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Impact of the oil industry crisis on the GCC and potential responses

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The oil industry is facing its gravest crisis in 100 years, leading to a steep decline in fiscal revenues for many countries in the GCC. With the global economic downturn signaling lasting reduced oil prices, we look at whether some countries in the region, particularly Saudi Arabia, would benefit from re-calibrating their visions by prioritizing the most resilient transformation programs to stimulate their future economies.

The dual crisis engendered by the conflict over price between Saudi Arabia and Russia and the COVID-19 pandemic have prompted a global, sector-wide downturn in the Oil and Gas (O&G) industry that has left the oil-dependent economies vulnerable in terms of fiscal revenue. Demand for oil has fallen by over 18 percent since the beginning of the year, leading to a steep decline of more than 70 percent in the price of oil.

While OPEC+ has reduced oil production by almost 10 percent, the markets were not reassured. Oil price hit its lowest levels in 17 years, leading to the gravest industry crisis in 100 years. Matters were made worse when the storage units onshore and offshore were approaching full capacity[2], adding more pressure on the oil market. Due to less onshore storage space, the oil tankers were stranded along coasts globally, and the WTI US crude posted its first ever negative oil price, at an unimaginable negative US$38 a barrel, on 20 April 2020.

Figure 1: The oil market dual crisis[1]

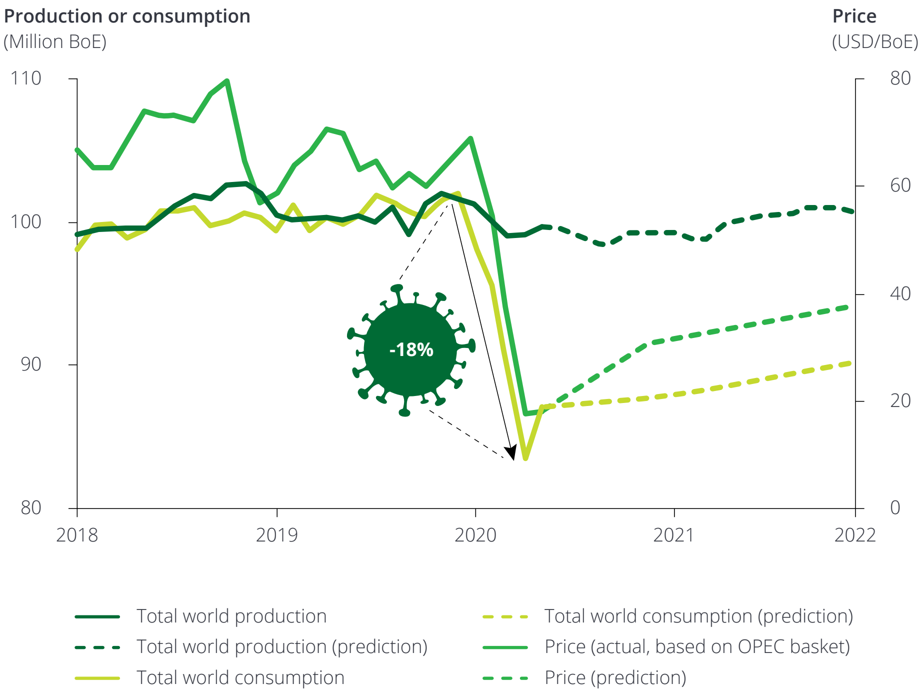
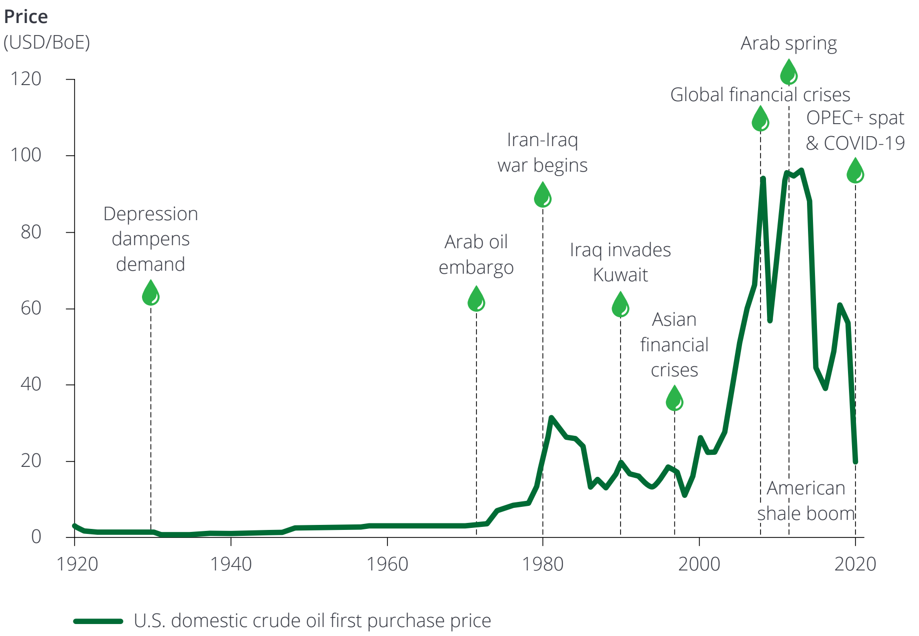


