Here comes 2022:

MENA energy investments to grow despite volatility.

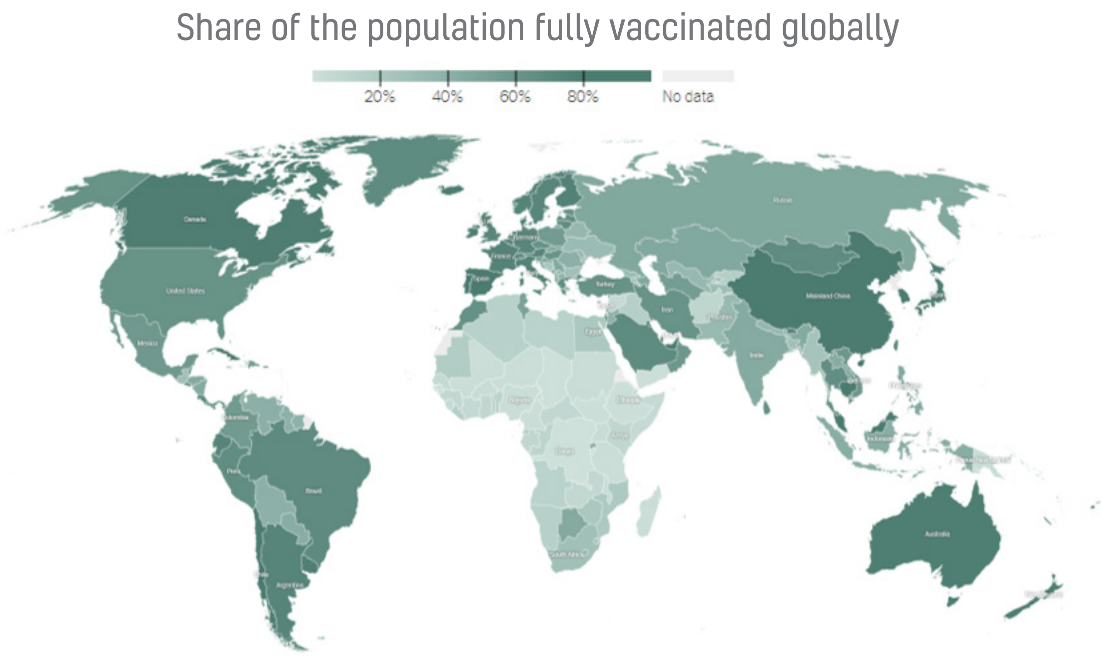
February 2022

Although 2021 was a tumultuous year with bouts of volatility in the trifecta of the health, economic and financial fronts, we enter the year of 2022 expecting that it will be no less of a rollercoaster as several uncertainties loom. On the health front, new variants are expected to emerge as the virus mutates while the viral spread may be shifting from 'pandemic' to 'endemic'. On the economic front, public debts and inflation rates are at a record high, with fiscal austerity measures anticipated to cool off the market overheating and restraint commodity prices. The energy investments in MENA are expected to be revived, supported by elevated oil and gas prices that will persist during 2022. As for the energy transition journey, all eyes will be on Egypt this November as it hosts the COP27 summit.

New variants of COVID-19 will weigh down on the economic recovery.

Two years into the COVID-19 pandemic, and the world is back into a full circle fighting off new variants with mobility and travel restrictions re-imposed in several countries. The latest 'Omicron' variant was reported to the World Health Organization (WHO) in November 2021 after it was first detected in South Africa. The only data known so far is that it spreads more easily but with less severity on vaccinated individuals. At the time of writing, scientists are now tracking a rise in cases caused by a new variant termed BA.2, which is starting to spread in parts of Europe and Asia.

With global vaccine inequity, new variants will keep emerging. As of December 2021, only 7.5% of Africa — a continent of 1.3 billion people — is fully vaccinated. In addition, the 'herd' immunity hypothesis turned out to be relatively dubious as immunity levels taper off after some time, and hence booster shots are frequently needed.

