Impacts of Weak Oil Prices on Fiscal Conditions in Middle East Oil-producing Countries

Takashi Matsumoto
Senior Coordinator
Global Energy Group 1, Strategy Research Unit

Summary

Despite crude oil prices began to decline in the middle of 2014, the Organization of the Petroleum Exporting Countries at its general meeting in late November decided not to cut oil production, switching to a policy of giving priority to securing its market share. The decision pushed the crude oil market into an oversupply. The oil supply-demand balance is expected to remain loose for several years, despite supply-destabilizing factors seen in the Middle East and Africa. Some forecast crude oil prices to remain below $100/bbl over the next decade.

In response to the prolonged oil price weakness, oil-producing countries with sovereign wealth funds are dipping into these funds. Those with and without SWFs are trying to cut subsidies for fuels, electricity and water. They are also delaying, reducing or shelving oil development and other capital investments.

But these countries may not be able to continue withdrawing from SWFs. This kind of action may greatly affect the world economy. Subsidy cuts may induce citizens' discontent, contributing to social unrest. Oil development investment cuts may serve as blows to gradually reduce oil revenue and make it difficult to secure market shares under the policy indicated by last November's OPEC decision.

OPEC countries may have to go ahead with steady oil development investments to maintain their surplus export capacity. They may also have to promote energy conservation and other measures for holding down domestic energy consumption and step up renewable energy development in order to pave the way for exporting more domestic energy resources stably to secure revenue.

Introduction

In early 2014, concerns grew about slack global demand due to European economic deterioration and Chinese economic growth deceleration, although the U.S. economy was firm. Then, a forecast of U.S. shale oil output expansion induced concerns about a crude oil oversupply. The Organization of the Petroleum Exporting Countries was then expected to reduce oil production quotas to support oil prices at its general meeting scheduled for late November 2014, but it eventually decided not to do so.

These developments were combined to unleash a crude oil price plunge from mid-2014. The benchmark crude oil price declined 58% from $108/bbl on June 20, 2014, to $44/bbl on January

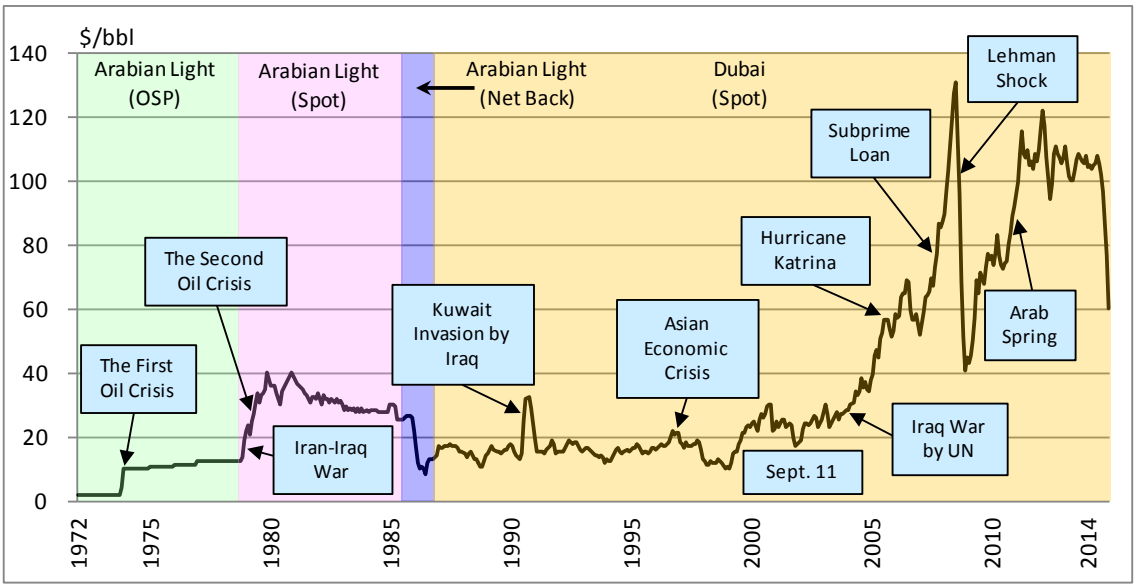
28, 2015. The plunge was the third sharpest in history after a 77% fall from $147/bbl to $33/bbl following the 2008 Lehman Shock and a 68% drop from $32/bbl to $10/bbl amid the 1986 reverse oil crisis. In May 2015, the West Texas Intermediate crude price rose back above $60/bbl due to actual slack growth and a projected decline in U.S. oil production. But this level was still far lower than a year earlier. As is well known, the oil price weakness is gravely serious for oil-producing countries that depend on oil revenue for national finance and economic management.

Then, this paper analyzes (1) how crude oil prices are predicted by oil-producing countries and major energy organizations to move in the future after the latest plunge, (2) what measures major oil-producing countries are about to take mainly for fiscal management in response to the predictions, and (3) what problems could emerge in the future as a result of these measures in oil-producing countries and the oil market.

