# Low Oil Prices and Defence Expenditure

IHS

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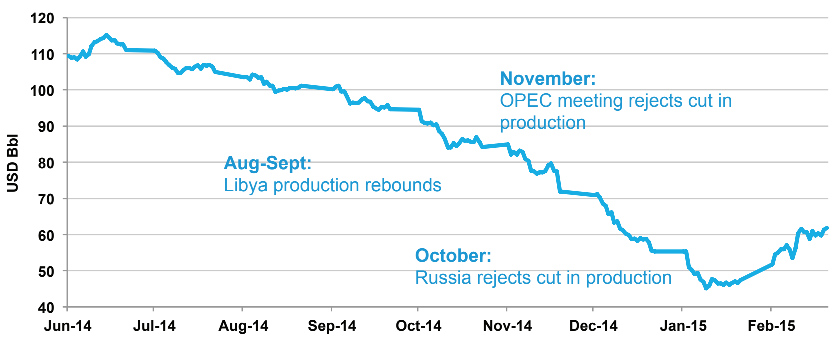
## Introduction

Between June 2014 and January 2015 crude oil prices fell by more than 50% dropping from USD115 a barrel to less than USD50. The collapse reflected a combination of enduringly weak economic recoveries following the Global Financial Crisis (2008-09), slower growth in China and the emergence of unconventional (shale) energy production in the US. Decisions by Russian and then by the Organization of the Petroleum Exporting Countries (OPEC) to reject cuts in production added momentum to the decline towards the end of 2014 and while the market stabilised from the middle of January 2015, prices remained at a level of USD50-60 in February and March with few signs that a significant rebound would occur in the short term.




The rapid fall in crude prices has produced considerable economic and fiscal disruption in countries that are dependent on oil and gas exports and in frontier countries that are counting on new projects to transform their economies in the future. The impact of the downturn on oil and gas producers differs significantly from country to country and depends upon economic exposure, the availability of alternate sources of revenue and/or budgetary support and the ability to set in place appropriate policies to either mitigate the impact or capitalise on the opportunities provided by lower oil prices.

As declining energy sector revenues begin to impact upon government expenditure many of the more producer states will be required to adjust budgetary plans. For others, a severe process of fiscal consolidation, potentially lasting several years, will be required to rationalise their fiscal position. As a discretionary element within government spending defence budgets in many states will be placed under significant pressure by a period of lower oil prices. This IHS Jane's Defence Budgets Quarterly Report assesses the likely impact of low oil prices upon 13 key defence markets.

**Note: The forecasts contained within this report are based upon assumptions that the oil price will recover to around USD80 a barrel by 2017 and pass USD100 again by the end of the decade as per analysis by IHS Energy (March 2015).**

