October 2019

Aktia

Middle East: Oman, Egypt, Saudi Arabia & Lebanon

Trip Notes

We visited Muscat, Riyadh, Cairo and Beirut during six days in October, where we met with representatives from central banks, governments, supranational organisations, international financial institutions, academia, corporations, commercial banks and local investors.

Oman, Egypt, Saudi Arabia & Lebanon

▶ It was an appropriate time to visit the region as the recent drone attacks showed the vulnerabilities in global oil supply chains and as geopolitical uncertainty has risen in the region generally with the changes in the balance of power in Syria and the reheating conflict with Iran against Saudi Arabia and the US. Turkey's invasion of northern Syria during the trip functioned as a reminder of the tangibility of geopolitics in the region. Geopolitics and the security situation were an omnipresent worry and quoted as the main risk in all four countries. The base case was that the conflict between Iran and the Saudi-led coalition would not, but the biggest realistic risk was considered to be that oil supply would decrease massively as a result of to the conflict.

▶ Geopolitical realities in the Middle-East have changed since the US is set to become a net oil exporter in the near future, and US incentives to remain a guarantor of security have diminished. It is possible that the region will start looking for new partners, where the large oil-importers of Asia (China or India) could play an increasingly important role. The importance of the US has not been limited to security, as for example all countries except Egypt have currencies pegged to the dollar. These economies have by and large benefitted from stable currencies, but the utility of a dollar peg might decrease with diminishing US oil purchases.

▶ The decrease in oil prices from sustained high levels five years ago has compelled changes in government budgets and social structures alike, throughout the region, as also oil importers have been hit through more uncertain remittances and budget support from oil rich countries. Some countries, like Saudi Arabia, have managed to be proactive during this structural change whereas others, like Oman, have yet to start reforms. We met with several very motivated, competent and pragmatic technocrats in each country. Authorities in all of these four countries seem to have the competence for executing reforms, but the political will and possibilities for change varies within the region, as the authorities face very different political realities.

Oman

	2014	2015	2016	2017	2018	2019F	2020F
Real GDP (%, end of period)	1.4	4.7	4.9	0.3	1.8	0.0	3.7
Inflation (%, end of period)	1.0	0.1	1.1	1.6	0.9	0.8	1.8
GDP Per Capita (USD)	21814	18244	16332	17045	18970	17791	17723
Current Account Balance (% of GDP)	5.2	-15.9	-19.1	-15.6	-5.5	-7.2	-8.0
General gov. financial balance (% of GDP)	-1.1	-15.9	-21.2	-12.9	-8.1	-9.4	-8.0
General Government Gross Debt (% of GDP)	4.9	15.5	32.7	46.4	53.4	59.9	63.9
Population (million)	3.7	3.8	4.0	4.1	4.2	4.3	4.4

Saudi Arabia

	2014	2015	2016	2017	2018	2019F	2020F
Real GDP (%, end of period)	3.7	4.1	1.7	-0.7	2.4	0.2	2.2
Inflation (%, end of period)	1.9	1.3	1.2	-1.1	2.3	-1.1	2.2
GDP Per Capita (USD,)	24929	21063	20289	21114	23539	22865	22533
Current Account Balance (% of GDP)	9.8	-8.7	-3.7	1.5	9.2	4.4	1.5
General gov. financial balance (% of GDP)	-3.5	-15.8	-12.9	-9.2	-5.9	-5.5	-6.7
General Government Gross Debt (% of GDP)	1.6	5.8	13.1	17.2	19.0	23.2	28.4
Population (million)	30.3	31.1	31.8	32.6	33.4	34.1	34.8

Egypt

	2014	2015	2016	2017	2018	2019F	2020F
Real GDP (%, end of period)	2.9	4.4	4.3	4.1	5.3	5.5	5.9
Inflation (%, end of period)	8.2	11.4	14.0	29.8	14.4	9.4	8.7
GDP Per Capita (USD,)	3524	3731	3686	2495	2573	3047	3478
Current Account Balance (% of GDP)	-0.9	-3.7	-6.0	-6.1	-2.4	-3.1	-2.8
General gov. financial balance (% of GDP)	-12.0	-11.6	-12.0	-10.4	-9.5	-8.4	-7.5
General Government Gross Debt (% of GDP)	85.1	88.5	96.8	103.2	92.7	84.9	83.8
Population (million)	86.7	89.0	90.2	94.8	97.0	99.2	101.5

