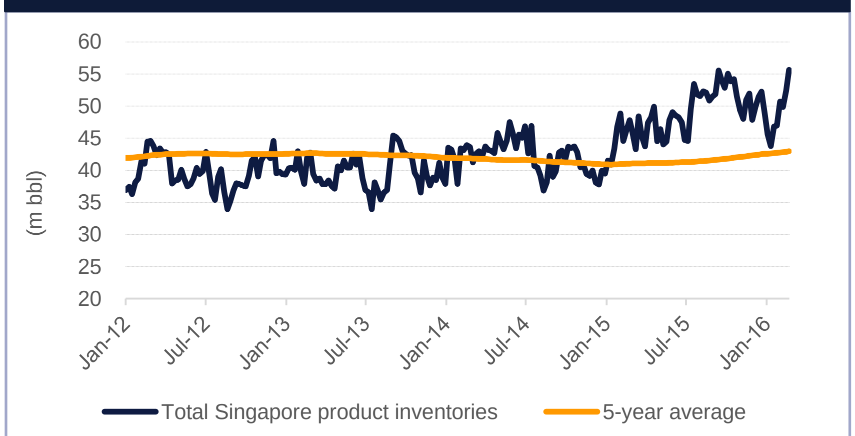
Market has moved into surplus at global level



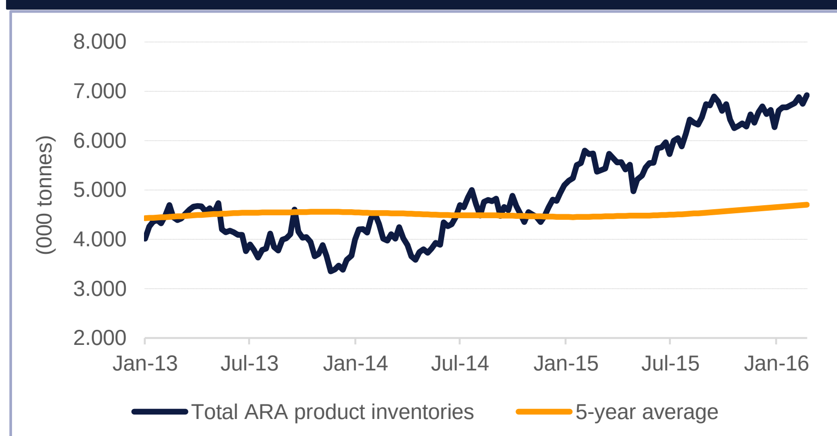
US inventories at extremely high levels, across the barrel



Singapore inventories are rising as China emerges as significant product exporter



ARA inventories have expanded despite strong European demand in 2015



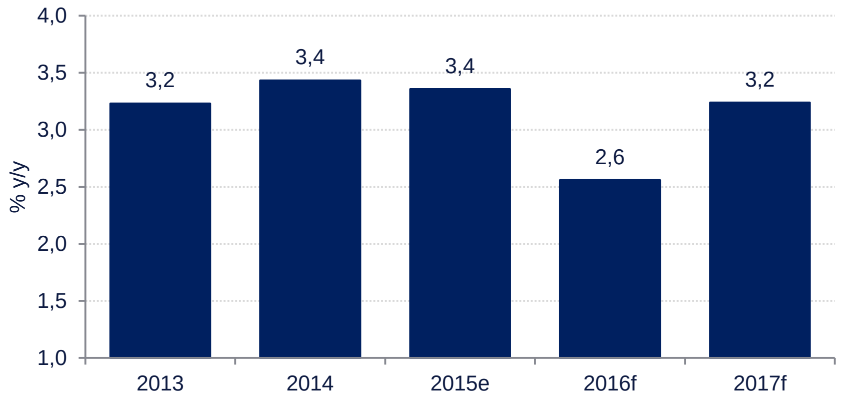
Source: EIA, IEA, International Enterprise Singapore, Bloomberg.

What do lower oil prices mean for GCC Economies?