Chapter 1 Crude oil price trend

1-1 Long-term trend (1972-2014)

Chart 1 Long-term crude oil price trend



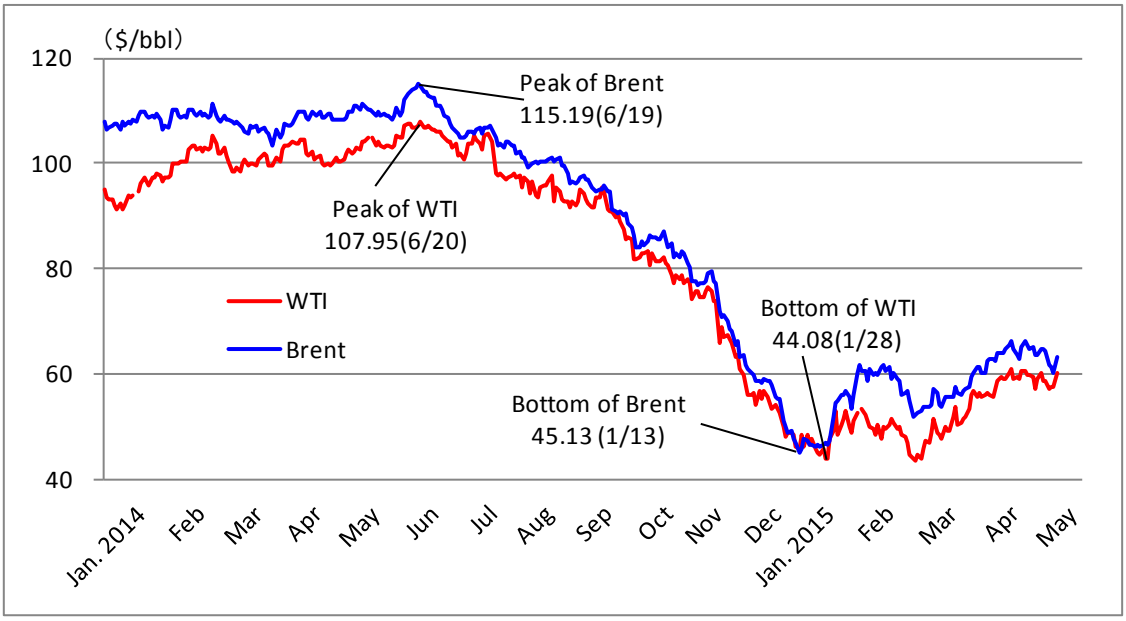
Source: Petroleum Association of Japan, "Petroleum Industry in Japan 2015"

Chart 1 indicates a long-term crude oil price trend between 1972 and 2014. The price soared from only $3/bbl in 1973 to $40/bbl in seven years due to the second oil crisis and the Iran-Iraq war and plunged from $30/bbl to $10/bbl through the 1986 reverse oil crisis. Later, the price repeated ups and downs on Iraq's invasion into Kuwait in August 1990, an economic slump amid the 1998 Asian economic crisis and the outbreak of the 2003 Iraq War. The 2008 Lehman Shock drove the crude oil price down by as much as 77% from $147/bbl to $33/bbl. But the price spiked later as Arab Spring democratic movements started in Tunisia in December 2010 and spread

to other countries, including Middle East oil-producing countries, triggering a psychological concern that the Middle East could become unable to export crude oil or natural gas (but actual navigation through the Suez Canal and the Hormuz Strait remained unaffected). The price remained around $100/bbl from 2011.

1-2 Short-term trend (January 2014-May 2015)

Chart 2 Short-term crude oil price trend



Source: EIA, "Spot Prices for Crude Oil and Petroleum Products"

Chart 2 indicates the trend of the West Texas Intermediate and Brent crude oil prices from the start of 2014. Until the middle of 2014, both prices remained around $100/bbl. But these prices began to decline rapidly in the middle of the year as a forecast that oil demand growth would slacken with a European economic slump affecting exports from China and other emerging countries was coupled with a prediction that a sharp increase in U.S. shale oil production and Iraq's recovery and comeback to the oil market could lead to a crude oil oversupply. Only in six months, the monthly average WTI price plunged from $108/bbl to $44/bbl.

In and after May 2014, Islamic State terrorists invaded major Iraqi oilfields. Security deterioration in Libya and Nigeria led to a decline in crude oil production. But OPEC's decision to refrain from cutting production at its general meeting in late November came as a decisive trigger of the crude oil futures market plunge.

The crude oil price rose from around $55/bbl to a 60-65/bbl range later as a forecast of a shale oil production cut amid a fall in the operating rate of oil drilling rigs in the United States and a prediction of an Iraqi production fall after the reported postponement or cancellation of crude oil production plans in 2015 were combined with an oil supply insecurity amid the tense Middle East

situation (including Libyan militants' attack on an oil terminal and Saudi Arabia's aerial bombing on Yemen) and a projection of oil demand growth after the sharp price drop.

1-3 Future prospects (over several years from 2015): forecasts by energy agencies and senior government officials

What are the factors and timings for oil prices' upturn as projected by energy agencies, OPEC and Middle East oil-producing countries? Some answers are seen in various releases and remarks by senior officials in oil-producing countries over the past several months.

(1) Saudi Arabia-led OPEC basically believes that the crude oil price plunge is attributable to 1) speculations, 2) global economic stagnation and 3) a substantial oil output expansion in the United States and other non-OPEC countries and that OPEC should not unilaterally reduce production unless non-OPEC countries cooperate in cutting output. The OPEC secretary general noted that the 2014 OPEC decision was not designed to exclude non-OPEC countries such as the United States and Russia.

(2) OPEC countries are not unified

- Saudi Arabia has no intention to implement OPEC's unilateral production cut or serve as a swing producer to help limit the crude oil price plunge.
- The United Arab Emirates, Kuwait and Qatar keep in step with Saudi Arabia.
- Iran has remained under a Western trade embargo due to its suspected nuclear weapons development and failed to utilize its full oil production capacity while total OPEC output has topped the overall quota of 30 million barrels per day. As crude oil prices were still falling under an oversupply, Iranian Oil Minister Bijan Namdar Zanganeh called for cutting total OPEC output by 5% for the purposes of keeping the global oil supply-demand balance and securing an Iranian quota for increasing production once the Western trade embargo is lifted[1]. At the June 5 OPEC general meeting, however, the oil cartel rejected the Iranian request and kept its overall production quota unchanged at 30 million bpd under the market share-securing policy adopted last November.
- Iraq has had difficulties in securing oil revenue for national finance due to the invasion by Islamic State militants and the weak crude oil prices and failed to proceed with oil development as earlier planned. It has wished to see an oil price recovery without expressing its stance.
- Venezuela and Nigeria, plagued with difficult fiscal conditions, have sought to cut production quotas to raise oil prices as the prolonged oil price weakness has deteriorated their economies.