Lebanon

	2014	2015	2016	2017	2018	2019F	2020F
Real GDP (%, end of period)	1.9	0.4	1.6	0.6	0.3	0.2	0.9
Inflation (%, end of period)	-0.7	-3.4	3.1	5.0	4.0	3.4	2.4
GDP Per Capita (USD)	8619	8540	8530	8778	9251	9655	10043
Current Account Balance (% of GDP)	-28.2	-19.3	-23.1	-25.9	-25.6	-26.4	-26.3
General gov. financial balance (% of GDP)	-6.2	-9.1	-9.4	-7.0	-11.2	-9.5	-8.7
General Government Gross Debt (% of GDP)	137.8	140.7	146.1	149.0	151.0	155.1	161.8
Population	5.6	5.9	6.0	6.1	6.1	6.1	6.0

Sources: IMF WEO and Moody's

Oman

- We are currently not invested in Oman's external debt. The country has been on a steady path towards weaker credit metrics for several years, and we are not prepared to invest in the hard currency bonds before we see concrete fiscal reforms, even though current spreads already reflect further deterioration.
- Local currency investments are currently not attractive in our opinion. Rates are low as monetary policy follows the Fed, due to the currency peg to the US dollar.

The situation in Oman hasn't significantly changed since our visit last year. The government has not managed to bring down fiscal deficits and external liabilities have continued to grow due to this. There is much talk of reforms, but these have so far mostly remained on the drawing board. The uncertainty around the successor of Sultan Qaboos remains, further weighing on the reform momentum.

Growth has been muted in 2019 but is expected to pick up in 2020 (expectation of 2.8% by Moody's) with especially mining and tourism expected to contribute, e.g. hotel revenue growth was 12% YoY in June. Even though the authorities have plans to diversify away from oil and gas, hydrocarbons still account for one third of GDP and 65% of merchandise exports. The authorities expect oil production to grow and lifting costs to go down by USD 3 in the next three years. The problem is that the country does not have reserves like its richer neighbours; oil and gas reserves currently cover only around 15 years of production. The private sector still suffers from too high public sector compensation and serious rigidities in the labour market; it is still very difficult discharging Omani nationals. Apart from tourism, future growth will be driven e.g. by two very large-scale projects: the Duqm refinery (where Kuwait is a large investor) and Liwa Plastics, a huge petrochemicals project (completion pushed forward from 2020 to 2021). The hope is that these will accelerate the creation of further downstream industries. Future possible growth sectors could include fisheries and aquaculture and mining (mostly iron ore, in the explorative phase). China has promised USD 10 billion of FDI, so far USD 400 million has been invested. The current account deficit is seen to continue growing as oil production eventually will go down, although much of the deficit is due to outward flowing remittances, which would also decrease at the same time.

The largest problem in Oman from an investor point of view remains the very slow fiscal consolidation. We understand that the authorities have not taken firm action due to worries about further popular unrest and that action would have to wait for clarity on the succession. When we last visited Oman the VAT-reform was expected in 2020, now it had been postponed to 2021, with the explanation that they do not want to make operative mistakes and are consulting different sectors. The VAT-reform should improve the fiscal balance with 1.5% of GDP and the authorities have agreed with the IMF that the reform will be implemented. So far however, most of fiscal improvements are due to higher oil prices, as around 70% of government revenues still derive from the energy sector, with a budget break-even oil price of USD 90. There are plans of a wider budget consolidation and a national committee for fiscal balance with very senior people has been formed to come with a recommendation for a medium-term fiscal strategy, which is much needed. A comprehensive and credible plan, followed by actual implementation, to address the fiscal situation is needed, as government debt is estimated to exceed 60% by 2020 (it was 15.5% in 2015), which should still be sustainable, but it is the direction and lack of actual consolidation that is worrying. Sovereign owned enterprises have a debt load of around 25% of GDP on top of this, and e.g. Oman Air has plans to borrow USD 3 billion in the coming years, so contingent liabilities are rising. However, on the other side of the balance sheet, the sovereign wealth fund has assets of 42% of GDP (though their liquidity is unclear). The government has started to patch the budget with privatisations like the sale of a 10% stake of the Khazzan field and there are plans for privatisation in the electricity sector. Eventually, though, the budget needs to be adjusted. The government wage bill is large, even by Gulf Cooperation Council (GCC) standards, as around 60% of Omani nationals are employed by the government. There were efforts to limit the costs through a hiring and bonus freeze, but these were annulled with a royal decree. One concrete action the government should take is the publication of the IMF Article IV-report, which we strongly encouraged them to proceed with, in order to start rebuilding investor confidence and increase transparency. There seems to be a firm belief in the country that their GCC-neighbours would help Oman if there would be a crisis, like in Bahrain. We think that this help would not be unconditional, and Oman's trade with Iran and its regional neutrality would be at risk.