For more information, please visit the
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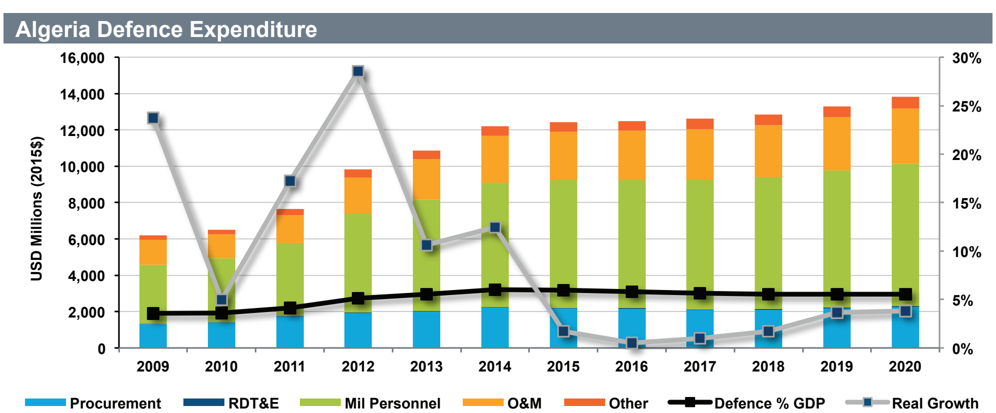
| Category | Core OPEC | Non-Core OPEC | Non-diversified | Frontier | Diversified | Net Importer |
|---|---|---|---|---|---|---|
| **Countries** | • Saudi Arabia<br>• UAE<br>• Kuwait<br>• Qatar | • Algeria<br>• Angola<br>• Ecuador<br>• Iran<br>• Iraq<br>• Libya<br>• Nigeria<br>• Venezuela | • Russia<br>• Kazakhstan<br>• Azerbaijian<br>• Colombia<br>• Yemen | • Ghana<br>• Kenya<br>• Tanzania<br>• Uganda | • Canada<br>• Norway<br>• UK<br>• US<br>• Brazil<br>• Mexico | • China<br>• India<br>• Indonesia<br>• Malaysia<br>• Thailand |
| **Principal Risks** | • Drawdown of financial reserves until demand picks up / other producers respond | • Current account & fiscal balance pressures<br>• Debt problems | • Current account & fiscal balance pressures<br>• Debt problems<br>• Project delays / cancelations | • Fiscal balance pressures<br>• Debt problems<br>• Project delays / cancelations | • State/ provincial fiscal problems Project delays / cancelations | • Project delays / cancelations<br>• Lower subsidy costs |
| **Countermeasures / new initiatives** | • Fine tuning imports and spending<br>• Providing assistance for some non-Core OPEC | • Drawdown of financial reserves<br>• Seek bilateral aid ( China & Gulf states) | • Currency devaluations (Russia)<br>• Cuts in imports and government spending | • Seeking multi and bilat-eral aid (from IMF, China & Gulf states) | • Increases in oil product taxes<br>• Selective adjustments in fiscal terms | • Cuts in oil price subsidies |

# Algeria

**Key Points**

- Oil accounts for 93% of export earnings and 60% of Algerian government revenue
- Budget break-even point of USD120/bbl, resulting in a widening fiscal deficit in 2015
- Strong reserves of around USD160bn will act as a buffer in the short term
- 2015 draft budget based on oil price of USD90/bbl, 2015 oil price expected to be USD50/bbl
- Worsening fiscal position and inclination towards welfare could subdue defence spending

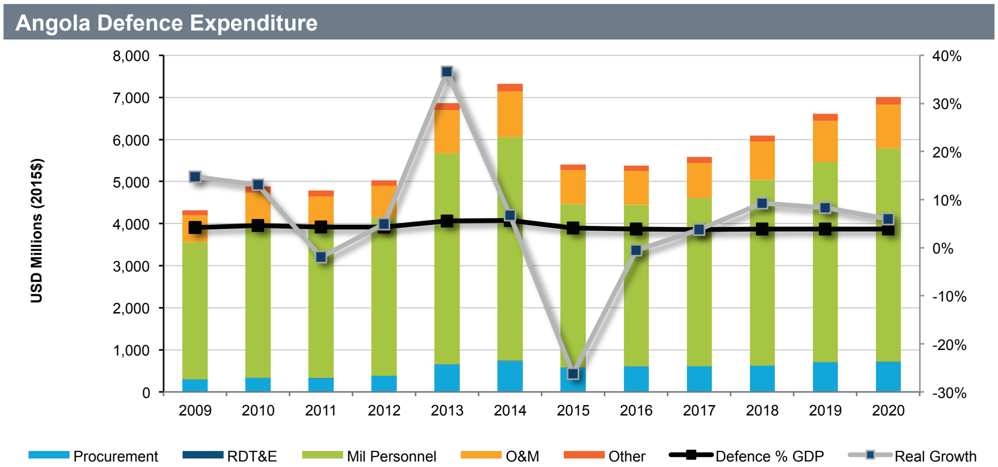



**CURRENT OUTLOOK: STABLE/POSITIVE**

Reserves to act as a short-term buffer – stable budget in real terms with stronger growth from 2018.

