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Quarterly Energy Newsletter
Q1 2022

A Message from Mashreq's Energy Sector Team

The success of our team is built on consistent knowledge exchange with our stakeholders, partners, and customers. We hope you find the insights inside valuable and useful.

Thank you for taking the time to read our quarterly newsletter.

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MASHREQ OPINION EDITORIAL

Energy Security vs Transition: Where Should the Money Go?

By Badar Chaudhry, Senior Vice President, Unit Manager, Energy Sector, Mashreq Bank

An essential marriage of the 21st century: this is how best to describe the equal importance of energy security and the energy transition. One does not trump the other in what will be the toughest balancing act our generation has ever faced. Finance is a cornerstone of achieving this non-negotiable equilibrium and it is fast becoming clear that many roads can lead us to a united destination of net zero by 2050. But have no doubt: the world has only just taken its first financial steps in this climate marathon.

However, we look at the energy-climate paradigm, financiers are key. Upstream investments in oil and gas must be at near pre-COVID-19 levels of $525bn up to 2030 to support energy security, according to the International Energy Agency (IEA). This remains true despite peak oil forecasts creeping ever closer. In this vein, the next two years are critical for sanctioning and allocating capital toward new oil and gas projects to ensure adequate supply comes online by 2027, warned the International Energy Forum. Simultaneously, the world must more than triple clean energy investments by 2030 to around $4trn to meet net zero by 2050, warned the IEA. Efforts are underway across the globe, including $130trn of private capital allocated by the newly established Glasgow Financial Alliance for Net Zero. But there is still a long way to go.

A new world

Turning this tide will take a gargantuan effort. Consider that energy consumption accounts for 76% of the globe's human-caused greenhouse gas emissions, according to the World Resources Institute. And this is far from a recent trend; it is deeply established in our economic and societal norms. For one, CO_2 emissions from energy and industry have climbed by 60% since the United Nation's Framework Convention on Climate Change was signed 30 years ago. Looking ahead, the current planned fossil fuel production by 2030 is twice the maximum production consistent with the 1.5°C limit, detailed the World Economic Forum. Clearly, we face an extraordinary balancing act. Think of financiers as one of the thickest, strongest threads in the rope that we must use to climb out of the deep, dark climate hole we have dug for decades.

Still, therein lies an entirely new landscape for financiers, both those established in energy markets and those new to the energy sphere. On one hand, the historically linear and dominating fossil fuel market has suddenly become far more complex with the increasingly diverse, greener energy basket. Equally, therein lies great opportunity for financiers to enter new, largely untapped markets and capture a first mover advantage.

Middle East: One to follow?

Having spearheaded the global oil and gas market for decades, producers in the Middle East now have to work harder than ever. These nations are being asked to play a big role in sustaining energy security – "please keep the lights on and our cars running with fossil fuels" – while also having to invest heavily in green energy projects and significantly cut their carbon footprints. They are not the culprits in the energy transition. To a large extent, they are now key orchestrators. The Middle East has a golden opportunity to set an example to the rest of the world in how to manage an even-keeled transition without compromising its energy security. If the region succeeds, the reputational win will be enormous. Meaningful efforts are already underway. Individual announcements to support clean energy by Saudi Arabia and the UAE – OPEC's linchpin and its third largest producer, respectively – totaled a staggering $264bn at the end of 2021.

But financiers also need help, especially from governments. At the very least, they need the reassurance of regulatory clarity, which governments in the Gulf Corporation Countries are certainly providing more and more. Overall, the clearer countries' energy-environmental policies are, the faster investors can figure out the commercial viability of projects. And as we see every day in ink and digital news headlines, the clock is ticking.

Focus on the prize

The energy security and energy transition "camps" make each other's lives more complex, but they do not threaten one another – they are allies who are still pinning down areas of common ground. But real threats will gain strength as the decade rolls on, such as water scarcity, cyber threats, and the availability of critical minerals to build renewable energy projects.