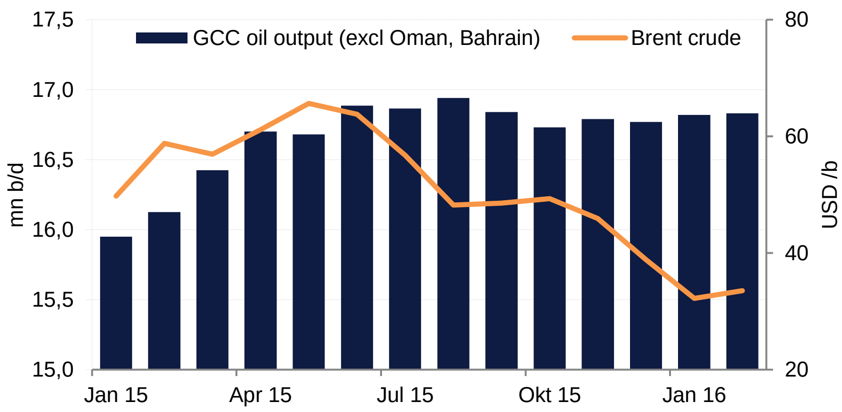
HIGHLIGHTS

- **Real growth would be affected by changes in oil production** (oil sector) and government spending (non-oil sector).
- **All regional budgets are still heavily reliant on oil**. Increased expenditure in recent years has pushed up the 'break-even' oil price
- Fiscal policy stance in the region is becoming more prudent as oil prices remain lower for longer.
- Interbank rates rose sharply in 2015 on tight liquidity. We expect conditions to remain challenging in 2016.
- Already measures announced to mitigate loss of oil revenues:
  - Cuts to fuel subsidies
  - VAT to be introduced at 5% in 2018
  - Corporate taxes proposed in several GCC countries
  - Raising government bond issuance, syndicated loans
- Capex remains protected for now, key projects in the UAE and Qatar related to Expo 2020 and FIFA 2022 moving ahead.

GCC real GDP growth*



GCC oil production rises as prices fall



Sources: Bloomberg, Emirates NBD Research

Saudi Arabia: Under scrutiny

HIGHLIGHTS

Growth estimated at 3.4% in 2015, forecast 1.9% in 2016

- PMI points to firm, but slowing non-oil sector activity. Oil production up 6% in 2015, supporting manufacturing sector and overall GDP.
- 2016 budget signals tighter fiscal policy, and we have revised down our spending forecast on lower oil price projection.

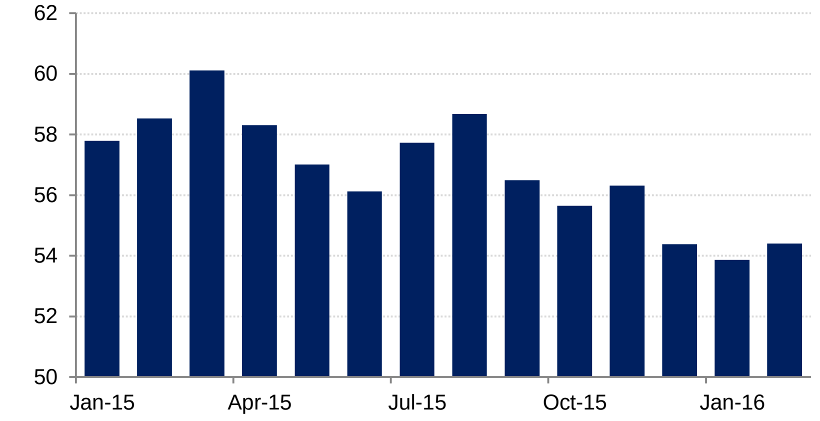
Budget deficit to narrow to -13.9% of GDP this year from -15% in 2015

- Energy subsidies cut in 2016, further cuts likely before 2020.
- Increased focused on raising non-oil revenues through taxes/ fees.