# Angola

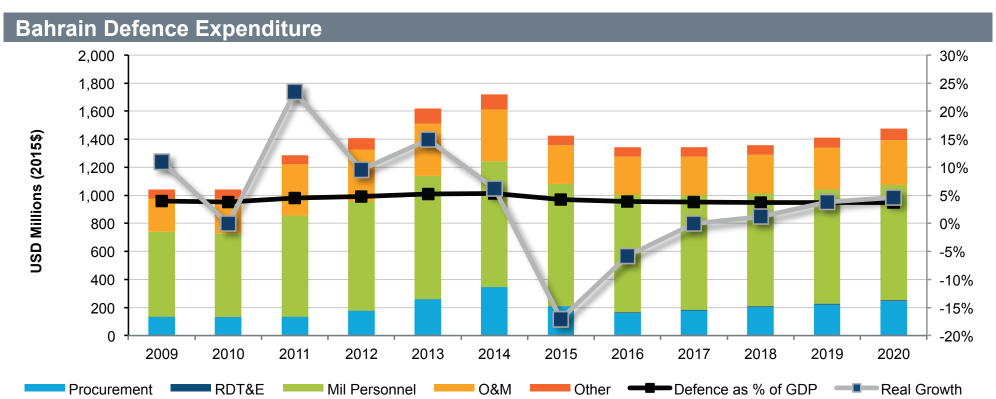
**Key Points**
- Oil accounts for 98% of export earnings and 66% of Angolan government revenue
- Fiscal break-even point of USD120/bbl
- No foreign reserves cushion – just UDS30bn
- 2015 draft budget based on oil price of USD80/ bbl, revised down to USD40/bbl
- 2015 defence budget cut by 25% in the wake of the lower oil price




**CURRENT OUTLOOK:**
**NEGATIVE**
Substantial 2015 cut, stagnation over the short term, 5 year recovery path back to 2014 level of spending.

# Bahrain

**Key Points**
- Energy sector accounts for 89.8% of government revenues
- Oil price of USD120 required to balance the budget
- Fiscal consolidation had been advised before oil price crash by IMF
- Significant budget cuts expected until at least 2017 with defence unlikely to be protected
- Core defence budget is expected to fall by as much as 25% in real terms



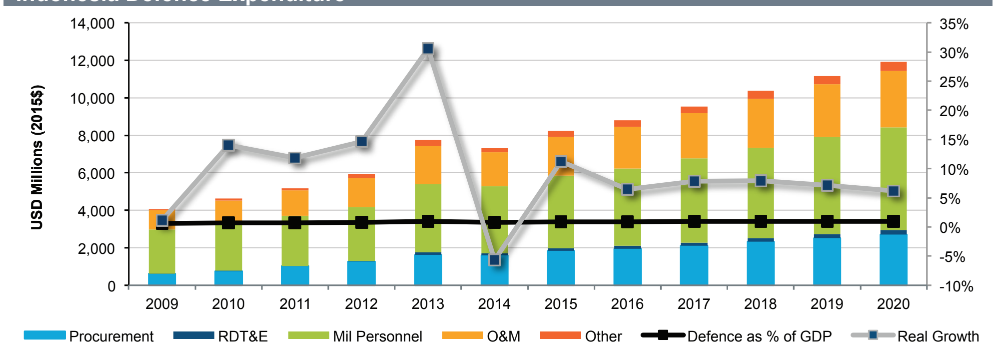

**CURRENT OUTLOOK:**
**NEGATIVE**
Sustained cuts from 2015 with major procurement programmes delayed until at least 2017. Gradual growth possible from 2018 with defence spending falling as a percentage of GDP.