These areas will increasingly need our attention, so we must be focused and united. Ultimately, we are all looking at the same energy-climate quandary, just through very different lenses. Each country, each company, and each investor will find different solutions – diversity that financiers must embrace in 2022 and beyond.

"OPEC SPARE CAPACITY REMAINS THE ELEPHANT IN THE ROOM!"

Ehsan Khoman
Director, Head of Emerging Markets Research – EMEA, MUFG Bank

We are extremely bullish and see average Brent at $96 this year and $112 for 2023, supported by supply side constraints. Throughout the pandemic, the market's focus has been squarely on the demand side of the equation. In April 2020, the global market was awash with supply with concerns that storage capacity was reaching top levels. Fast forward to today and it's increasingly clear that tight supply is top of mind. The last time we had this sort of scarcity was the 2003 to 2014 era when China demand accelerated, and supply struggled to keep up. There are expectations of more volumes coming online as we move into Q2, but OPEC spare capacity remains the elephant in the room. By summer, it could drop below two million barrels. It's rarely hit those levels and that's when markets will get extremely nervous to the upside. Add to this the deficits in inventory levels and the broader lack of structural investment in oil and gas since the financial crisis. In terms if when we might rebalance, our forecast for demand destruction is around the $100–$115 level. That's when we will start to see a slowdown in industrial activity in the global economy that could lead prices to correct. We're not at that maximum pain yet. We still need much higher prices.

Source: Gulf Intelligence

"WEST SHOULD FOCUS ON CHINA'S RISE AND NOT DECLINING POWER LIKE RUSSIA!"

Narendra Taneja
India's Leading Energy Expert

Any democracy which is invaded the way Ukraine has been in the modern civilized world in 2022, is unacceptable. I sympathize with the people of Ukraine, and they have my full support. An unstable Europe is also terribly bad news for India, simply because we are so dependent on each other. Of course, we need to herald democracy, but the West should not get bogged down in Europe fighting with a declining power like Russia. We want the west to focus on the Indo-Pacific region. That's where the centre of global economic gravity and centre of energy gravity has moved to, but the West is refusing to acknowledge it. They will end up compromising their own geopolitical interests and facilitating the further rise of a very belligerent China. The Indo-Pacific region is where the real geopolitical challenges start, with China at its centre. China wants to see a unipolar Asia. Also, from an economic point of view, the Russian economy is much smaller than ours. We have a $3 trillion economy while Russia's is $1.75 trillion. When Russia's Rosneft was in trouble, India's national oil company, ONGC, bailed them out. The West needs to consider what they are doing for Ukraine. Are they fighting for its people or looking to topple one individual, Vladimir Putin? The threats, the challenges, and the opportunities, are all here in our part of the world.

Source: Gulf Intelligence

"CHINA'S OIL IMPORTS ARE DECLINING FOR SECOND YEAR IN A ROW!"

Victor Yang
Senior Editor, JLC Network Technology

How vulnerable is China's economic growth to $130 oil? The government has adjusted its growth target to 5.5% for this year, partly because of the Ukraine crisis and rising crude prices. China is already cutting crude imports for April arrival because of the possible risks associated with taking crude from Russia. Some of the independent refiners are worried about the problems with shipping and other issues so they are planning on other crude grades from regions like the US and Africa, but this means their costs will jump so it's dampening demand already. The country also has a pricing mechanism that does not adjust its gasoline and diesel prices when oil is above $130, so refining margins will shrink quite significantly and particularly for the independents that do not have government subsidies when crude prices rise above that level. Crude imports had already dropped in the first two months of this year by 4.9% year on year, mainly because of reduced industrial activity ahead of the Beijing Olympics, but we are now going into the maintenance season and if crude stays around $100, for six months or more, it will have a negative impact on imports.