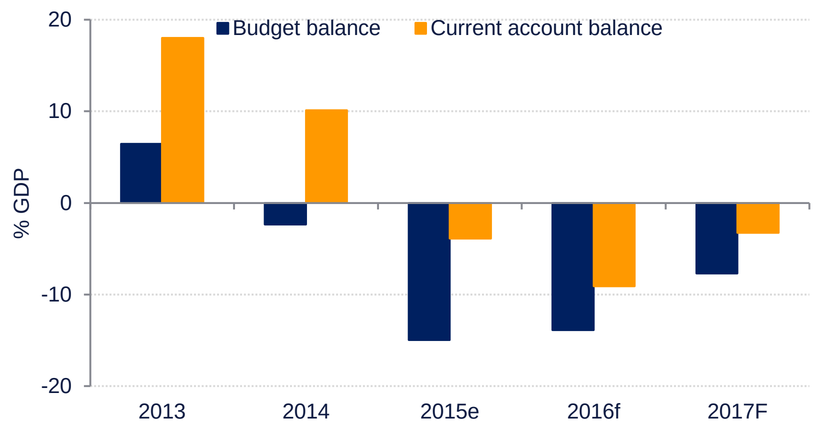
Financing the deficit is not problematic in the short term

- Foreign reserves have been tapped, but still substantial
- Debt issuance estimated at USD 36bn in 2016, most of which likely to come from international capital markets.
- Privatization proceeds expected to help plug deficit gap.

Emirates NBD Saudi Arabia PMI



Fiscal and external balances in deficit



Sources: Haver Analytics, Markit, Emirates NBD Research

UAE: Diversification is paying off

HIGHLIGHTS

Growth underpinned by oil

- Oil output in the UAE rose 4.1% in 2015, despite the sharp decline in oil prices last year. Production rose further to highest level ever (2.98mn b/d) in February 2016.
- This helps underpin headline GDP growth last year, even as the non-oil sectors of the economy slow. The non-oil economy is still expanding albeit at a slower rate.

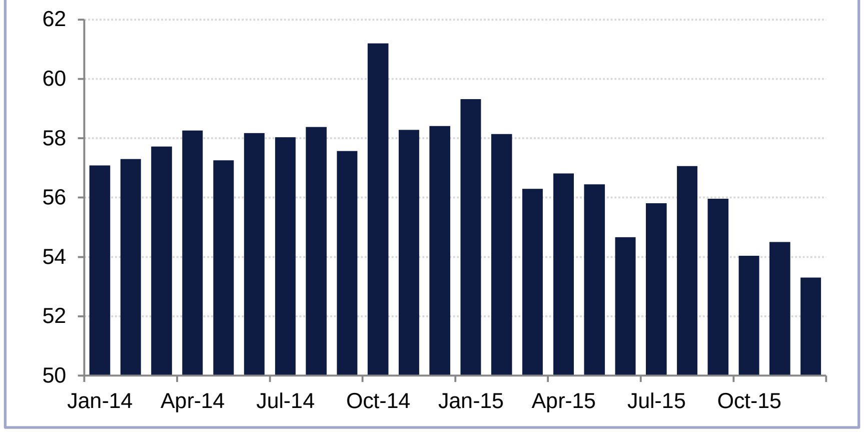
Capital spending likely to be maintained for now

- Expo 2020: Infrastructure spend of at least AED 22bn (official est.)
- Tourism/ hospitality strategy: target 20mn tourists p.a. by 2020. The supply of hotel rooms in Dubai increased by 6.7% y/y in 2015 to 79,002 rooms (target: 140,000 to 160,000 hotel rooms by the end of the decade).
- Dubai Economic Tracker indicated declining business activity in February, as services and trade sectors struggle with strong USD, slow global growth, weak confidence.