Figure 2: Zoom-out on the oil market price historical trends[1]



With macroeconomic predictions signaling a deep global recession, the pressure on GCC economies due to the current low oil prices is unlikely to fade.

The outlook in the O&G industry continues to be driven by the radical stay-at-home and social distancing measures adopted by governments globally to tackle the highly contagious COVID-19 virus, drastically affecting oil demand and the larger global economy. The global economy is expected to shrink by more than 3 percent in 2020, making this the worst economic downturn since the Great Depression. The Middle East economies are highly correlated with global macroeconomic trends and the region's GDP is also expected to fall on par with the global average.

The oil-rich countries of the region are not immune either, and while the Saudi Arabian economy is expected to perform slightly better than the world average with an estimated shrinkage of 2.3 percent, the UAE is expected to perform slightly worse, with an estimated shrinkage in GDP of 3.5 percent.

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Figure 3: GDP annual percent change[3]

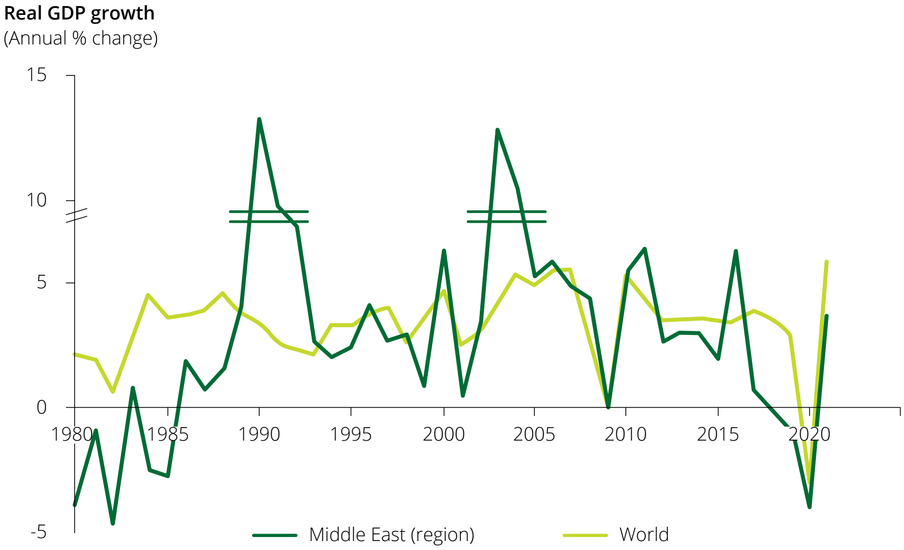
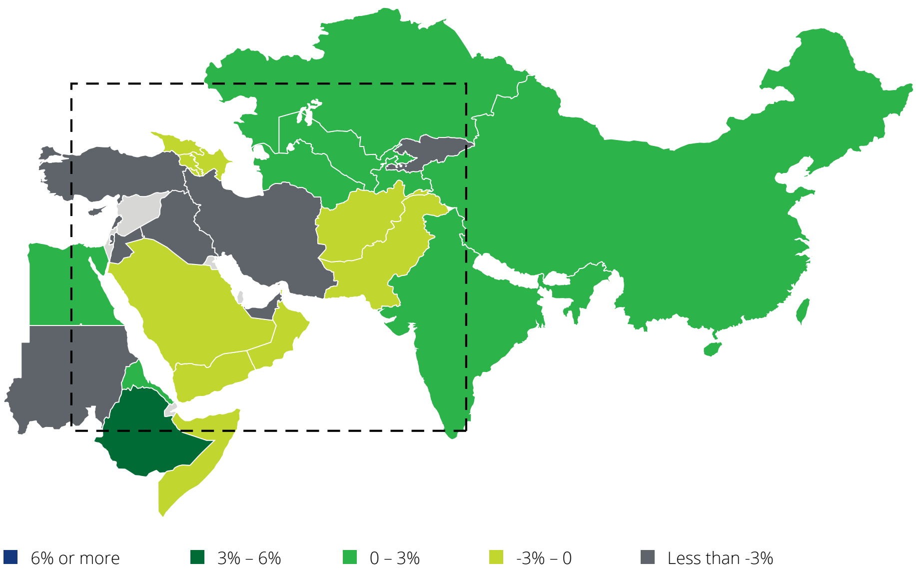