The Omani rial peg is still considered to be useful for Oman by the IMF. The peg is not as strong as the other GCC-pegs but is rather similar to Bahrain before the GCC-bailout, where the peg was tested a few times before a bailout. The central bank has even stress tested bank balance sheets with a 10% deprecation of the rial, so there are actual worries about the sustainability of the peg, should the external imbalances be protracted. The central bank still has net reserves of five months of imports, with a target to remain above three, and a plan to act if reserves go below four months. Gross reserves decreased by USD 1 billion to 16 billion during the first six months of 2019, so the depletion rate is worryingly high.

"The government has not managed to bring down fiscal deficits and external liabilities have continued to grow"

Saudi Arabia

- Saudi Arabia is in an early stage of its reforms and there are crucial political, social and economic reforms that need to be implemented. However, the reform momentum is credible and many changes have been implemented. We are positive on the external debt and have increased our investments after the trip.
- Local currency investments are similar to other GCC-countries and currently not attractive in our opinion. We are, however, following the development of the local market.

Saudi Arabia is the largest economy and has the largest population of the GCC-countries. The economy has been and is still very oil driven, but lower oil prices have rendered the old social contract with government subsidies coupled with social control unsustainable. Lower oil prices have thus generated a need for reforming not just the economy, but the country as a whole. Locals claimed that the whole country is on “reform-steroids” and aligning itself to Vision 2030, the Saudi reform package. Our meetings indicated that there was definitely much truth to this hyperbole.

There was a general agreement that Vision 2030 will never be fully achieved, but the direction is the correct one, all government capital expenditure is geared towards these goals and that a rise in oil prices would not slow down reforms, but even speed them up. Key objectives for the reforms include increasing women’s participation rate in the workforce, facilitate SME-lending in order to diversify the economy, increase renewable electricity generation and reforming the legal system to attract further foreign direct investments. The education budget has been doubled since 2010 and we’ve also understood that control of corruption and government effectiveness is improving, e.g. reforms are followed through KPI’s down to every ministry employee. The pace of the reforms has been staggering with more changes in the last 18 months than previous 40 years, and the speed of the social changes were marvelled at in all meetings, e.g. how quickly Saudis have accepted lower-paid private sector jobs (expats have left due to Saudization efforts) and the relaxation of the social code, which is a part of the vision to diversify into the tourism sector. Job creation and opening up the country are important, as 70% of the population are under 30 years old. Demographics are beneficial for long-term growth and the private sector is expected to drive also near-term growth, while the oil-sector will be a drag (even if large LNG-projects are planned for 2020) due to the OPEC+ agreement limiting output, expected to stay in place in 2020.

The fiscal deficit has been brought down from over -15% of GDP in 2015 to Moody’s expecting -5.5% for 2019. We understood more expenditure reforms will soon follow. Electricity subsidies have been cut heavily, leading to decreased demand. However, electricity is still heavily subsidised indirectly, as the electricity monopoly, SEC, has access to interest-free loans and does not pay a market price for fuel. SEC uses an 400 million barrels equivalent of oil yearly in electricity generation (of which about 45% is oil) and buys this at close to the production cost, meaning that the subsidy is still almost half of the budget deficit. Efficiency improvements during the last three years has amounted to 60 million barrels already, and further improvements will mean fiscal savings and more potential exports.

”Key objectives for the reforms include increasing women’s participation rate in the workforce, facilitate SME-lending in order to diversify the economy, increase renewable electricity generation and reforming the legal system to attract further foreign direct investments”

Saudi Arabia

Saudi Arabia is still doing most of the heavy lifting in the OPEC+ production limits. Saudi Arabia was producing 9.3 million barrels per day (mbpd) before the drone attacks, well below their quota of 10.3 mbpd. Maximum production would be 12 mbpd, which could be sustained for 12 months with a three month ramp up period.