Source: Gulf Intelligence

"RUSSIAN CRUDE OIL WITH BIG DISCOUNT WILL BE PICKED UP BY ASIAN BUYERS"

Dr. Raad Alkadiri
Managing Director, Energy, Climate & Resources, Eurasia Group

The $140 oil price that we saw last week was not sustainable. During the first two weeks of the Russian invasion of Ukraine, the market was looking for some foundation on which to rest where prices should be. I think it found that towards the end of last week and the volatility then started to seep out. Furthermore, oil markets are fungible. It's not sanctions that are getting in the way of calming oil and gas prices – it's self-sanctioning by Western buyers. The notion that you've got 1.5 million bd of crude and a million bd or more of product, necessarily being taken out of the market by sanctions, is too absolute a view. Russian Urals crude, which was trading at $65 a barrel this week, is going to be picked up. There are traders who, once they get through the compliance risk and who don't have the same sense of reputation risk - particularly buyers from the East - will take these cargoes. And that's where OPEC's head is – it's looking at the market fundamentals that were outlined prior to the war, which was an anticipation of stock builds from the second quarter all the way through to the end of 2023. That suggests weak fundamentals, a bearish outlook and downward pressure on prices. Another aspect which gives the market pause is anticipation of a deal with Iran that could bring back one million bd or more, very quickly, and probably volumes far higher than in 2015 and 2016. The Iranians have been placing barrels close to market for a few months. Demand is the other factor – the IEA has revised demand growth forecasts from 3.3 million bd to almost two million bd. Add to that worries about Covid in China, high commodity prices, and interest rates rising, and the spill over effect on growth globally will be a further drag. Under those circumstances, it's more difficult to paint a picture of bullishness with absolute certainty, and we now have a market hedging around $100, as it waits to see what unfolds next.

Source: Gulf Intelligence

Energy News Highlights – Q1 2022

Opec-Plus Stands Firm as Ukraine Crisis Deepens
Opec-plus producers remain adamant about sticking with their policy of gradual increases in oil output at their Mar. 2 ministerial meeting, even as crude oil trades around $100 per barrel and the Ukraine crisis deepens. The US and the EU announced new sanctions at the weekend — focused mainly on isolating Russia from the global financial system and inflicting economic pain. So far, Western sanctions have not directly targeted Russian oil and gas exports although the White House has said energy sanctions are still "on the table." However, a US official told Energy Intelligence that the Biden administration wants to avoid that option because of the difficulty of replacing all of Russia's oil and gas exports and because it would drive prices even higher and boost Russia's revenues.

Source: Energy Intelligence

Shell to exit Russia after Ukraine invasion, joining BP
Shell will exit all its Russian operations, including a major liquefied natural gas plant, becoming the latest major Western energy company to quit the oil-rich country following Moscow's invasion of Ukraine. The decision comes a day after rival BP abandoned its stake in Russian oil giant Rosneft in a move that could cost the British company over $25 billion. Norway's Equinor (EQNR.OL) also plans to exit Russia. Shell said in a statement it will quit the flagship Sakhalin 2 LNG plant in which it holds a 27.5% stake, and which is 50% owned and operated by Russian gas giant Gazprom.

Source: Reuters

White House Quietly Calls on U.S. Oil Companies To Increase Production
In a move that likely angered his environment-conscious base, the White House has issued a muted request for U.S. oil companies to increase crude oil production in the wake of high crude oil and gasoline prices. Though words are different than deeds—and President Joe Biden's deeds have been decisively anti-fossil fuel expansion—a White House official told U.S. oil companies on Tuesday that they could increase production if they want. "Prices are quite high; the price signal is strong. If folks want to produce more, they can and they should," White House National Economic Council Deputy Director Bharat Ramamurti said. While the words fell short of an official request to U.S. oil companies to increase production, it is decidedly different from ignoring U.S. oil companies' production plans altogether while asking OPEC+ to do the heavy lifting when it comes to oil production—to no avail, no less.

Source: Oilprice.com

OPEC+ has an ostrich problem. It's ignoring Ukraine
The decision by OPEC+ to stick to its plans for only a small increase in crude oil output in April shows the producer group is increasingly disconnected from the new reality of the market following Russia's invasion of Ukraine. The group that houses the Organization of the Petroleum Exporting Countries and allies - including Russia itself - agreed on Wednesday to maintain a long-planned 400,000 barrels per day (bpd) production increase next month. The group made no mention of the Ukraine crisis in a statement after the meeting, only referring to unspecified "geopolitical developments". But more telling was the statement that the "current oil market fundamentals and the consensus on its outlook pointed to a well-balanced market, and that current volatility is not caused by changes in market fundamentals." OPEC+ is both right and wrong in this assessment.