Figure 4: Focus on GDP predicted annual percent change in the GCC[1]



Both national and international oil companies are under unprecedented pressure and are unlikely to meet the expectations of their stakeholders.

Oil companies, both national (NOCs) and international (IOCs), are experiencing major revenue losses of around 40 percent. Their revenues are expected to decline from US$2.47 trillion last year to US$1.47 trillion this year against a backdrop of crippling demand. Faced with unprecedented pressure, NOCs and IOCs have cut back on both capital and operating expenditures by more than 20 percent. As a result, some oil companies have also resorted to reduce or postpone payment of dividends.

These cuts will likely have lasting implications, not only within the industry, but also without. Lasting negative consequences within the industry include the impact on long-term production levels from active production fields as well as mitigating future potential discoveries, progression of pipeline projects, supply chain and distribution models, innovation and digital transformations that lead, ultimately, to cost optimization. Beyond the oil companies' solidity, stakeholders are also negatively affected, as is the workforce and adjacent services and ecosystems related to the industry.

Figure 5: NOCs and IOCs 2020 CAPEX change[4]

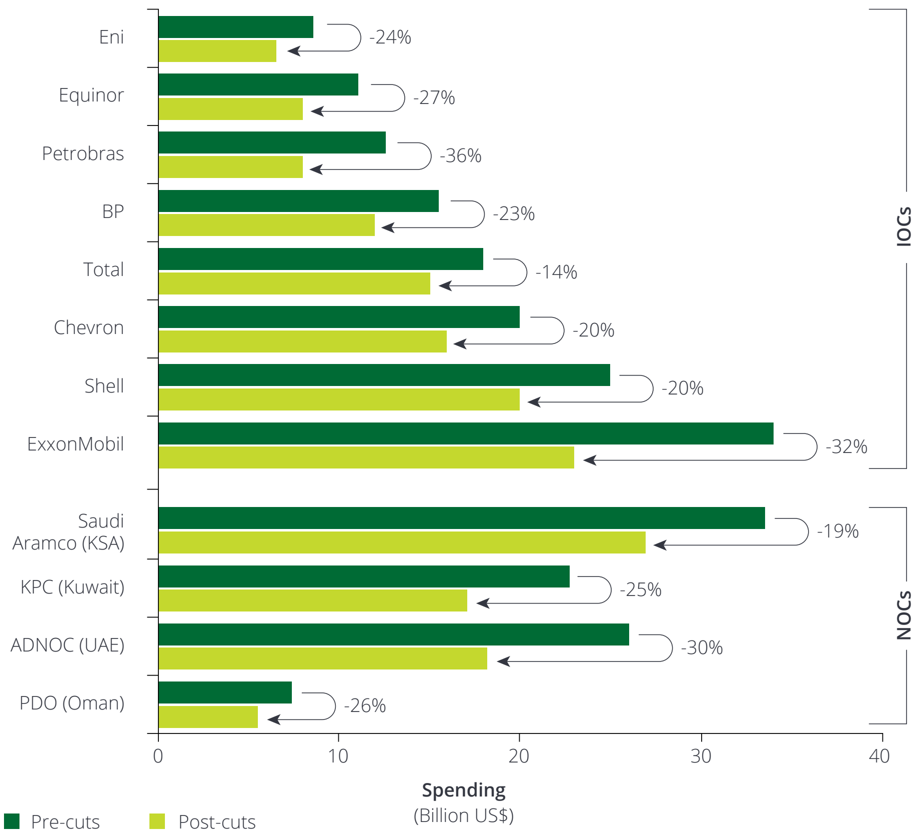
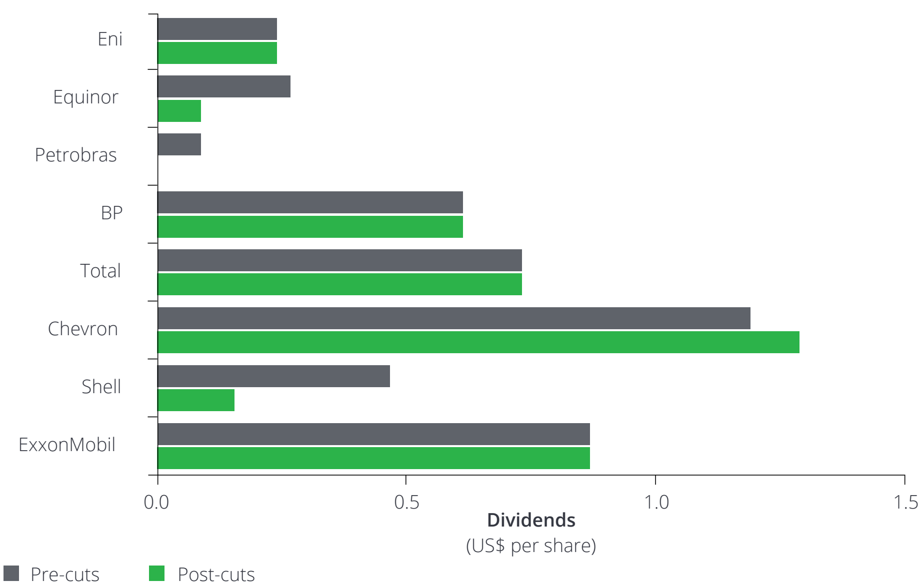


Figure 6: Oil majors dividends' change[3] (2019 vs. 2020)



While oil revenues account for more than 50 percent of GCC fiscal revenues—with the exception of the UAE, where oil accounts for about 35 percent of the fiscal budget—the impact of the current crisis will spread across the entire GCC. Although 2020 GDP growth forecasts have been revised downwards from their pre-COVID outlook, fiscal budgets, highly dependent on the price of oil, continue to be based on a price that seems far from a longer-term reality. As can be seen in Figure 8, the Break-Even Price (BEP), or the minimum price per barrel needed to meet expected spending needs while balancing budgets, is far from the projected reality all across the GCC.

The impact is spread across the entire GCC. Saudi Arabia accounts for almost half the total oil revenue loss, estimated at around US$120 billion in 2020[6]. As a result of the direct link between oil prices, government budgets and economic activity, the budgets of GCC countries, particularly KSA, will be critically strained owing to massive losses in annual oil revenue.