The Saudi balance sheet is still a "fortress", regardless of several years of fiscal deficits. The net sovereign debt is still a negative 18% of GDP, the net international investment position is about the size of the GDP and FX-reserves are around 60% of GDP. The Saudi riyal is pegged to the USD, a natural peg as their income stream is also pegged (oil is sold in dollars). The IMF is also of the opinion that the peg has a positive net effect. The government fully owns and is planning to IPO a part of Saudi Aramco, the world's most profitable company, and according to several people we spoke with it is "the best managed oil operation in the world".

The IMF signals that the mortgage market has grown quickly and might present a risk down the road. Home ownership has traditionally been very low, and the mortgage market is hence fairly new. Boosting home ownership is part of the authorities' 2030 goals, and lower income families' purchases are currently subsidies by the government, new mortgage products are appearing, so there are clearly risks of overheating. Currently risks are still low, as risk-weights for mortgages are 50% (foreclosure is still very difficult socially, so a high risk weight is sensible), banks are well capitalised, have been stress-tested recently and have access to low cost funding due to none-interest bearing deposits due to Sharia. One worry is, however, that the authorities' Vision 2030 will trump the central bank's macroeconomic stability targets, and e.g. mortgage risk-weights would be lowered too quickly.

”The Saudi balance sheet is still a ‘fortress’, regardless of several years of fiscal deficits”

The authorities have started to revive the local fixed income market after no issuance for 12 years during the era of high oil prices. The riyal market is still quite shallow, most of the market participant are hold to maturity institutions and there is basically no secondary market. The government aims for a split of 60/40 between local and hard currency debt and there are talks with Euroclear to facilitate foreign investor participation and hopefully eventually deepen the market.

The population consists of around 22 million Saudi nationals and 10 million foreigners. We believe that a too quick exodus of expats represents one of the largest risks to the economy, as their departure will affect the economy in so many different ways through consumer demand, productivity, the real estate sector and hence the banking sector. It is hence critical that the process of Saudization is managed with care, in order to avoid non-linear shocks to the economy, especially if the private sector is going to remain a driver of growth. So far, the departure of 2 million foreigners, due to an increase in expat fees, has already affected the real estate sector.

Egypt

- We remain very positive on Egypt's external debt and it is one of the biggest weights in the fund. The reform story remains intact and fiscal consolidation is advancing while growth is accelerating. We are currently only invested in the EUR-denominated bonds and are preparing to increase the allocation in the upcoming new issuance.
- Egyptian local currency investments have formed a strategic part of our frontier and local currency strategies already for a couple of years, driven by moderating inflation and attractive yield levels coupled with a stable currency and large central bank reserves.
- Local currency bonds will be supported by the upcoming Euroclearability and potential index inclusion

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We have met with the Egyptian authorities several times during the last few years, and our view of Egypt was confirmed, again, during our visit to Cairo. Reforms have continued and are starting to bear fruit in the form of accelerating growth, new foreign direct investments (FDI), moderating inflation and larger and more diversified currency inflows. The biggest worries also in Egypt were geopolitical and current US trade policy.

Real GDP growth is set to accelerate in 2019 to 5.5% according to the IMF and increase to around 6% in the following years. The economy is still not growing at full potential, e.g. Zohr, the large gas field in the Mediterranean is not yet operating at full capacity and the same goes for the manufacturing sector. Restraints in the business environment and the elevated interest rates were quoted as drags. At the same time, private sector credit is growing, there has been a massive increase in the number of tourists (although at low room rates, but these are expected to increase) and growth is diversifying into exports and investments. A bank that we spoke to commented that their customers are waiting for rates to come down before they recommence their capital expenditure, until now corporates have mostly borrowed for operating expenditure and working capital.

The current account deficit will remain around 3% of GDP, which the authorities think is suitable for an economy like Egypt and well covered by net foreign direct investments. The domestic savings rate was only 2 % in 2017, but bounced back to 6% in 2018, which is still too, as Egypt needs further investments in the economy. There might, however, be hidden savings in the system, due to the high share of the unofficial economy. Net FDI is around USD 6 bn (gross USD 20 bn) but should increase in the future as companies have repatriated accumulated earnings, which expected to dissipate. The new bankruptcy law, land-allocation schemes, investment law coupled with improvements in ports and roads should all help to improve FDI-flows. Outside of oil, construction and retail, the sectors with most potential are textiles, telecom, fertilisers (facilitated through the gas production) and manufacturing.