# Indonesia

**Key Points**

- Energy sector revenues will fall by around 64% or USD11 billion in 2015
- End to fuel subsidies will however more than compensate for lost income
- Fuel subsidy was worth USD19.3 billion in 2014, accounting for 15% of government spending
- Optimistic tax based revenue expectations are the key short term obstacle to spending growth
- Signs that government is following up on plans to increase defence expenditure

**Indonesia Defence Expenditure**




## CURRENT OUTLOOK:

### POSITIVE

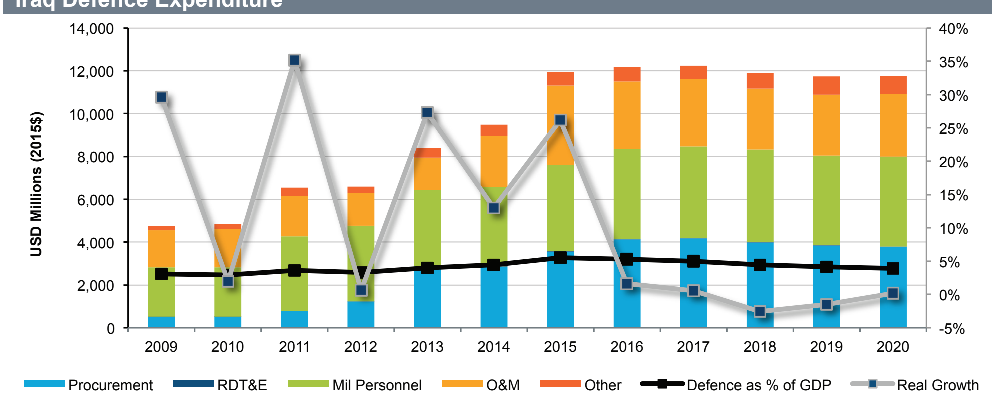
Removal of fuel subsidy will offset lower energy revenues. Accelerating economic growth to support continued rapid growth in defence spending.

# Iraq

**Key Points**

- Energy sector accounts for 90% of government revenue
- Defence expenditure trends have generally tracked trends in oil prices since 2007
- Cuts have been made to the 2015 budget however deficit of 9% of GDP still projected
- Islamic State conflict means that defence remains a primary focus of the government
- Defence budget due to expand in 2015 however further significant growth unfeasible

**Iraq Defence Expenditure**




## CURRENT OUTLOOK:

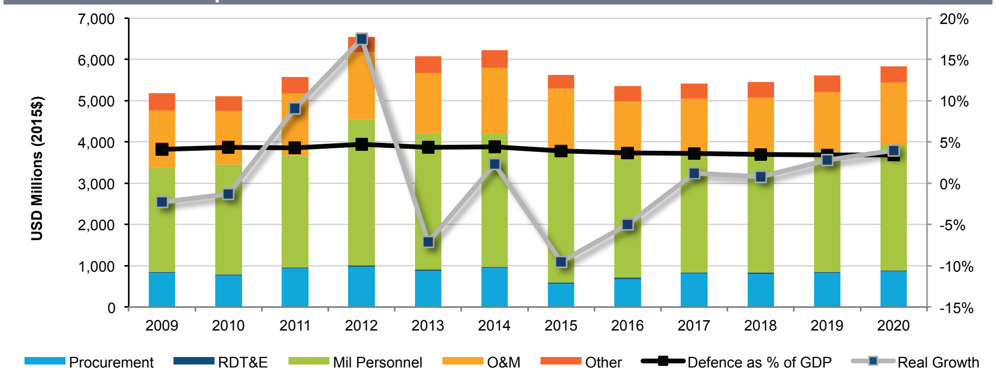
### NEGATIVE/STABLE

IS crisis will ensure defence remains a central concern limiting potential cuts. Fiscal realities mean further huge increases are unlikely.

# Kuwait

**Key Points**
- Oil accounts for 91.2% of government revenue
- 2015/16 budget projects a deficit of 20.2% of GDP based on conservative oil price of USD45
- Spending to be cut by 17.8% by reducing "non-essential" spending
- Kuwait's overall fiscal position remains relatively strong
- Defence spending likely to be reduced in 2015/16 with conservative growth returning 2017/18