(3) Arab OPEC members have agreed that OPEC's market share securing policy has pushed the crude oil market into a clear oversupply and that oil prices are unlikely to rapidly recover within

[1] Platt's Oilgram News, April 15, 2015

this year unless the oversupply is resolved. They expect that several months to several years could be required for resolving the oversupply. They believe that crude oil prices are unlikely to rise back to $100/bbl within 2015[2].

(4) The IEA secretary general pointed out that the crude oil market changed dramatically due to shale oil, differing from the past. As OPEC clarified its market share securing policy by deciding not to cut production in November 2014, U.S. shale oil was serving as a swing producer in place of OPEC, he noted[3].

(5) In its Annual Energy Outlook 2015 (AEO2015) released on April 14, 2015, the U.S. Energy Information Administration substantially lowered spot WTI and Brent price projections for the next decade from the previous levels released last year (Chart 3).
In its short-term outlook released on April 7, 2015, the EIA estimated that if Western economic sanctions on Iran were lifted to allow Iran to expand crude oil exports, the Brent crude price would fall by $5-15/bbl from $75/bbl in the reference scenario in 2016.

Chart 3 EIA-projected WTI and Brent prices

(Unit: $/bbl)

	Year 2020		Year 2025	
	AEO2014	AEO2015	AEO2014	AEO2015
WTI	94.57	73.00	106.99	85.00
Brent	96.57	79.00	108.99	91.00

Source: EIA, Annual Energy Outlook 2014/2015

While this paper refrains from analyzing any specific timing for crude oil prices' recovery or specific prices, energy agencies, OPEC and Middle East oil-producing countries forecast that crude oil prices would not rise substantially from the present levels (around $50/bbl for WTI as of April 2015) to around $100/bbl. The average price for 2015 is estimated at $60/bbl or lower.

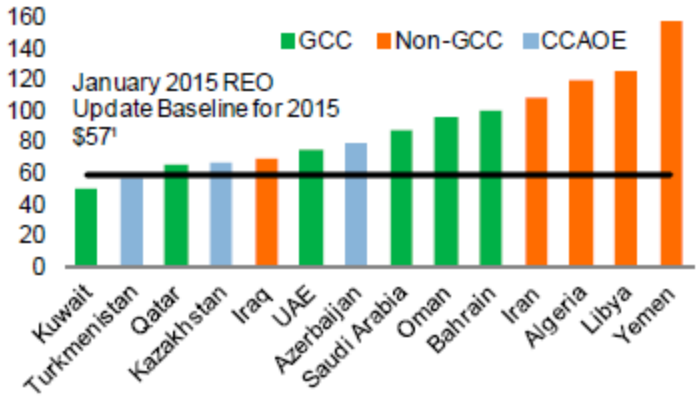
As a result, most oil-producing countries may have to tolerate crude oil prices to remain below levels meeting their past expenditure. Chart 4 indicates crude oil prices as estimated by the International Monetary Fund on January 21, 2015, to balance budgets for oil-producing countries. It shows that if the WTI, Brent and Dubai crude prices average $57/bbl in 2015, these prices would fail

[2] Remarks by leaders of Arab OPEC member countries are seen in Reuters, December 24, 2014; Reuters, January 7, 2015; Bloomberg, January 16, 2015; Platt's Oilgram News, January 22, 2015; Bloomberg, January 28, 2015; Bloomberg, March 9, 2015; Reuters, March 9, 2015; Bloomberg, March 23, 2015; Reuters, March 27, 2015.
[3] Jiji Press, February 11, 2015

to balance budgets in all oil-producing countries other than Kuwait.

Chart 4 Crude oil prices for balancing budgets in oil-producing countries

(Unit: $/bbl)



Source: IMF, Regional Economic Outlook Update, January 21, 2015

The IMF outlook indicates that unconventional oil producers must be prepared to see oil prices slipping far below their break-even levels.

Chart 5 Production costs for major crude oil brands (estimated)

(Unit: $/bbl)

Country	Cost	Field (Country)	Cost
Saudi Arabia	1.00-6.00	Bakken (USA)	56.00-61.00
Kuwait	3.00	Eagle Ford (USA)	46.00-53.00
Iran	5.00-20.00	Permian (USA)	57.00-60.00
Iraq	2.00-5.00	Oklahoma (USA)	91.00
Qatar	5.00-20.00	Barnett (USA)	93.00
UAE	5.00-10.00	Deep Sea (USA)	41.00-70.00
Libya / Algeria	9.00-11.00	North Sea	27.00-83.00
Angola / Nigeria	10.00-15.00	Russia	15.00-16.00
Venezuela	10.60-11.40	Brazil	11.50
Oman	10.00	Argentine	13.90
Egypt	9.00-11.00		

Source: PIW, March 16, 2015

Chart 5 indicates crude oil production cost estimates carried by Petroleum Intelligence Weekly on March 16, 2015. According to the estimates, production costs for U.S. shale oil, deep-sea oil and some of the North Sea oil produced by the United Kingdom and Norway would exceed sales