The inflation target and expectation of the central bank is still 9% plus or minus 3% for Q4 of 2020 and they are working on moving to a more precise inflation targeting regime. Core inflation is currently well contained, headline inflation was 4.8% in September, but is expected to increase towards the end of the year due to base-effects. The volatility of inflation has historically created problems for businesses, as visibility has been very poor. Food prices are still an important driver of inflation (40% of CPI-basket) and lack of competition in the food and transportation sectors has created sudden spikes in the prices of certain products. However, inflation has recently been lower than market and central bank expectations due to structural changes within the transportation sector, as the government has actively worked on improving distribution and logistics. The oil price and the EGP will also remain important drivers for inflation in 2020.

The biggest domestic risk to the recovery story is that reforms would not continue. There are clearly some social pressures, which might lead to fiscal reforms slowing down somewhat. Locals believed that the recent protests will remain small and short-lived, due to revolution fatigue and poverty alleviating cash subsidies. A concrete sign of the improved security situation was that there were considerably less soldiers on the streets of Cairo compared to when we visited last time two years ago.

> **”Inflation has recently been lower than market and central bank expectations due to structural changes within the transportation sector, as the government has actively worked on improving distribution and logistics”**

Egypt

Health, education and housing investments have been increased with the savings from energy subsidies. The government has e.g. started screening all the population for hepatitis, high blood pressure and diabetes. Medicine to these three are given free and people are encouraged to participate in the program in order to create a database for subsidies criteria. Subsidies can then be redirected to families that need them the most.

Unemployment has decreased, but the unofficial sector is still large, so it is difficult to gauge the overall improvement in employment. More people are entering the formal sector though, as companies are forced to register due to VAT-reform. The central bank has initiatives to increase SME lending, leading to more financial inclusion and small firms have started getting accountants to be able to participate. This will bring them into the official sector and hopefully increase the tax pool.

The authorities are currently in talks with the IMF for a potential new program (Egypt outperformed IMF-target in the current program), probably one that does not involve any funding. Post-program monitoring will, however, be performed, no matter what happens with the new program.

The adjustment of the government budget has proceeded according to plan and the primary surplus target of 2% was met last budget year. The debt to GDP target for 2020 is below 80% (from 103% in 2017). Cost recovery ratios for fuel are close to current oil price levels, so fuel subsidies have now been phased away completely. Energy subsidies are currently only left for butane, that lower income families use for cooking, but natural gas connections are being worked on, which would be cleaner and cheaper.

There are no plans to increase tax rates, but the tax process will be simplified, especially for SME's, where efficiency and increasing the tax pool is the goal. Tax collection is slow and in the mean time the government is paying high interest rates to borrow money. The minimum wage increase for public employees was still a theme, but the public wage bill will still go down as a percentage of GDP. It is important to also notice that the overall budget will quickly benefit from the lower rates, as local currency debt is still very short term and thus savings will be quick. Everyone we spoke to agreed that the central bank still has plenty of room to cut rates (around 400 bps), the only disagreement is how fast this will be done.

The authorities have announced that they will extend the yield curve (with lower rates) and increase the issue sizes. There is also an aspiration to have 60% of debt in bonds in 2020 (now around 40%). There are two extra technical factors that will support government bonds in the near future: a possible JPM-index inclusion (possible watchlist in a few months) and Euroclearability (already confirmed, Q1 2020 timetable). The estimated inflow from these is between USD 10-13 billion, a substantial increase compared to current foreign ownership of local government bonds. Foreign investors own around USD 20 billion of government bonds and bills, where the bills represent the majority of investments. However, recent inflows have been mostly into the bonds.

Hard currency liquidity has increased considerably; there are no USD-backlogs anymore and deposit dollarization has gone down to around 20% of total deposits. The net foreign assets of the financial sector are also considered to be sufficient to absorb any shocks. Hard currency sources have broadened considerably with flows from e.g. exporters, tourism, the Suez Canal and the gas sector. The central bank is comfortable with current amount of reserves (USD 45 bn, 8 months of imports). Most private actors still expected some EGP appreciation. One new factor that supports the pound is that the dollar is no longer considered as a safe haven, as USD-holders have lost relatively due to this years pound appreciation and the considerably lower rates for USD.

”The adjustment of the government budget has proceeded according to plan and the primary surplus target of 2% was met last budget year”

Lebanon

- We have not invested in Lebanese government bonds, in dollars or Lebanese pounds and the country is currently labelled red in Aktia's traffic light model, meaning that we are not prepared to fund the government.
- We are, however, looking into investing in short dated pound-denominated bonds issued by a supranational, AAA-rated issuer.