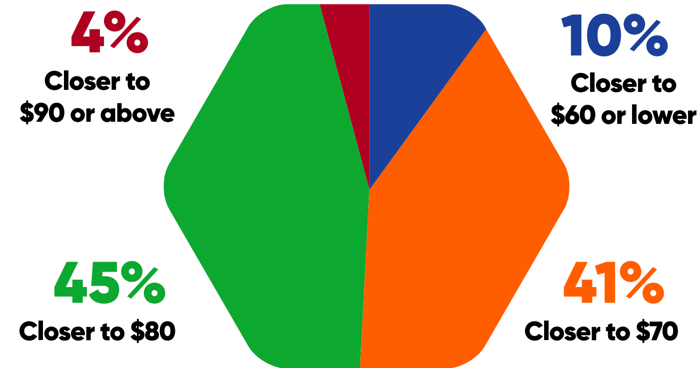
Source: Reuters

Ukraine War Could Wipe Out 1 Million Bpd In Local Oil Demand
War in Ukraine could result in as much as 1 million barrels per day (bpd) of oil demand being removed from the global market, Rystad Energy research shows. The human and material costs of the conflict have been catastrophic just seven days into the military operation. Russia has so far shown no signs of backing down, and prospects of a breakthrough in negotiations appear slim. As a result, investors and markets are scrambling to assess the ramifications of the worsening crisis as the West slaps even more stringent sanctions on Russia, while institutions and companies distance themselves from Moscow. Oil demand in both Ukraine and Russia is set to plunge if an end to the conflict does not materialize quickly. Ukraine is likely to see the largest drop in relative terms, potentially losing more than 50% of demand so long as the war persists, with long-term implications inevitable due to infrastructure damage and the speed of getting facilities back online once the conflict has come to an end.

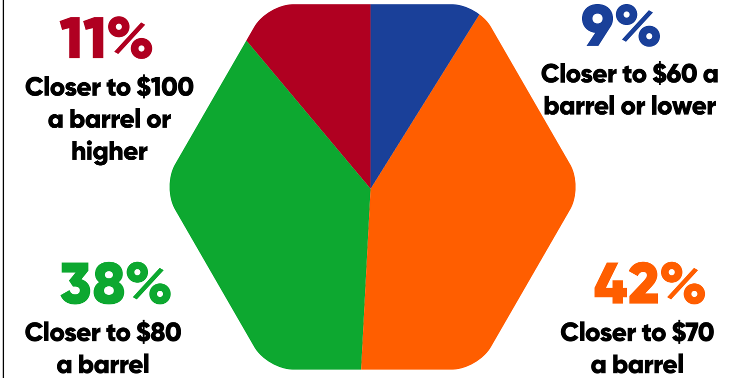
Source: Oilprice.com

Energy Markets Survey – Q1 2022

Brent crude oil averaged $40 in 2020; $71 in 2021 – What will be the AVERAGE price of Brent crude oil in 2022?

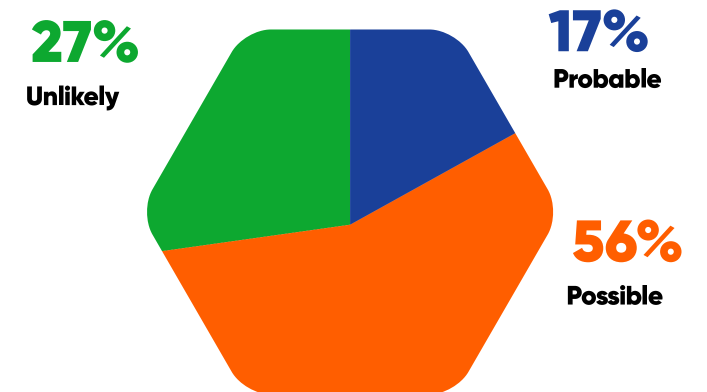


Now let's really test your crystal-ball skills: what will be the Average price of Brent Crude Oil over the next five years?