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Figure 7: Oil contribution to the fiscal budget for the GCC[5] (2018)

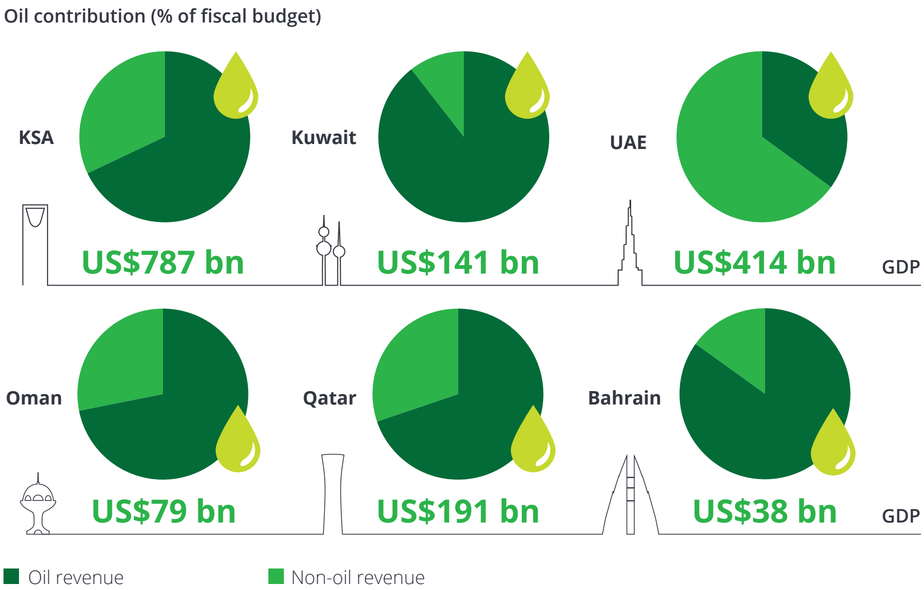


Figure 8: Respective fiscal break-even oil price for the GCC[5]

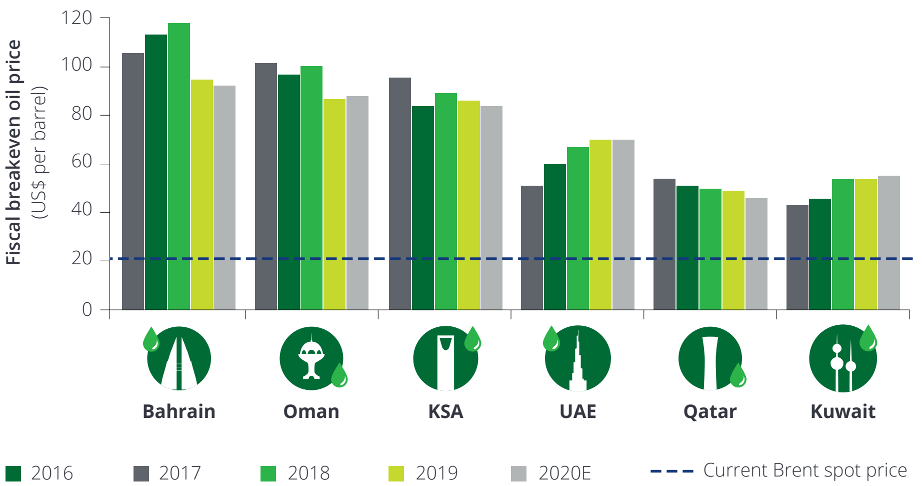
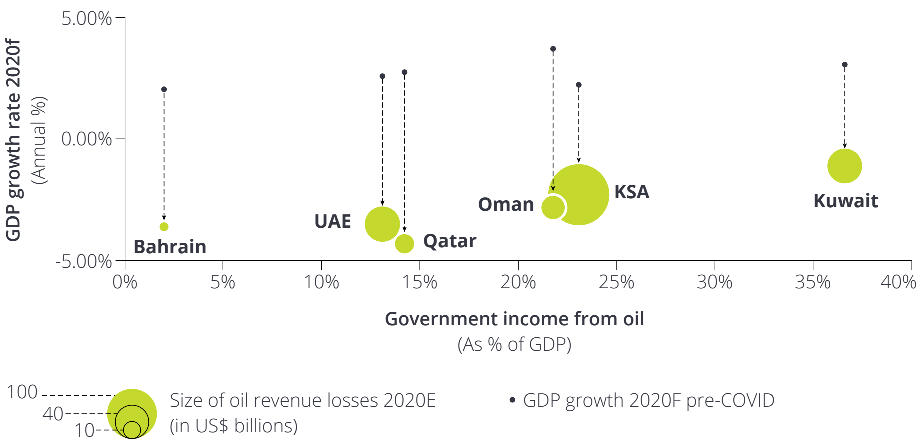


Figure 9: Estimated annual oil revenue losses in the GCC countries for 2020[7], in US$ billions per year



Impact on long-term development plans

Amid this challenging reality, GCC countries have embarked on ambitious development programs aimed at diversifying their economies: UAE vision 2021, Kuwait vision 2035, Oman vision 2040, Qatar national vision 2030, and Bahrain economic vision 2039.