Lebanon punches above its weight politically, due to its western orientation in a volatile region and the large diaspora globally, which is maybe twice as large as the population of the country. The US and France are very committed to the country, the US is funding the Lebanese Armed Forces and has a large presence through NGO's and US companies. The EU is very supportive of new gas sources, as it is eager to diversify its supply. The GCC-countries have financial and political interests in Lebanon and a common interest with the West not to lot Iran's proxy in the region, Hezbollah, gain ground. Many of the actors we spoke to believed, however, that financial aid would be conditional (and related to Hezbollah's presence in the region) going forward, especially from Saudi Arabia. At the same time, US sanctions on additional banks due to alleged links to Hezbollah, was mentioned as risk, as this could generate further deposit flight.

The dysfunctional electricity sector is one of the key reform areas in Lebanon. The direct cost for the government for subsidies to the ailing state owned Electricité du Liban is USD 2 billion (3.5% of GDP), but the indirect costs are much higher. Electricity in Lebanon is currently expensive and unreliable, with persistent blackouts. Losses are also huge due to technical losses and theft. Many industrial sectors rely on their own generation (with expensive imported diesel) and are not even connected to the grid, which heavily weighs on the overall growth of the economy. The private sector is eager to start electricity generation, but regulation and vested interests provide hurdles. The problems are partly due to the sectarian nature of the country, where for example transmission lines have not been allowed to cross certain areas for 20 years and all three groups demanded a Floating Storage and Regasification Unit in their respective region, even though only one was needed for the whole country. The overall goal is gasification of the electricity sector, regardless of the gas exploration process. The hope is that this would decrease costs and increase reliability, which would remove one of the main impediments to doing business in the country.

Lebanon has high twin deficits, a large public debt and low growth, coupled with a very large banking sector with an exposure to the sovereign of close to 70% of assets, leading to a situation that should have been unsustainable years ago. The large government deficit has been sustained by the combination of deposits by the diaspora and the domestic elite, banks willing to buy government bonds and an innovative central bank which has increasingly resorted to financial engineering to bolster banking sector capitalisation and maintain government liquidity and the peg to the US dollar. The central bank has tried to maintain confidence in this scheme with very large foreign exchange reserves, available reserves now at USD 32 billion, covering almost one year of imports. High interest levels to attract deposits has also hurt growth domestically. There has, however, lately been signs of trouble, with deposit inflow dissipating and reserves going down. We also witnessed ourselves the shortage of dollars and rationing of petrol at gas stations. The uncertainty is amplified by the fact that the central bank balance sheet isn't public, and there are very wide estimates of the actual usable net reserves, ranging from the official figure all the way to negative ones. The central bank government financing has become expensive for the bank and they have currently negative equity (and we heard claims that the central bank is not audited at all).

> **”Lebanon has high twin deficits, a large public debt and low growth, coupled with a very large banking sector with an exposure to the sovereign of close to 70% of assets”**

Lebanon

External debt service needs are USD 5.6 billion until June 2020, which is not covered by the most conservative estimates of foreign exchange reserves. A few experts we spoke to felt that the authorities need to address the situation within a couple of months, before it is too late. The solution should probably be fiscal, the IMF for example does not feel that restructuring would be beneficial or that the benefits from abandoning the currency peg would be low compared to the costs, even though the currency is overvalued on a real effective exchange rate measure. Restructuring would be difficult as most of the debt is held domestically, 80-90%, of which a large chunk is held by the central bank.

The IMF considers a primary surplus of 4.5% sufficient to reach sustainable debt levels and current measures fall short of reaching this target. Electricity sector reform is one step in the right direction. Tax leakage is a huge problem, one estimate is 6-8% of GDP (Hezbollah's tax and customs compliance is very low). Corruption reduction is also crucial, a politically independent anti-corruption commission is needed, followed by actual convictions. Other solutions include raising and broadening VAT and luxury and excise taxes. In addition to the electricity sector, the inefficiencies in telecom and ports are apparently extremely high, even compared to the region. Simultaneous and upfront reforms to the SOE's in these three sectors could yield tangible results fairly quickly.