Kuwait Defence Expenditure




**CURRENT OUTLOOK:**

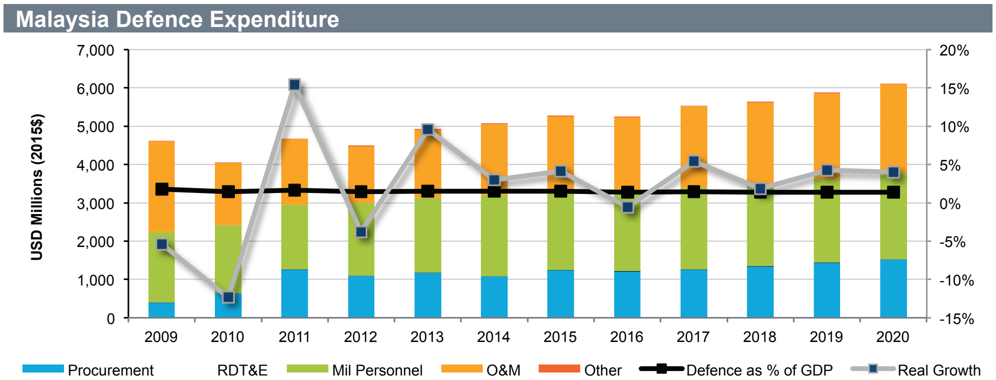
**STABLE/NEGATIVE**

Significant cuts in short term followed by gradual fiscal consolidation. Conservative growth returning by end of decade in line with previous trends.

# Malaysia

**Key Points**
- Oil and gas sector accounts for around 30% of government revenue
- Lower revenue expectations led to a marginal downward revision to 2015 budget in January
- Will stall progress in reducing the budget deficit, a key concern of the government
- Lower prices have allowed the dismantling of fuel subsidies
- Short term negative impact on revenue will give way to long term benefits on expenditure

Malaysia Defence Expenditure




**CURRENT OUTLOOK:**

**STABLE/POSITIVE**

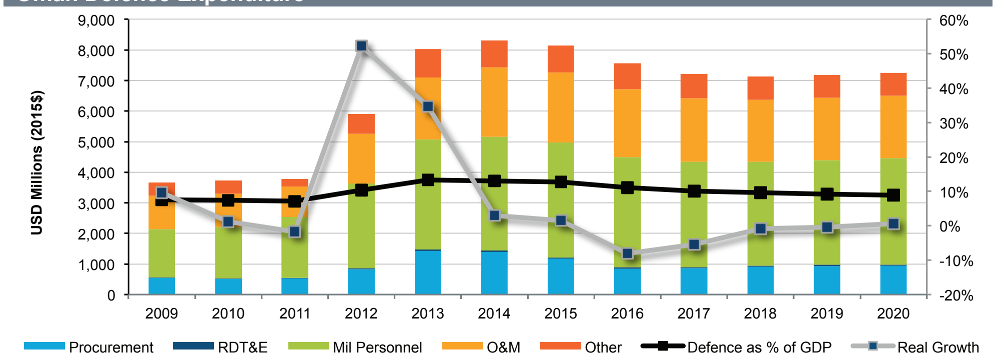
Short term constraints from lower energy revenues will be replaced by long term benefits of subsidy reduction. Growth expected to be conservative yet sustained.

# Oman

**Key Points**

- Oil and gas sector account for 79% of government revenue
- State spending increased for 2015 despiteoil price crisis
- Government intends to await stabilisation before taking remedial action
- Significant cuts likely to be implemented from 2016 onwards
- Defence expenditure likely to fall in real terms in 2016 and 2017 before stabilising

Oman Defence Expenditure




**CURRENT OUTLOOK:**
**NEGATIVE**

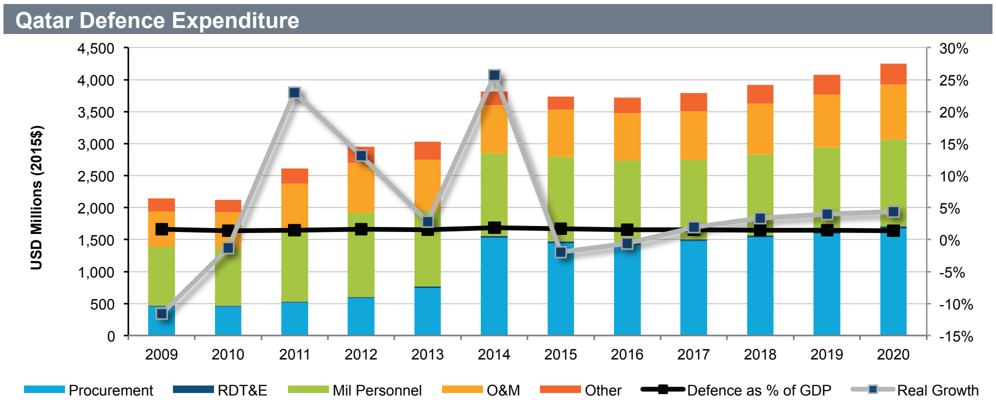
Cuts to defence and security in the short term followed by marginal growth thereafter. Budget to fall in real terms. Procurement cycle to end.