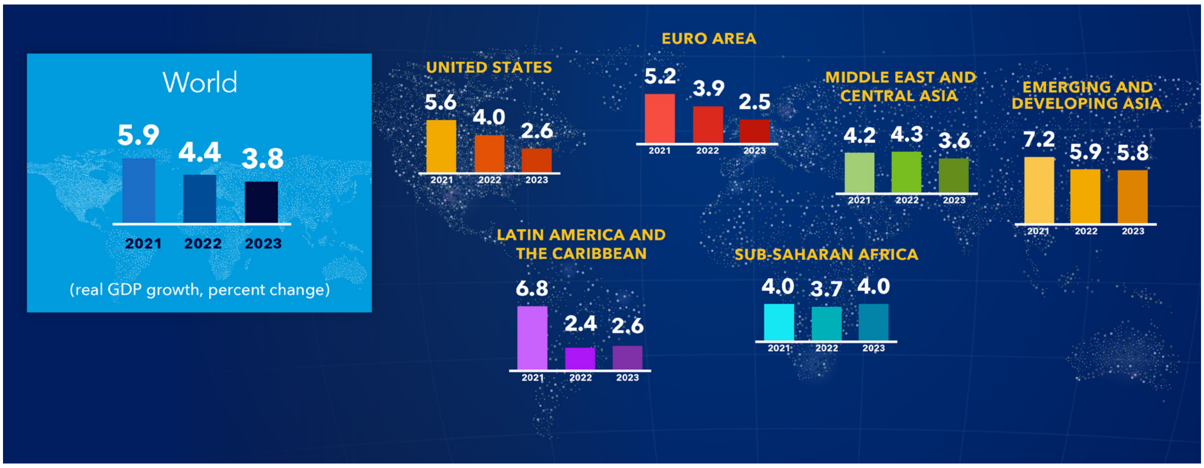


Source: The New York Times, January 2022

Governments are caught in a dilemma between easing societal measures to boost economic growth, and risking the spread of new variants – thus building pressure on the healthcare systems. With countries emerging from renewed lockdowns, such as Morocco, Austria and the Netherlands, other countries are considering the option due to the rapid surge in cases. Although this global déjà vu might occur more than once during 2022, the world will not be caught off guard as nations are much more prepared to fight off new variants.

The latest surge in cases globally will continue to weigh down on global trade, supply chains and services, while sporadically disrupting international travel and tourism which will leave a dent in the economic growth during 2022. This prompted a slight downward revision of the 2022 GDP growth forecasts by the IMF and we still expect the global economic recovery to be asymmetric, K-shaped and not necessarily sustainable for all countries.

Growth projections by region (% change)



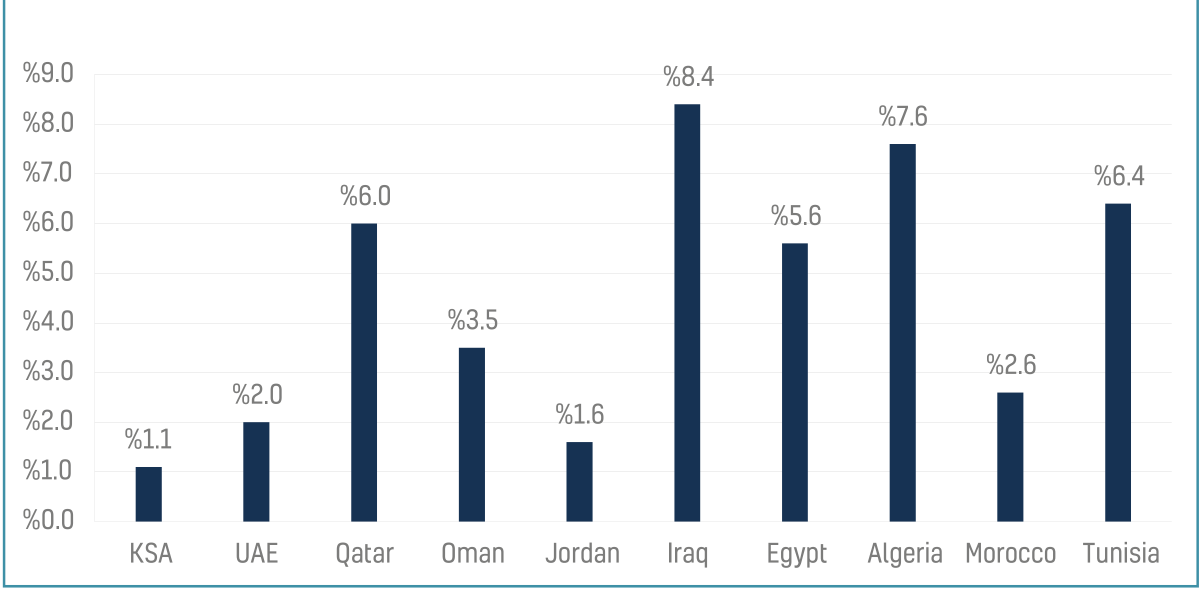
Source: International Monetary Fund, "World Economic Outlook", January 2022.