The potential of a nascent gas industry has given hope to the Lebanese economic story. Exploration in Lebanon's territorial waters will start in December, the first production sharing agreements have been signed with e.g. Total and Eni and we will probably get the first estimates of the size of the first finding in April 2020. Success in deep-water drilling is on average only around 30% and the Mediterranean salt layer makes it more difficult to assess findings, but findings in Cyprus, Israel and Egypt brighten the outlook. Even if gas is found, the first small revenue streams would only materialise after five years and larger export revenues in ten years.

A group comprised of international financial institutions and sovereign countries (e.g. France and the GCC-countries) promised USD 11 billion of funds to Lebanon in 2018 under the name Cedre 1. However, this time these grants were tied to reforms (fiscal consolidation) and structural changes and according to our understanding very little of the funds have so far been disbursed. Many of the Cedre-projects are related to the electricity and transport sectors, both sectors where quick improvements could be achieved fairly easily. There should be a Cedre follow-up in mid-November 2019.

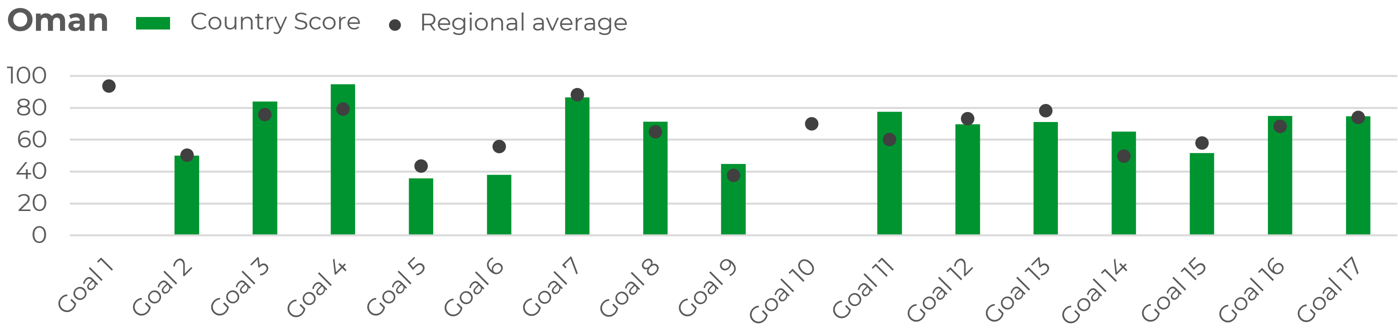
The uncertainty of the situation was confirmed by the prolonged street riots that ensued after our trip. The authorities reacted by bringing forward a modified economic package and suggested changes in the government, but the protesters seem to demand real change to the political system, genuine anti-corruption measures and deep measures against vested interests in the country's political class, no matter religion or region. Eventually the government of prime minister Hariri resigned. Lebanon is red in Aktia's traffic light model, i.e. we are not prepared to finance the government. In order for this to change, a credible plan for structural reforms, political and economical is needed, along with independent anti-corruption efforts, along with actual implementation, preferably together with multinational partners.

"The potential of a nascent gas industry has given hope to the Lebanese economic story. Exploration in Lebanon's territorial waters will start in December"