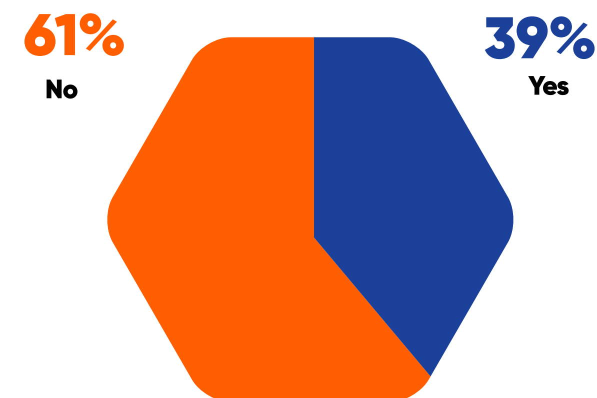


Will the global oil market return to 100 million barrels a day in 2022 despite the commitments made at COP26 towards Net Zero targets?

Saudi Arabia's oil minister warned last month that global oil production could drop 30% by the end of the decade due to falling investment in fossil fuels – Hyperbole or Reality?



China's oil imports registered their first yearly decline last year since records began in 2004 – does that signal the start of China's oil demand leveling off and plateauing like many developed countries?



Egypt and the UAE will host COP27 and COP 28 respectively over the next two years – this will finally deliver a seat to the hydrocarbons industry that have been longed barred from the Climate Solutions Table?

Source: GIQ

Energy & Investment – Mind the Gap: *Irresponsible vs Responsible Capital?*

Badar Chaudhry, Senior Vice President, Unit Manager, Energy Sector, Mashreq Bank

Stricter regulations, shareholder expectations, and an overarching global climate change agenda are shedding a spotlight on the investment gap in oil and gas.

Investment in upstream oil and gas dropped by 25% in 2021, to approximately $240bn. To meet energy demand going forward, $500bn per year is required – so it is critical to strike the right balance in funding conventional and non-conventional resources.

In the Middle East, national oil companies (NOCs) are working on cleaner and greener production solutions for their oil and gas, which in turn is boosting their Environmental Social Governance (ESG) credentials and attracting more international investors. The industry is not only a source of energy, but also a feedstock in industries that whole economies depend on (such as petrochemicals) and therefore, must be preserved. Oil and gas revenues are also needed to finance new technologies and cleaner energy as part of the transition.

25%
decline in upstream investments for oil and gas last year brought the total investment to $240bn. Approximately $500bn per year is required to meet future energy demand.

$50trn+
in ESG assets are anticipated by 2025, representing more than a third of the projected $140.5trn in total global assets under management (AUM).[1]

[1] Bloomberg Intelligence

Variables matter

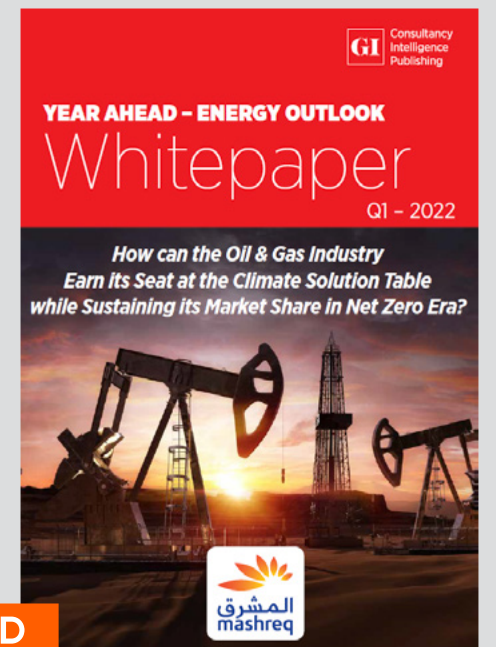
Future investment strategies in oil and gas require comprehensive consideration. Economic and demand growth forecasts for the next ten years differ widely, as do price expectations – therein lies one challenge. Against this backdrop lie difficult questions. Should oil and gas investments in poorer nations, which have no other option on which to build their economies, be discouraged? Do the same rules apply to wealthier nations? ESG comparisons are also using different metrics. All these factors, and many more, need clarity for sustainable and profitable investment decisions to be made. The transition must not move too quickly – the world needs higher fossil fuel prices to fund the transition. Plus, energy markets still need to find resolutions to key climate issues, such as carbon pricing and storing renewable energy.