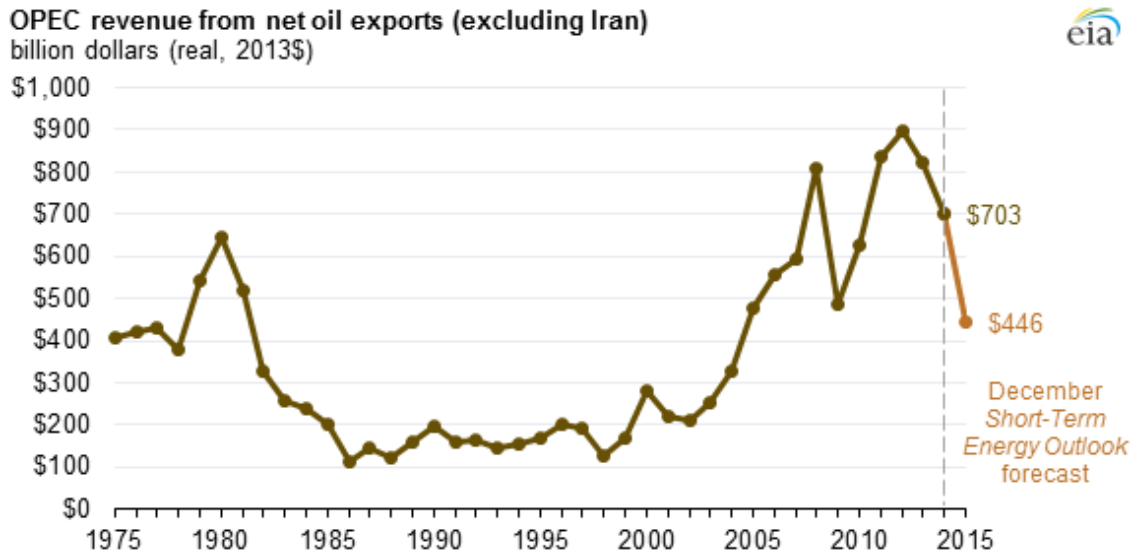
prices to cause negative margins if crude oil prices remain slack. Negative margins mean losses on production and sales and force producers to decide whether to cut costs or suspend production.

Since its general meeting in November 2014, OPEC has left market forces to determine crude oil prices. If financial and other non-supply/demand factors are excluded, the supply-demand balance may determine crude oil prices. This means that crude oil prices may fall if supply exceeds demand and may rise if supply slips below demand. If high-cost oil supply is required to expand to meet future demand growth, crude oil prices that settle at levels for the supply-demand equilibrium may rise in line with high production costs for unconventional and other marginal oil suppliers. If high-cost crude oil supply is large enough to influence crude oil prices in the international market despite such wide production cost gaps between conventional and unconventional oilfields, U.S. shale oil may be interpreted as having replaced OPEC oil to play a swing producer role, as noted by the IEA secretary general.

Chapter 2 Major Middle East oil-producing countries' budget, fiscal and economic responses

On December 17, 2014, the EIA announced estimated oil revenue in the OPEC countries excluding Iran, predicting that their oil revenue would fall from $821 billion in 2013 to $703 billion in 2014 and to $446 billion in 2015 if the benchmark Brent crude price stands at $109/bbl in 2013, $100/bbl in 2014 and $68/bbl in 2015. It concluded that most OPEC countries would take into account unstable economic trends, crude oil prices and production in reforming their national budgets in the future.

Chart 6 Actual and estimated oil revenue in OPEC countries excluding Iran



Source: EIA, Short-Term Energy Outlook, December 17, 2014

Under the environment, Middle East oil-producing countries have begun to take budget,

fiscal and economic responses to low oil prices (responses to oil prices expected to remain low and measures to overcome low oil prices). They have individually revised their 2015 budgets drafted in 2014 and taken expenditure reduction measures. They have also indicated attempts to cooperate with other OPEC and non-OPEC countries.

2-1 Saudi Arabia

Chart 7 Saudi Arabia's national budget

(Billion Saudi Rial)	Year 2013 (Actual)	Year 2014 (Budget)	Year 2014 (Estimate)	Year 2015 (Budget)
Revenue	1,130	855	1,046	715
Expenditure	925	855	1,100	860
Balance	205	0	−54	−145
Balance (Billion $)	54.7	0	−14.4	−38.7
(Oil Price)		$66/bbl*		$55-60/bbl*

Source: JIME, News Report, December 26, 2014

*: Estimated

Values other than those in yellow columns are denominated in the local currency.

In Saudi Arabia, the Ministry of Finance released the 2015 budget on December 25, 2014. Published data indicate that revenue in 2015 would plunge by 16% from the 2014 budget level and 32% from the 2014 estimate to $715 billion Saudi rial (hereinafter, referred to as SR). Saudi Arabia has traditionally assumed revenue based on safe-side oil price and export volume projections and adjusted expenditure according to actual revenue. As for 2015 alone, however, critics view the estimated revenue as ambitious. As usual, the Ministry of Finance has not released crude oil prices or exports assumed for the budget. Energy agencies estimate crude oil prices at $55-60/bbl and exports at 9.5-9.6 million bpd. There is no room for adjustment for 2015.

Remarkably, expenditure is planned to increase from the 2014 budget level despite the rapid crude oil price fall, although the increase is small. The Ministry of Finance explained that it positively and selectively gave priority to economic development projects, social welfare including subsidy, defense and assistance to allies, while the crude oil price fall made global economic growth difficult.