Fiscal austerity measures will be taken to curb soaring inflation rates.

The Quantitative Easing (QE) monetary policy taken by the Fed led to soaring inflation rates and record-high public debts as a result of the fiscal stimulus packages deployed to boost the economic recovery. Although the markets ended 2021 with high returns (the S&P500 index ended 2021 with a 27% end-year return), inflation rates increased accompanied by a modest recovery in labor markets and soaring commodity prices. As of January 2022, almost all global financial markets experienced a retreat towards a bearish mode while experiencing a dip in prices. The markets are clearly registering the geopolitical risk premiums and the possibility of several hikes in interest rates.

A fear of stagflation looms as fiscal stimulus packages are withdrawn, asset purchasing programs are being tapered and interest rates are to be hiked. The economic recovery will slow down, but the lagging unemployment rates will remain relatively high amid a simmering inflationary cycle that turned out not to be transitory after all.

Reported 2021 MENA Countries Inflation Rates (%)



Source: APICORP, data adapted from the International Monetary Fund.

2022 will be a year of transition from active fiscal stimulus to fiscal restraint aimed at stabilizing or reducing debt burdens. This transition will begin with the withdrawal of emergency support measures and will lead to more deliberate fiscal rebalancing that will play out in 2023 and beyond.

Worldwide, the public sector deficit is projected to shrink by about USD 2 trillion, from USD 6 trillion in 2021 to USD 4 trillion in 2022. As the share of GDP, the global fiscal deficit will decrease from a high of about 10% in 2020 to 6.5% in 2021 and 4% in 2022. This exceeds the pre-pandemic norm of about 3% of GDP where we expect that fiscal rebalancing will continue well beyond 2022.

Central banks are expected to start gradually increasing interest rates in 2022 where the Fed is expected to taper asset purchases and increase interest rates starting from March – between four to seven times during 2022 – in an attempt to stave off soaring inflation. Although inflation rates might fall, there will likely be persistent underlying pressure on prices due to tight labor markets and increase in wages.

Many countries have used the favorable market conditions and the very open recent financing environment to lock in longer maturities and to manage their liabilities, reducing near-term capital repayments. Official bodies like the IMF also appear more flexible in this cycle and less demanding regarding near-term fiscal austerity than perhaps in previous cycles.