Of these, Saudi Arabia has undertaken, by far, the most ambitious, if costly, journey of economic diversification under the umbrella of Vision 2030. Aimed at growing and diversifying the Kingdom's economy and reducing oil dependency, the plan aims at creating employment opportunities and long-term prosperity for Saudi citizens. Key targets reflect the need to create and further enable a business environment to transform the Kingdom into an investment powerhouse with the ability to unlock promising economic sectors, enable job growth through small and medium enterprises (SME) and micro-enterprises, and attract investment.

In line with other GCC countries, KSA has established the Public Investment Fund as its central financial engine for economic diversification, by unlocking investment, innovation and technology, and strategic economic relationships. Despite these efforts, Saudi Arabia may continue to face significant economic challenges that need to be considered.

Continue, accelerate, slow down or scale back?

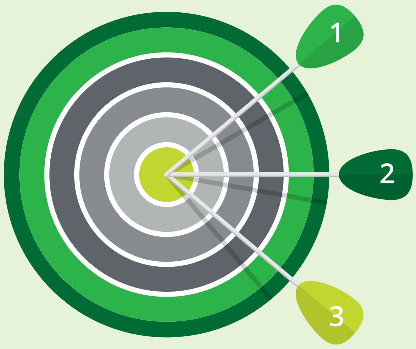
While one choice is to continue with the Vision 2030 execution as planned, it may be worth evaluating other options. By assessing different perceptions of the future, we have identified four potential scenarios.

Figure 10: Saudi Arabia Vision 2030 themes and targets

VISION رؤيـــة 2030
المملكة العربية السعودية
KINGDOM OF SAUDI ARABIA

Vision 2030 builds upon three key themes...

A thriving economy	A vibrant society	An ambitious nation



1. **To raise the share of non-oil exports** in non-oil GDP from 16% to 50%
2. **To move from current position** as the 19th largest economy in the world to the top 15
3. **To increase FDI** from 3.8% to the international level of 5.7% of GDP

The first option is to continue with the plan based on the premise that while the crisis has affected the Saudi economy in the short term, economic recovery will be relatively quick and the Kingdom's cash position remains strong enough to maintain the pace of execution.

Another option is to accelerate the process of change, the crisis having revealed a certain vulnerability to oil prices requiring fast adoption and forcing immediate fiscal policy imperatives.

A third option is to slow down the journey. This option is based on the notion that the crisis has affected KSA's fiscal stability, prompting it to tread carefully while focusing on value preservation and contingency planning by prioritizing critical transformations that fit the new reality.

A final option is to scale back the vision acknowledging that the global impact of the crisis is so significant as to warrant a review of future plans, scaling back the transformations that create the least value and maximizing those that do deliver value affordably.

Building resilience

In order to properly assess these various options, and respond with resilience, it pays to develop a concrete understanding of the different dimensions to future-proof the economy and society. We have identified four key dimensions with key questions per dimension to be considered:

The first dimension focuses on crafting the strategic direction of the transformation by responding to tough questions such as:

- What is the winning aspiration for the transformation programs?

- How to develop and leverage future competitive advantage?
- How is needed to strengthen positioning in future markets?

The second dimension focuses on understanding the fiscal future position by drawing a picture around the following questions:
- What is the current revenue strategy?
- What are the big ticket expense items and cost optimization plan?
- How to achieve fiscal sustainability?

The third dimension focuses on navigating the required Investment and policy enablers by responding to questions such as:
- What is the investment plan and supporting value proposition?
- How to support private sector development and drive PPPs?
- Which structural reforms, policies and regulations are needed for intervention?