As a result, the 2015 budget envisages a deficit of 145 billion SR (about $38.7 billion). The Saudi government is expected to dip into reserves and overseas assets held by the Saudi Arabian Monetary Agency. SAMA reserves totaled $732 billion (including $545 billion in securities and $131 billion in overseas bank deposits) as of November 2014. In 2009, Saudi Arabia implemented overseas SAMA asset sales and other measures to cover a $12 billion budget deficit in 2009 just after crude oil prices plunged rapidly on the 2008 Lehman Shock.

Since the 2015 budget was released, the Saudi government has urged the people to reduce energy consumption by 20% (improve energy efficiency by 20%) by 2030. The energy consumption

reduction target was decided in 2012, but it failed to attract serious attention under high crude oil prices then. The energy consumption cut is estimated to produce an increase of 1.5 million bpd in surplus export capacity. In addition, the King Abdullah Petroleum Studies and Research Center has proposed to raise industrial fuel prices while leaving residential fuel prices unchanged, indicating that higher fuel prices would encourage the industry sector to expand renewable energy investment instead of inefficient equipment investment to bring about 2.1 billion bpd in crude oil consumption savings by 2032.

Under such environment, Saudi Aramco, which promotes Saudi oil and natural gas projects, signed a deal to take in $10 billion in commercial bank loans to expand oil refinery and petrochemical projects and enhance cooperation with Asian countries. Some of the amount is expected to cover a $4 billion loan repayment due at the end of 2015. Given that the recent crude oil price plunge has required spending to be saved and that lending rates have fallen due to an oil drilling rig oversupply emerging from a decline in ambitions to develop oil amid the oil price plunge, the company has reviewed rig contracts and switched to cheaper contracts (20% cheaper) and increased the number of rigs subject to contracts to 125 in March 2015 from 108 in October 2014.

2-2 Kuwait

Chart 8 Kuwait's national budget

(Million Kuwait Dinar)	Year 2014 (Budget)	Year 2015 (Budget)
Revenue	20,069.0	12,052.1
【Oil Revenue】	18,805.7	10,598.9
Expenditure	23,212.2	19,073.0
RFFG	5,017.3	1,205.2
Balance	-8,160.5	-8,226.1
Balance (Billion $)	-28.1	-28.3
(Oil Price)	$75/bbl	$45/bbl

Sources: MEES, January 16 and 30, 2015

Values other than those in yellow columns are denominated in the local currency

On January 26, 2015, the Kuwaiti cabinet approved the budget for FY2015 starting in July. Revenue in the budget is planned to plunge by 40% from the FY2014 budget level to 12.05 billion Kuwait dinars (hereinafter referred to as KD). The revenue decline emerges from the oil price plunge with crude oil exports estimated to remain unchanged from the previous year.

Expenditure is set to decline by 18% from the FY2014 budget level to 19.07 billion KD. At a regular cabinet meeting on November 10, 2014, the Amir Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah asked cabinet ministers to rationalize expenditure in response to the oil price plunge. On October 15, 2014, Development and Planning Minister Hind Al-Sabeeh announced a plan to reduce diesel and kerosene subsidies to raise the prices by more than 200% to 0.05 KD/liter for diesel and

0.17 KD/liter for kerosene. As a result, expenditure indicates a wage cut of 1.2 billion KD, a subsidy cut of 1.99 billion KD and other cuts totaling 960 million KD. But capital investment is planned to remain almost unchanged from the FY2014 budget level at 3.18 billion KD.

There are two key points regarding the FY2015 budget. First, the parliament approved a new five-year development plan starting in FY2015. It includes a great number of large-scale infrastructure and other development projects, calling for 34.15 billion KD. In the first year of the five-year plan, 521 projects will be implemented with investment totaling 6.6 billion KD. The FY2015 budget will provide 1.8 billion KD with the remaining 4.8 billion KD being shouldered by companies participating in these projects. Most of these projects are reportedly related to the oil industry, including a project to boost crude oil production capacity to 4 million bpd by 2020. Given that various projects were stalled under the previous plan from FY2014, project implementation in FY2015 is attracting attention.

The second point is the Reserve Fund for Future Generations (RFFG). Kuwait has set 10% or 25% of annual revenue to be put into the reserve fund. The government has chosen to earmark 10% of revenue in FY2015 for the fund after putting 25% of revenue into the fund in FY2014.

As a result, the FY2015 budget logs a deficit of 8.23 billion KD ($28.3 billion). But Kuwait as well as Saudi Arabia has a buffer to absorb such budget deficit. The Kuwait Investment Authority reportedly has more than $500 billion in assets that could be used to secure a certain level of expenditure despite a revenue fall caused by an oil price plunge and other events. The authority's buffer function is expected to work in FY2015.

2-3 Iran

Chart 9 Iran's national budget

(Trillion Iran Rial)	Year 2014 (Budget)	Year 2015 (Original Budget)	Year 2015 (Revised Budget)
Oil Revenue	778	710	537
Oil Revenue (Billion $)		31.0	24.1
General Budget	2,050	2,674	2,744
State Budget	5,880	5,967	5,706
Total	7,930	8,641	8,450
Subsidy	630	420	390
(Oil Price)	$100/bbl	$72/bbl	$40-50/bbl*

Sources: JIME, News Report December 8, 2014, and February 27, 2015; MEES, February 14, 2014, December12, 2014, and March 3, 2015

*: Estimated

Values other than those in yellow columns are denominated in the local currency.