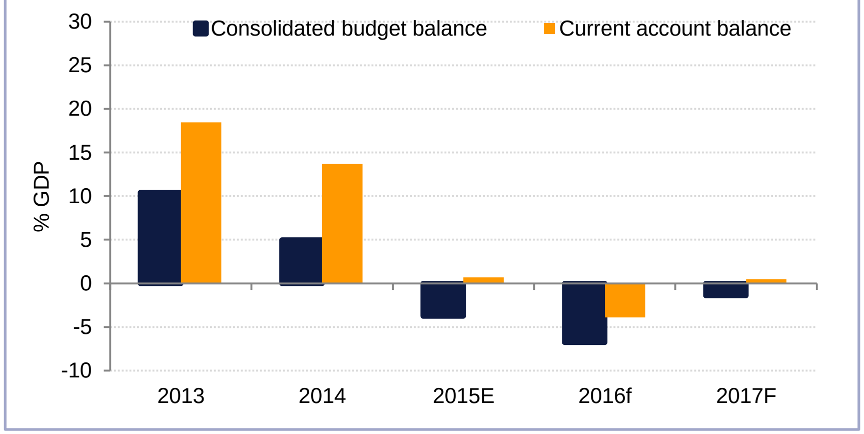
Cuts in subsidies and government transfers on the cards

- Lower transfers to Abu Dhabi GREs
- Cuts to foreign grants – implications for Egypt
- Increased fees and indirect taxes
- Reduced subsidies on fuel and utilities by 6% in 2015

Emirates NBD UAE PMI



UAE budget and current account in deficit



Sources: IMF, Markit, Emirates NBD Research

Liquidity conditions tightening

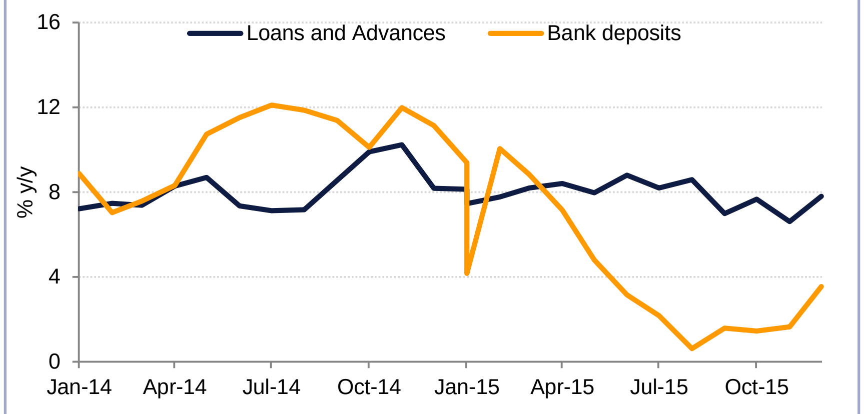
HIGHLIGHTS

- Government deposits are a large chunk of total bank deposits
  - Driven largely by oil revenues, which have fallen sharply
- Budget deficit in Saudi Arabia financed partially from SAR bond issues
- Private sector credit growth is still relatively strong, but has slowed in Q4 2015
- Loan to deposit ratios have increased (101.4% in UAE in January)
  - Banks paying more to attract corporate and non-resident deposits; eventually this will feed through to higher interest rates for borrowers
  - 3m interbank rates are rising, reflecting tighter liquidity conditions
- Fed rate hikes to contribute to higher borrowing costs in 2016

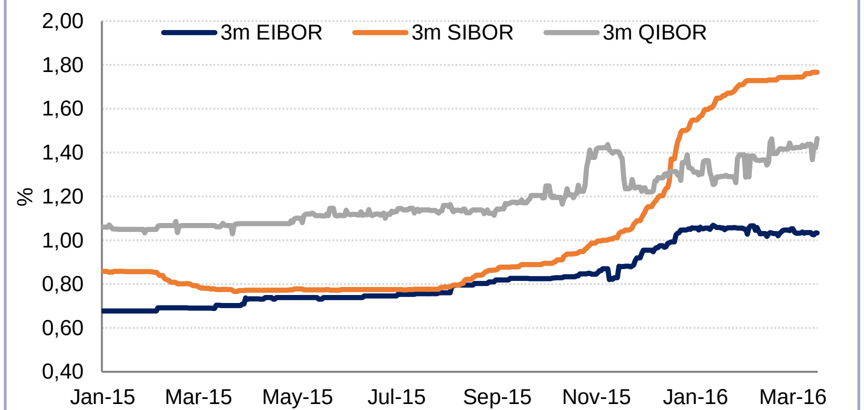
Deposit growth improved at end-2015

- Deposit growth slowed sharply last year, falling to 1.4% y/y in October, as government deposits declined during the year on the back of low oil prices.
- However, the government increased deposits in local banks in November and residents' deposits rose further in December, bringing the annual growth in bank deposits up to 4.2% y/y in January 2016.