The fourth dimension focuses on laying out the future blueprint for Governance and Socio-Economic Effects by responding to questions such as:
- What are the governance challenges in managing the transition?
- How to build social consensus to drive implementation?
- How to ensure proper monitoring and evaluation?

Managing trade-offs
The options outlined above cannot be considered in isolation. In evaluating the different scenarios available there are trade-offs that can be managed between future ambitions and current pressures. Current pressures faced by countries in the GCC include:
- How to protect critical revenue streams?
- How to cut back on spending and increase the efficiency of public spending?
- How to rationalize available government spending?
- How to bridge infrastructure investment gaps to fuel transformation programs?
- How will energy transition affect fiscal sustainability?

In counterbalance to these pressures, there are key considerations that guide a transformation program. These include:
- When to implement the program and how to measure success.
- How to target investment sources from future markets.
- How to implement a financially sustainable social welfare model.
- How to harness and maximize local economic potential—citizens and businesses.
- How to ensure coordination and collaboration among stakeholders.

Re-calibration
In the particular case of Saudi Arabia, a re-calibration of the Vision 2030 plan and a prioritization of certain programs may be necessary to align the vision of today with the economy of tomorrow.

Figure 11 shows the key drivers necessary for the alignment of Vision 2030 today to help realize future ambitions. In prioritizing transformation programs that are resilient, strategically sound, and that create value, the direct enablers of the plan that include champion industries and public or private investment, give way to more indirect long-term enablers that are more concerned with infrastructure and economic capabilities and fostering the right fiscal and investment environment to accelerate the vision.

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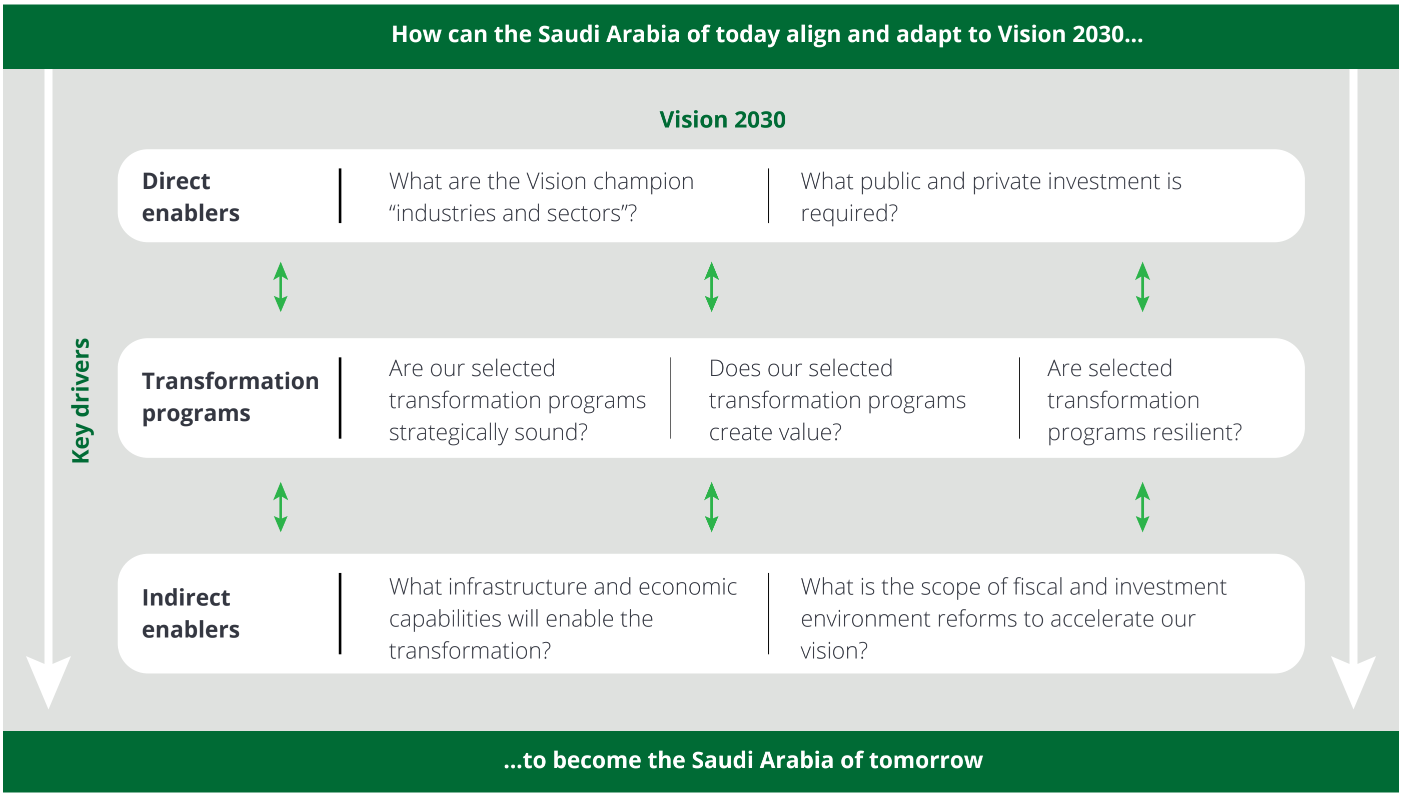