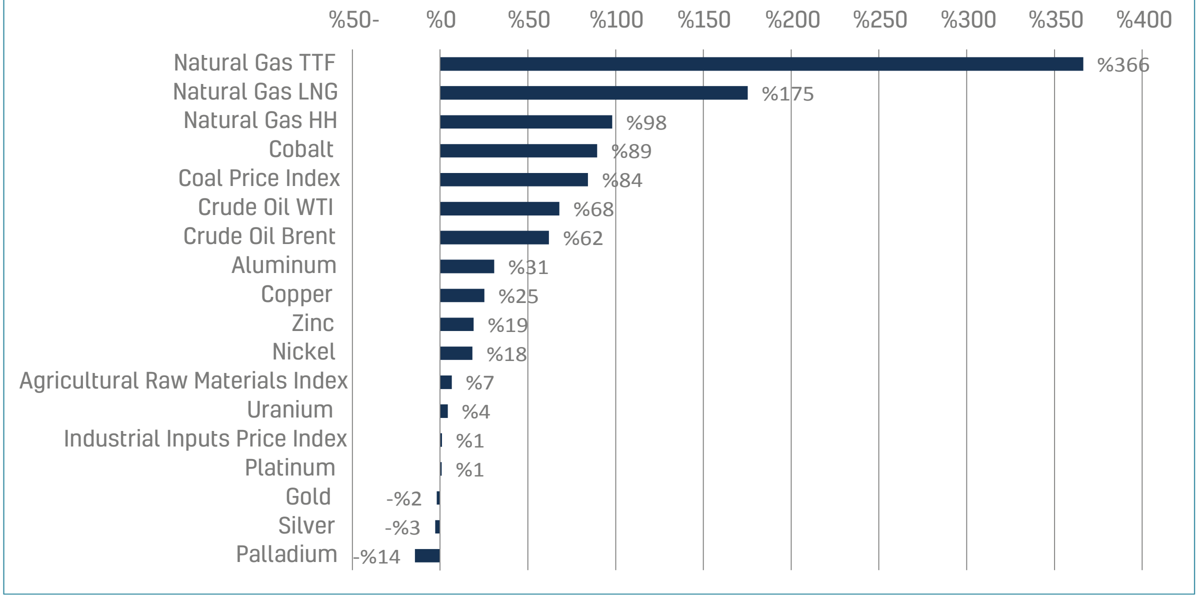
Volatility in commodity prices will prevail with uncertainty looming in energy markets.

Although commodity prices enjoyed a modest and un-even correction during 2021, it will take time for this change to migrate downstream and cost pressures to ease during 2022.

Energy markets are naturally price-inelastic and thus volatile due to their basic nature of necessity and the lack of fuel substitutes. Volatility in commodity markets will persist in 2022 as they grapple with the effects of the pandemic, uncertainty over macroeconomic policy, and supply chain disruptions.

Although the energy markets have been a source of inflation this past summer, they are expected to relatively stabilise during 2022 with increases in oil production by OPEC+, non-OPEC countries, and increased gas production and LNG supply. The ability of OPEC+members to abide by the 400,000 b/d target increase to reach pre-pandemic levels by mid-year will be under the lens. This is mainly due to lower output due to historically low upstream E&P investments over the past years. Brent is expected to experience bouts of sharp volatility due to tight energy markets, before stablising between USD 65/bbl. and USD 75/bbl. As for gas, the JKM and TTF/NBP hub prices in Asia and Europe are expected to cool down below the all-time highs of 2021, especially after the winter season.

Commodity % price change in 2021 as compared to 2020



Source: APICORP, data adapted from the International Monetary Fund.

Energy investments in MENA will be supported by elevated oil and gas prices.

APICORP's *MENA Energy Investment Outlook* for the period 2021-2025 (published in Q2 2021) registered a modest increase of just USD 13 billion over last year's 5-yr outlook – from USD 792 billion to USD 805 billion – a clear indication of the magnitude of the 2020 crisis' impact across MENA despite the region's relative resilience. 2021 witnessed revived investments in the energy sector in MENA supported by robust O&G prices, which triggered a chance to return to pre-pandemic activity. As of 2022, we expect energy investments in MENA to register growth for the upcoming 5-years supported by elevated oil and gas prices.

A small decline was registered in MENA's committed oil and gas investments between 2021 and 2025 after the peak growth witnessed in 2020 due to the completion of several megaprojects. However, the overall outlook looks solid with an upside in planned investments, hinging mainly on unconventional gas developments and upstream investments across the region.

For petrochemicals, the drive for further integration and rationalization will continue. Reconfigurable petrochemical plants shifted to high-margin products during the pandemic (e.g., plastic packaging films and healthcare and hygiene products). Despite the region's strong appetite for directing more funds to petrochemicals, especially for planned commitments, it makes more sense under current market conditions to focus on enhancing cost and operating efficiencies rather than absolute expansion – thus to favor brownfield vs. greenfield projects.