An array of capital

NOCs are becoming more creative in tapping different sources of finance – one reason why financial structures are changing in the region. This includes Saudi Aramco's debut initial public offering (IPO), other regional companies' large and competitively priced debt financing packages, plus more green-orientated finance. Egypt became the first sovereign from the MENA region to issue a green bond in late-2020, for example, spurring similar requests from other nations in the region.

Up production, cut emissions

A healthier oil price and an increasingly strict climate agenda are causing NOCs to hasten their oil and gas production in a bid to capture as much market share as possible. Therein lies a delicate balancing act. Saudi Arabia and the UAE have invested in projects to enhance their oil production capacities – Saudi Arabia is targeting 13mn b/d by 2027, for example – yet the Kingdom and the UAE have also committed to net zero by 2060 and 2050, respectively. How to hit both goals in a timely and cost-competitive manner remains to be seen.



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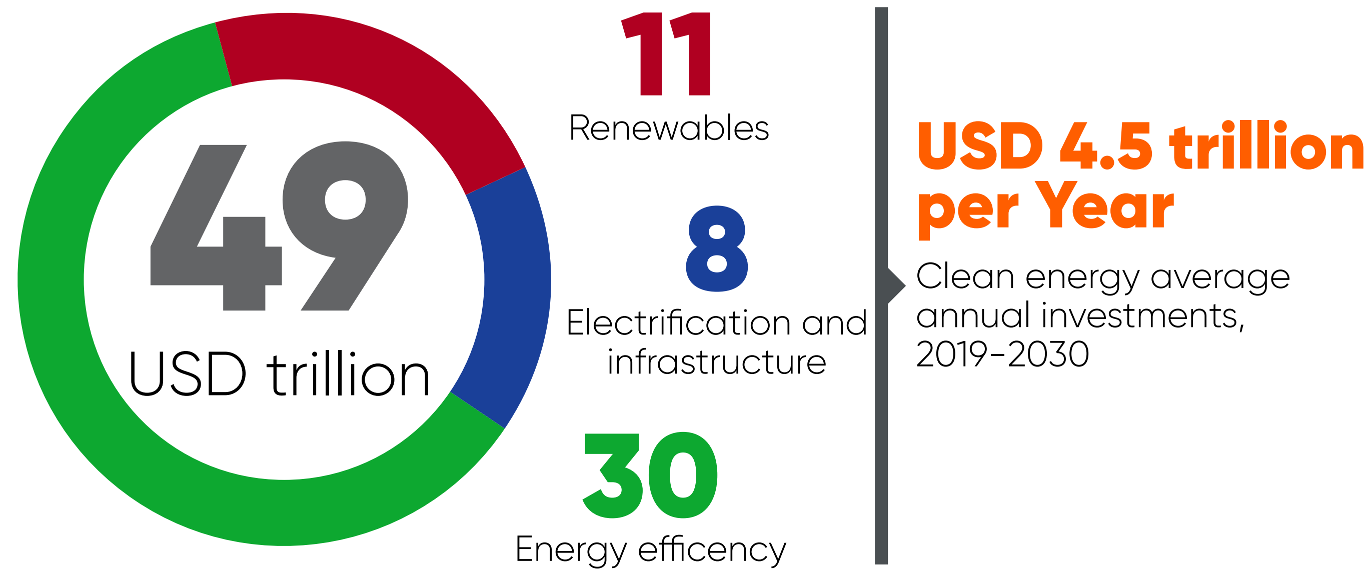
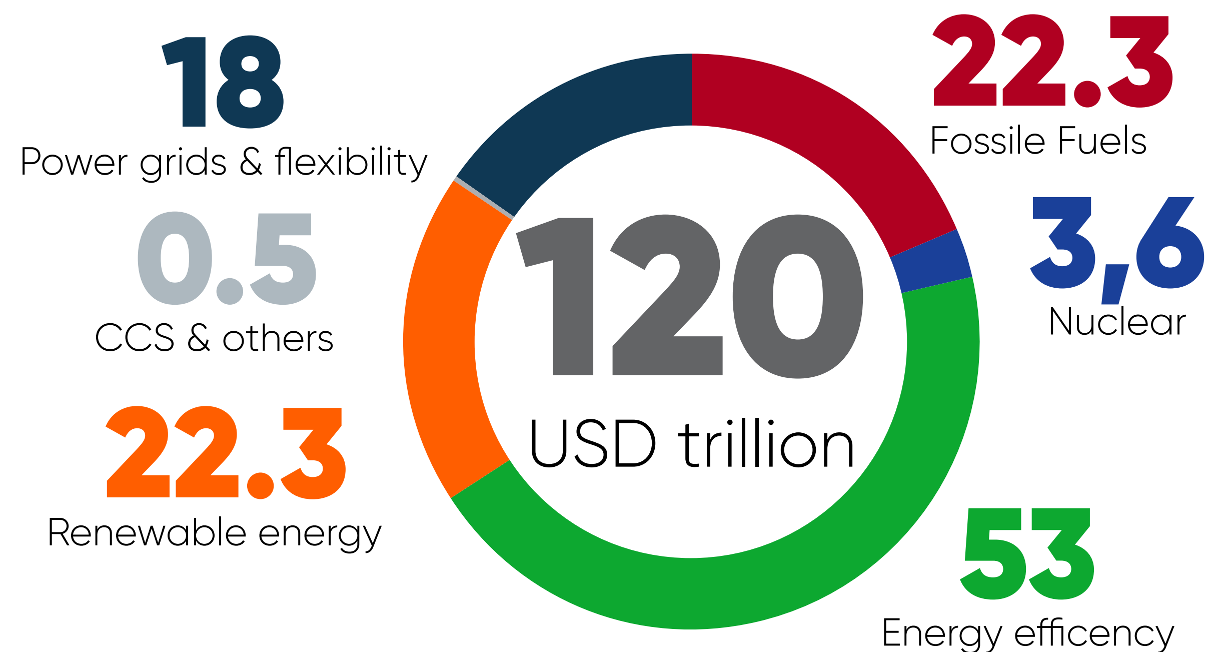
Cummulative clean Energy Investments between 2019-2013 in the transforming Energy Scenario (USD Trillion)



Source: Researchgate

To meet climate goals, renewable energy investment need to rise 30% to USD 120 trillion by 2050



Source: IRENA

Mashreq In-Numbers:
MENA Energy Investment
in Renewables

MENA Renewables Energy Investments 2020-2025

Energy transition investment in Europe, Middle East and Africa grew by **16%** in 2021, reaching **$236 billion**. Renewable energy investment was flat, but electric transport spending jumped **46%**.

Source: BloombergNEF: Energy Transition Investment Trends 2022

MENA Renewables Energy Investments 2020-2025

In MENA, some $104bn-worth of renewable energy projects are planned, of which about **$21.5bn** are at the contract tendering stage and are likely to lead to contract awards in 2021 and 2022.

- The country's **$42.1bn** of planned renewables projects is the region's biggest pipeline, but some **$41.9bn** are still under study.
- The Kingdom's **$18bn** renewables projects pipeline offers the best prospects, with some **$13bn** of renewable energy projects at or close to the tendering stage.
- The UAE, which far outstrips Saudi Arabia in terms of installed renewable capacity, has only **$370m** of renewables projects at the bidding stage.

Source: MEED

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