# Qatar

**Key Points**

- Energy sector accounts for 57.8% of government revenue
- LNG price fall more important to Qatar's fiscal position than oil
- Foreign reserves appear to be being utilised to support investment spending
- Fiscal and economic position remain strong with non-oil growth offsetting lost revenues
- Cautious growth expected for core defence budget following massive investment in equipment

Qatar Defence Expenditure




**CURRENT OUTLOOK:**
**STABLE/POSITIVE**

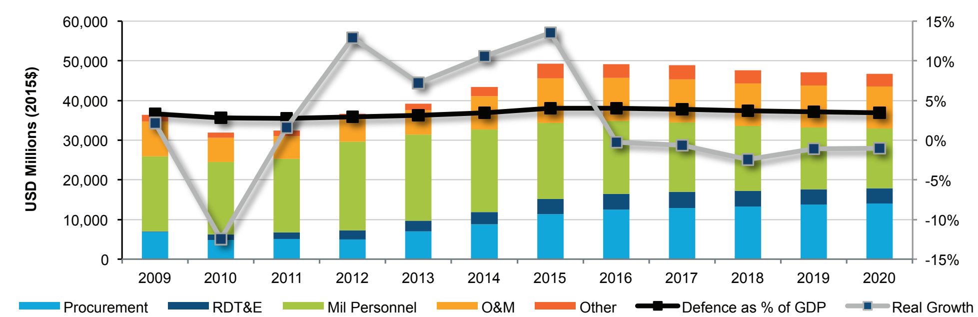
Real terms cuts in core defence spending possible in short term however investment increased rapidly in 2014. Long term prospects remain strong.

# Russia

**Key Points**

- Energy sector accounts for around 50% of Russian GDP
- Budget cuts have already been made to 2015-17 state budget
- Foreign reserves have fallen by around one quarter since Q3 2014
- Defence budget has grown rapidly since 2010 placing strain upon government finances
- Cuts to level of growth of military spending appear to be under consideration

**Russia Defence Expenditure**




## CURRENT OUTLOOK:

### NEGATIVE

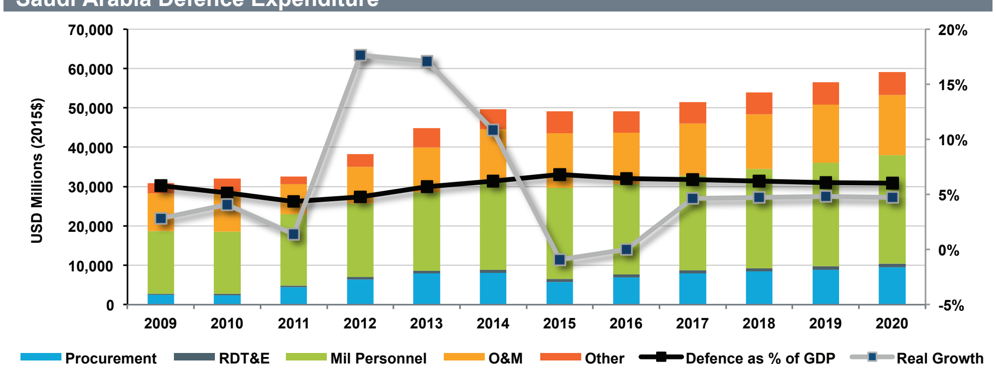
Rapid growth will end in 2016, spending to be flat for the remainder of the decade in real terms. Real terms cuts a distinct possibility after 2015.