In Iran, a national budget for the Iranian year 1394 (the year from March 21, 2015, hereinafter referred to as FY2015) was submitted to the parliament on December 7, 2014. The

budget assumed the crude oil price at $72/bbl, far more optimistic (failing to reflect realities) compared with market prices of less than $50/bbl for WTI and Brent crude brands. On January 15, 2015, the Iranian government revised the budget, assuming the crude oil price at $40/bbl closer to market prices. On January 27, the parliament decided to lower oil export revenue from 710 trillion Iranian rial (hereinafter referred to as IR) to 537 trillion IR. Iran does not put all oil export revenue into government revenue. Under the FY2015 budget, it plans to allot 14.5% of oil export revenue to National Iranian Oil Company (NIOC) and put 20% into the National Development Fund (NDF). Given that oil export volume has not been published, we cannot decide whether the revised FY2015 budget is really based on the crude oil price of $40/bbl. The budget approved at last on March 3 also has two key points. The first point is that the budget committee of the parliament decided in January 2015 to impose tax on Khatam al-Anbia, a general contractor under the umbrella of the Army of the Guardians of the Islamic Revolution that had been free from taxation.

The second point is that Iran began to eliminate cash benefits to wealthy people. The measure is in line with Management and Planning Organization head Mohammad Bagher Nobakht's remark on February 17 that the government would strictly handle careless benefits to those subject to cash benefits under Article 21 of the budget law for the previous year (FY2014). The elimination has started for overseas residents. The measure may be one of Iran's responses to falling oil revenue.

Iran has general and special accounts for expenditure. The general account, common to many countries, reportedly includes subsidies in Iran. The special account covers revenue and expenditure for government-related companies and banks, including NIOC. On February 16, Iranian Oil Minister Bijan Namdar Zanganeh requested that the NDF allot $4.8 billion to the Oil Ministry. But the parliament turned down the request. Instead, the parliament on February 27 decided to allow the NDF to spend $4.8 billion on the development of oil and natural gas fields neighboring Iraq and Qatar. The event indicates that financial conditions are severe even for the Oil Ministry that vowed in January 2015 to invest $15.2 billion to raise crude oil production capacity by 550,000 bpd. The NDF reportedly had financial resources worth $62 billion at the end of FY2014.

2-4 Iraq

Chart 10 Iraq's national budget

(Trillion Iraq Dinar)	Year 2015 (Original Budget)	Year 2015 (Revised Badget)	Year 2015 (Final Budget)
Revenue		99.8	94.0
【Oil Revenue】		84.0	78.6
Oil Revenue (Billion $)			65.1
Expenditure	141.0	123.0	119.1
【Current Expenditure】			77.1
【Capital Expenditure】			42.0
Balance		-23.2	-25.1
(Oil Price)	$85/bbl	$60/bbl	$56/bbl

Sources: MEES, January 16 and 30, 2015, February 6, 2015, and March 6, 2015; JIME, News Report, February 2 and 27, 2015

Values other than those in yellow columns are denominated in the local currency.

Iraq's 2014 budget failed to be enacted as the parliament came to a deadlock and was dissolved for a snap election. The 2015 budget was considered with the oil price assumed at $85/bbl in November and at $60/bbl in December. But the details were reconsidered frequently due to the uncertain fate of crude oil prices. Finally, the budget was enacted on January 29, 2015, with the oil price assumed at $56/bbl. Crude oil export volume is projected at 3.3 million bpd including 550,000 bpd from the Kurdish autonomous region. Oil revenue is planned at 78.6 trillion Iraqi dinars (hereinafter referred to as ID) and total revenue at 94 trillion ID.

Expenditure includes 77.1 trillion ID in current expenditure and 42 trillion ID (about $36 billion) in capital expenditure. After the enactment of the budget, the Iraqi Oil Ministry asked international oil companies engaged in oil development in Iraq on February 9 to postpone or cancel oil development operations planned in 2015 and cut or delay development cost and compensation payments under existing contracts. Furthermore, the oil and finance ministers met on March 11 and announced a plan to issue government bonds totaling $12 billion from March 2015 to raise funds for payments carried over from 2014 and those for 2015 to international oil companies.

An oil development consortium led by Russia's Gazprom, which had signed a service contract with Iraq to receive cash or crude oil in exchange for Badra oilfield development cost ($5.50/bbl), has chosen to receive crude oil from 2014. In April 2015, the consortium received 500,000 barrels in crude oil shipments from Ceyhan, Turkey.

While the crude oil price plunge substantially reduced oil revenue and affected oil development projects in Iraq, the oil minister stated on March 25 that the government would continue to pay subsidies for petroleum products. Private companies' gasoline sales prices stand at 1,000 ID per liter against the state-run price of 450 ID/l in Baghdad, at 900 ID/l against 650 ID/l in the North and at 1,200 ID/l against 700 ID/l in the Kurdish autonomous region, indicating that the state-run sales are still subsidized.

2-5 Others

(1) Qatar

Chart 11 Qatar's national budget

(Billion Qatar Rial)	Year 2014 (Budget)	Year 2015 (Budget)
Revenue	225.7	169.3
Expenditure	218.4	163.8
【Public Sector】	87.5	65.6
【Current Expenditure】	71.1	53.4
【Salaries & Pensions】	47.5	35.6
【Capiral Expenditure】	12.3	9.2
Balance	7.3	5.5
(Oil Price)	$65/bbl	$65/bbl

Source: MEES, March 27, 2015

On December 31, 2014, the cabinet decided to have the 2015 budget cover a special nine-month period between April and December. On March 22, 2015, the finance minister stated that the year 2014 saw a budget surplus of 100 billion Qatar rial (hereinafter referred to as QR, $27.5 billion) as crude oil prices exceeded the level assumed in the budget. The minister also noted that the government would implement large-scale investment in 2015 toward the 2022 FIFA World Cup tournament Qatar would host. The remarks by the finance minister indicated no tension in response to the oil price plunge. In April 2015, the IMF noted that while Qatari economic growth was undoubtedly expected to remain firm, the rapid crude oil price fall could lead the domestic payment balance to deteriorate. It thus indicated concern that Qatar could fall into a budget deficit in 2015.