In the immediate term (coming weeks to 6 months), we anticipate that Saudi Arabia, in developing its response based on the selected options available to it, will largely focus on value preservation in anticipation of the potential scale and duration of the crisis. We also anticipate that Saudi Arabia will define a set of tactical response measures that include safeguarding critical value generation, identifying short-term prioritization in discretionary spending and re-assuring beneficiaries and investors.

In the medium term (2- years), we anticipate that the emphasis of the government will be on value maximization, in particular through maximizing revenue generation from existing sources (such as oil), sanctioning or delaying transformation projects that do not generate the highest immediate returns, and attracting and retaining investors for supporting the Kingdom's longer-term ambitions.

For longer-term success (5-10 years), we anticipate that Saudi Arabia will identify robust yet flexible measures in line with value creation that will provide the base for a prosperous future. To determine these measures, the Saudi government may consider how to determine the vision champion "industries and sectors", identify new skills and capabilities that will be required to enable the Kingdom workforce to realize future ambitions, and assess measures for creating impact in the local labor market, supply chain and innovation.

In choosing the strategic direction and its underlying measures to address the longer-term crisis, the leaders in Saudi Arabia have the opportunity to not only tackle today's challenges, but also preempt and address future ones by undertaking the right approach today.

Figure 12: Proposed guiding areas of focus for measures to address the immediate and beyond dimensions

Immediate term

Value preservation
- How to safeguard critical value generation?
- How to identify short-term prioritization in discretionary spending?
- How to re-assure beneficiaries and investors?

Medium term

Value maximization
- How do we maximize revenue generation from existing sources?
- Which transformation projects should be sanctioned/delayed?
- How do we attract and retain investors for supporting the vision programs?

Long term

Value creation
- What are the vision champion “industries and sectors” for the future?
- What new skills and capabilities will enable our workforce to realize future ambitions?
- What will the focus be on for creating impact in the local labor market, supply chain and innovation?

Tough choices

In the face of these multiple crises affecting businesses and governments globally, there are no easy solutions. Governments and leadership worldwide are being faced with the most difficult choices, each subject to multi-dimensional challenges and risk. The manner in which leadership responds in the next few months will be critical in maintaining, as well as boosting trust among all stakeholders involved. At the same time, any response will shape the foundation for future relationships, both in the internal and external ecosystem of any country.

In choosing the strategic direction and its underlying measures to address the longer-term crisis, the leaders in GCC countries have the opportunity to not only tackle today’s challenges, but also preempt and address future ones by undertaking the right approach today. Our recommendation would be to not focus solely on the current business space, but also use the momentum of the crisis as a catalyst for further accelerating the development of its transformation platform to thrive in the future.

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Endnotes

1. Financial Times
2. Energy Information Administration
3. IMF
4. Reuters and homepages for respective companies
5. Ministry of Finance for respective countries
6. Monitor Deloitte analysis
7. World Bank

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