UAE deposit and loan growth



3m interbank rates



Sources: Bloomberg, Markit, Emirates NBD Research

GCC pegs in focus

Emirates NBD

HIGHLIGHTS

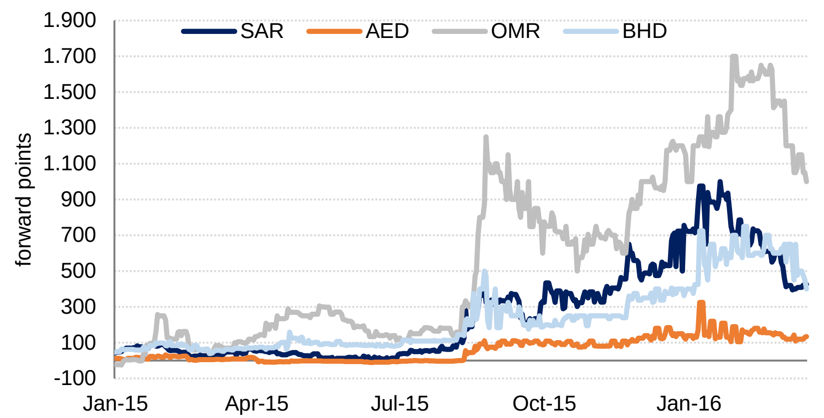
Speculation on the pegs continue

- The market continues to speculate that Saudi Arabia will abandon its peg against the USD in the face of the continued decline in oil prices
- SAR 12m forward points surged to over 1000 points in January 2016, the highest in at least a decade, but has since fallen back.
- While in the short term a devaluation would relieve some pressure on the budget, we believe the medium term costs would outweigh these benefits.

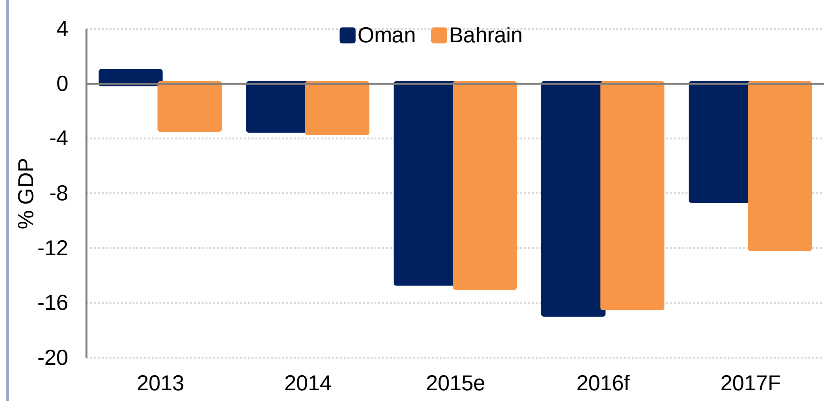
Oman most at risk

- Oman and Bahrain are most at risk from low oil prices, with large fiscal and external deficits and relatively low levels of accumulated reserves.
- While we expect Saudi Arabia to backstop Bahrain, Oman forwards remain elevated, signaling a higher degree of uncertainty about whether the peg will be maintained.
- The government has indicated that it will finance the deficit through savings, privatization and debt. We estimate a deficit of USD 12.7bn in 2016, although the official budget targets a deficit of USD 8.6bn.

GCC 12m forwards



Budget deficits



Sources: Haver Analytics, Markit, Emirates NBD Research

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