(2) Oman

Chart 12 Oman's national budget

(Billion Oman Rial)	Year 2014 (Budget)	Year 2015 (Budget)
Revenue	11.7	11.6
【Oil & Gas Revenue】		9.2
Expenditure	13.5	14.1
【Current Expenditure】		9.6
【Capiral Expenditure】		3.2
【Subsidy】		1.1
Balance	-1.8	-2.5
(Oil Price)		$80/bbl*

Sources: JIME, News Report, January 5, 2015; MEES, January 15, 2015

*: Estimated

Oman's projection of the crude oil price at $80/bbl for 2015 is considerably optimistic. As measures to cover a budget deficit in 2015, the Ministry of Finance has cited transfer from a 2014 budget surplus (1 billion Oman rial (hereinafter referred to as OR)), withdrawal from national wealth

(700 million OR), domestic fundraising (400 million OR), assistance from abroad (200 million OR) and borrowing from abroad (200 million OR). If crude oil prices fail to reach the projected level of $80/bbl, Oman may adjust expenditure by postponing industrial and infrastructure investment, affecting energy investment including oil and gas development spending. In fact, the vice oil minister stated in early March 2015 that if oil prices remained at the current levels (below $50/bbl for WTI in early March), the government would have to consider shelving some of the oil and gas sector projects.

(3) Africa

Nigeria initially set the crude oil price assumption at $78/bbl and inevitably revised it downward later to $65/bbl and then to $52/bbl. It has also lowered the crude oil production assumption to 2.28 million bpd under the 2015 budget from 2.38 million bpd in 2014. As a result, the Nigerian government released a plan in early February to cut the state-run Nigerian National Petroleum Corporation's joint capital investment with international oil companies by 40% from the initial level of $13.5 billion to $8.1 billion.

In Angola on February 25, 2015, the parliament approved a budget revised to lower an oil revenue estimate in 2015 by $14 billion, with the oil price projection cut to $40/bbl from the initial level of $81/bbl. As a result, its state-run oil company Sonangol (Sociedade Nacional de Combustíveis de Angola) reduced capital investment in 2015 by 45% from the previous year to $5.55 billion. In Angola, an LNG plant has suspended operation since an accident that occurred in April 2014. The plant is planned to resume operation in mid-2015. But the weak crude oil prices are feared to cause shortages in funds for capital investment. France's Total, the operator of the LNG plant, has estimated losses on the suspension at $2.7 billion a year.

Meanwhile, Algeria drafted its 2015 budget in August 2014 and approved it on October 29. It has not revised the 2015 budget. Projecting the oil price for 2015 at the same as $37/bbl as estimated for 2014, it sets revenue at 4,685 billion Algerian dinar (hereinafter referred to as AD) ($59.3 billion), up 11.1% from the previous year, including 1,723 billion AD ($21.8 billion) in oil revenue accounting for 36.8% of the total revenue. Expenditure is planned at 8,858 billion AD ($112.1 billion), up 15.7% from the previous year, including 3,886 billion AD in capital investment, up 32.1%. As a result, the budget deficit increases by 21.4% from the previous year to 4,173 billion AD ($52.8 billion). Algeria has traditionally projected revenue (including oil revenue) at a far lower level than indicated by market oil prices in the budget and put income representing a gap between the projected and actual prices into the FRR (Fond de Regulation des Recettes) fund, which is used to cover any budget deficit. In the past, the actual oil price nearly tripled the projected level, allowing the fund to more than offset the deficit and bring about a surplus on a final settlement basis. As the gap is destined to become narrower to less than two times in 2015, the fund is expected to fall short of fully covering the budget deficit, resulting in a substantial deficit on a final settlement basis

for the year.

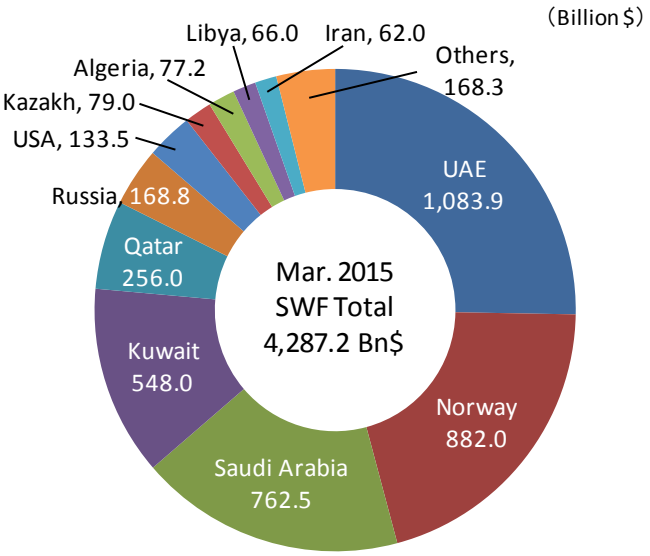
African countries have less foreign currency reserves and are expected to undergo severer impacts of the oil price plunge.

Chapter 3 Potential fiscal and financial problems

3-1 Limits on withdrawals from SWFs

All of the abovementioned countries, excluding Qatar that has formed a 2015 budget covering the April-December period, project budget deficits for 2015. Those with massive reserves and overseas assets are expected to cover deficits with minimum necessary withdrawals from reserves and proceeds from asset sales.