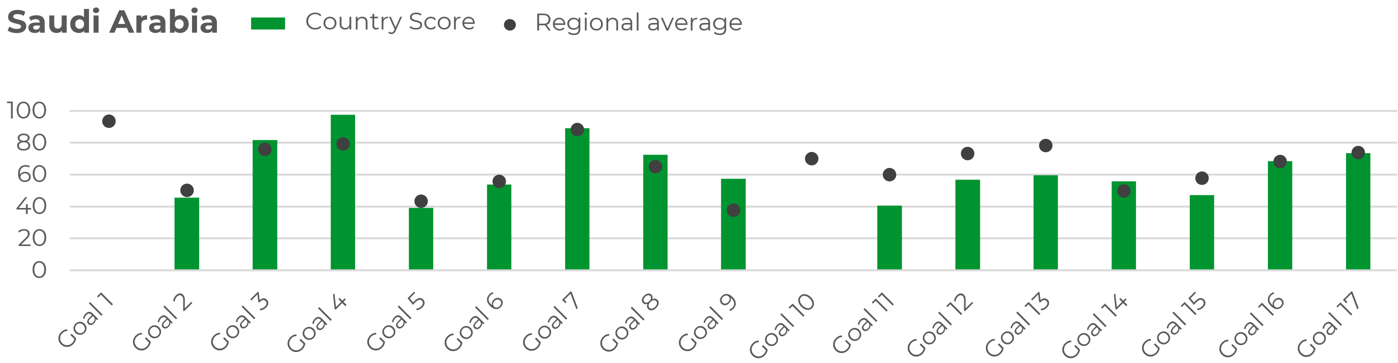
Aktia

SDG score profiles

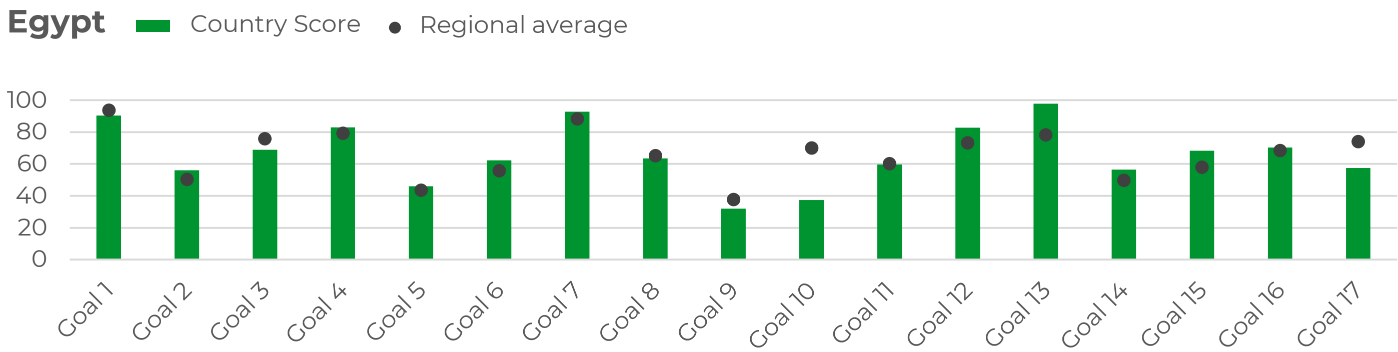
Oman



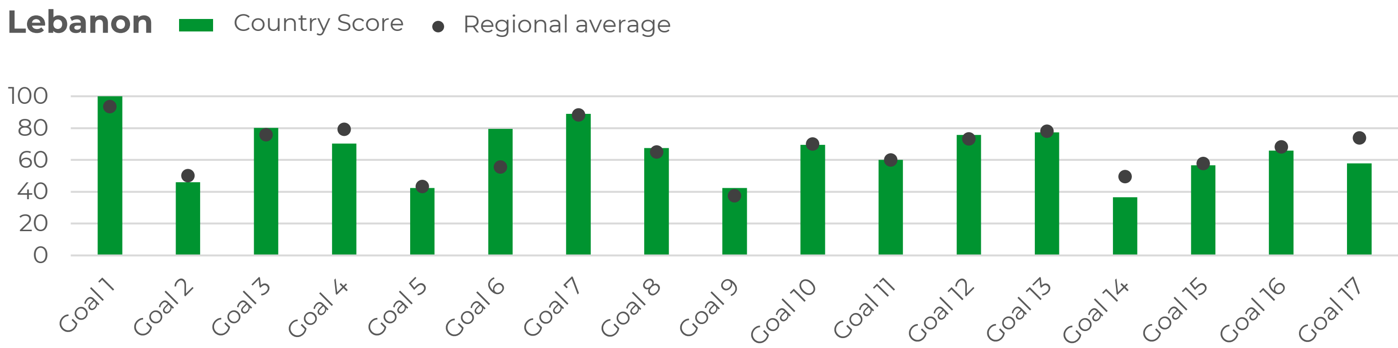
Saudi Arabia



Egypt



Lebanon



Goal 1: No Poverty, **Goal 2:** Zero Hunger, **Goal 3:** Good Health and Well-being, **Goal 4:** Quality Education, **Goal 5:** Gender Equality, **Goal 6:** Clean Water and Sanitation, **Goal 7:** Affordable and Clean Energy, **Goal 8**: Decent Work and Economic Growth, **Goal 9:** Industry, Innovation and Infrastructure, **Goal 10:** Reduced Inequality**,** **Goal 11:** Sustainable Cities and Communities, **Goal 12:** Responsible Consumption and Production, **Goal 13**: Climate Action, **Goal 14**: Life Below Water, **Goal 15:** Life on Land, **Goal 16:** Peace and Justice Strong Institutions, **Goal 17:** Partnerships to achieve the Goal

Data source: Bertelsmann Stiftung and Sustainable Development Solutions Network

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