Power sector investments in MENA are expected to continue to thrive, characterized by an accelerating shift towards renewables. Collectively, the region is expected to add nearly 20 GW of solar power over the next five years. However, given the intermittency of renewables and the lack of utility-scale grid storage solutions to date, fossil fuels and nuclear will remain indispensable in the power supply mix in the foreseeable future.

The combination of low-cost gas resources and renewable energy positions the MENA region as a strong candidate for becoming a major hydrogen-exporting region, whether it be blue or green. Few countries have taken measurable steps to position themselves as low-cost exporters of blue and green hydrogen, in addition to net-zero ammonia and other low-carbon products. We expect more strategic partnerships and hydrogen policies and roadmaps to be announced in 2022 as the MENA region aims to leverage its competitive advantage in the hydrogen ecosystem and secure market shares early on.

The energy transition journey will be tinted with mixed policy signals.

Rewiring a global economy that is almost 80% fueled by fossil fuels will be an extremely complex and costly mission - and it will take time. The delicate balance between emissions reduction, energy affordability, and energy security requires comprehensive and sustainable policies. Focusing on only one of these factors may lead to unintended consequences such as market distortions, heightened volatility, and energy shortfalls. Available data indicate a continuous global increase in demand for oil and gas. For instance, the demand for oil increased in a short period during recovery where the overall oil demand neared its pre-pandemic levels (around 95-100 million barrels per day), despite the price increase to around USD 85-90 per barrel.

The latest energy supply crunches amid demand recovery exposed the vulnerabilities of underinvesting in the upstream oil and gas sector – reaching a record low in 2020 with a slight uptick in 2021. The world needs, and will need, to maintain a healthy level of O&G capacity – while decarbonizing the existing O&G production - and investing in clean and new forms of energy. There are concerns that a supply crunch and a consequent energy crisis will be imminent by the end of this decade if investments in conventional energy do not return to pre-pandemic levels. Carbon capture and storage (CCUs) will be a key technology – globally and in the MENA region – to decarbonise oil and gas assets and ensure countries remain on the path towards net zero.

After the COP26 summit held in Glasgow in November 2021, there is a global consensus that our future shall be low-carbon. Although the 'what' is well defined, the 'how' remains debatable. Every country will chart its path as a function of energy security, level of socioeconomic development, financial capabilities and inherent energy mix.

As a direct result of COP26, we expect the focus to shift to assuring a sustainable energy transition for all nations ('SE4ALL') – with the UN SDGs in mind - and on how the required financing will be mobilized (the main task for the UN Glasgow Financial Alliance for Net Zero – 'GFANZ'). We also expect the 'Emissions Trading Schemes' (ETS) and voluntary carbon trading to substantially increase in volume from 2022 and beyond, as a result of the activation of Article 6 of the Paris Agreement.

As for the upcoming COP27 summit, the work has already started as several key decisions that were supposed to be taken at COP26 were postponed. The COP26 produced substantial progress on cutting greenhouse gas emissions, but the national carbon targets laid out fell far short of the near-halving of emissions required to stay within 1.5°C of pre-industrial levels. Recognizing that, nations agreed to review their targets before they convene this November.

The COP27 summit will underscore the sustainability aspect of the energy transition from the developing nations' perspectives - including MENA - which have been calling for a more 'inclusive' energy transition. Six years after COP21, Africa is still waiting for the materialization of the commitment made by developed countries to finance up to USD 100bn per year to mitigate global warming in developing nations. With only about 4% of greenhouse gas emissions, Africa would not want to pay this hefty price on its own.

We expect the focus at COP27 to be in areas such as climate financing, adaptation, and loss and damage, to keep pace with the progress that the world hopes to achieve in mitigation and carbon neutrality efforts. Governments will be under pressure to act on their pledges from COP26 as the momentum builds ahead of the summit next November.