Chart 13 SWF sizes based on oil revenue



Source: Sovereign Wealth Fund Institute, SWF Ranking

Chart 13 indicates a country-by-country breakdown of sovereign wealth funds, or SWFs, engaging in overseas investment using oil revenue at the end of March 2015. SWFs had taken advantage of high crude oil prices above $100/bbl for expanding their financial resources and of investment for increasing their total assets. But their situation has changed. Based on the March 2015 SAMA report, the May 8 Middle East Economic Survey (MEES) reported that Saudi Arabia's foreign exchange reserves declined by some $50 billion from the peak of $746 billion in September 2014 to $698 billion at the end of March 2015. This means Saudi assets declined by about 7% in a half year after crude oil prices started the rapid decline. The decline is expected to continue while slowing down for the immediate future. This means that SWFs could not be used permanently to cover budget deficits.

SWFs' pullout of overseas investment made to invigorate the world economy would help the world economy stagnate, leading to a decline in energy demand (including oil and natural gas). For oil-producing countries, SWF withdrawals can serve as a double-edged sword that would rescue their economies while risking a global slump. From this viewpoint, they must combine SWF withdrawals with their expenditure curtailment.

3-2 Subsidy reduction and social unrest increase

As a domestic spending reduction measure, many oil-producing countries have adopted subsidy curtailment. Subsidies cover water, light, heat and fuel costs for all residents including foreigners and education, medical, domestic marriage and other costs for those other than foreigners. In some cases, subsidies take the form of real estate provision and are given on a grant-in-aid basis (where governments shoulder 100% of living costs). These countries basically have no concept of income, inhabitant or other taxes. Massive oil revenue has allowed these countries to provide robust social security.

In response to the “Arab Spring” democratic movements that spread in Middle East and African countries between 2010 and 2012, their governments expanded subsidies and public servant wages to help reduce antigovernment sentiment. But they have recently begun to gradually cut subsidies for water, light, heat and fuel costs. Subsidy cuts have so far had little impact on people’s daily life. If subsidy reduction or elimination accelerates, however, social unrest may increase, causing antigovernment demonstrations, making people vulnerable to solicitation by the Islamic State terrorist group and triggering antigovernment movements including terrorism. Such scenario is conceivable.

Given Islamic State terrorists’ history of taking control of oilfields or refineries and used oil revenue for their operations, oil-producing countries’ governments in the Middle East and Africa will have to compare savings from subsidy cuts with costs for measures to address terrorist attacks that could be triggered by citizens' discontent.

Instead of fearing subsidy cuts’ negative impacts including increased social unrest, however, these governments may draft policies to prevent citizens’ contributions from increasing on subsidy cuts. For example, Saudi Deputy Minister of Petroleum and Mineral Resources, Prince Abdykaziz bin Salman, stated that how to achieve energy conservation without changing fuel prices would be important. According to this idea, we can expect to see a virtuous cycle in which energy conservation will make progress to prevent energy prices from rising, with citizens’ contributions remaining unchanged, even if subsidies are cut or eliminated. If these governments secure financial

resources for exporting crude oil and petroleum products through subsidy cuts and energy conservation promotion, they may be able to promote various social security measures.

3-3 Development investment cuts and market share maintenance

In late January 2015, the OPEC secretary general and the IEA chief economist noted that cuts in oil and gas development investment were feared to have great impacts on the future. This notion apparently has three implications. First, insufficient supply-side investment could affect the future supply-demand balance and bring about a rapid hike in energy (particularly oil and natural gas) prices by leading supply to fall short of catching up with oil demand recovery. Second, unconventional oil and gas production that becomes profitable on a rapid energy price hike could increase, making it difficult for OPEC to recover its share of total oil supply. Third, renewable and other non-fossil energy sources could enhance their price competitiveness, leading to an acceleration in the decline of oil's share of total energy consumption.

At a time when crude oil prices are unlikely to rapidly rally, it is difficult for oil-producing countries to invest robust funds in oil development while securing revenue and cutting expenditure. But the world is destined to continue dependence on oil and natural gas supply as global population and energy demand increase steadily. Therefore, oil-producing countries may have to proceed with systematic, steady investment in oil development that consumes massive time and cost.

Among Middle East oil-producing countries, Iraq asked international oil companies in February 2015 to postpone or suspend oil development operations planned this year, or reduce or delay development costs or income. Iraq is plagued with a mountain of problems including not only the substantial drop in revenue under the crude oil price plunge but also the sharp decline in oil exports through Islamic State militants' occupation of oilfields and refineries and their destruction of crude oil pipelines, and the central government's relationship with the Kurdish autonomous government. It also lacks abundant foreign currency reserves and any sovereign wealth fund with overseas assets that exist in other oil-producing countries. (Iraq has the Development Fund for Iraq that is limited to only $18 billion.) Therefore, the latest crude oil price plunge is expected to exert great impacts on its finance and future crude oil development.

Other Middle East oil-producing countries are now proceeding with oil development in line with their respective crude oil production capacity expansion plans. In the United Arab Emirates, particularly, a plan to increase crude oil production capacity from 1.6 million bpd at present to 1.8 million bpd is gaining momentum as the renewal of the ADCO (Abu Dhabi Company for Onshore Oil Operations) concession following its expiration in January 2014 is gradually making progress. In January 2015, France's Total obtained a 10% participating interest in the ADCO concession. Japan's

Inpex (whose subsidiary Japan Oil Development Co., or Jodco, undertakes oil development off Abu Dhabi) acquired a 5% interest in April and South Korea's GS Energy (backed by Korea National Oil Corporation, or KNOC) won a 3% interest in May.

Future key means for oil-producing countries to maintain oil export capacity include not only securing production capacity but also reducing domestic wasteful energy use to increase exports and promoting non oil & gas energy including renewable, nuclear or coal.

Contact: report@tky.ieej.or.jp