# Saudi Arabia

**Key Points**

- Oil accounted for 86% of government revenues in 2014
- Government appears content to endure a period of low prices despite projected deficit
- Reserves of over USD700 billion will be used to support government spending
- Budget growth set to slow but continue with annual overspend likely to be cut
- Defence budget likely to see marginal contraction however growth will not be reversed

**Saudi Arabia Defence Expenditure**




## CURRENT OUTLOOK:

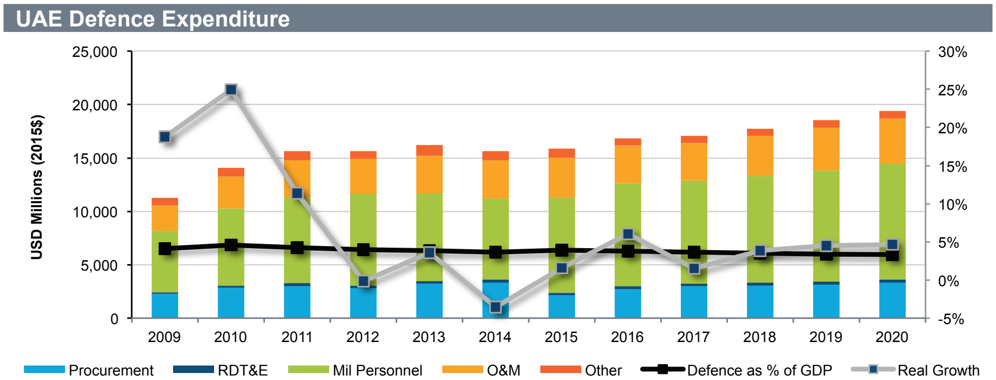
### STABLE/POSITIVE

Cautious nominal terms growth in near term with potential for slowdown in procurement activity. Robust growth to resume from 2017 onwards.

# United Arab Emirates (UAE)

**Key Points**

- Energy sector accounts for around 55% of GDP
- Comparatively diversified economy will limit the impact of low energy prices
- Federal budget for 2015 showed growth of 6.7% and projected no deficit
- Fiscal consolidation has been underway since 2011 creating room for manoeuvre
- Upward pressures likely to ensure non-capital defence budget continues to grow

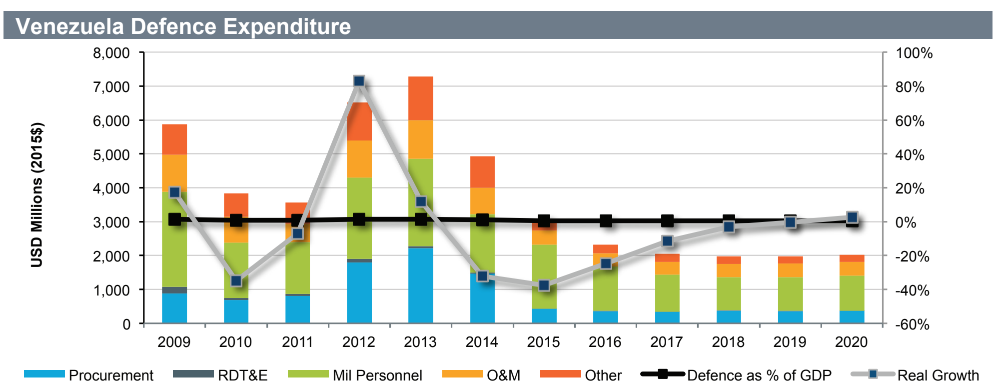



**CURRENT OUTLOOK:**
**POSITIVE**
Period of fiscal consolidation pursued by the government since 2011 will allow growth to continue in 2015. Upward pressures from national service law may drive short term growth.

# Venezuela

**Key Points**

- Oil accounts for 96% of exports and 50% of Venezuelan government revenue
- Budget break-even point reported to be USD117/bbl, resulting in fast-growing deficit
- 2015 will see 5.5% GDP contraction, inflation of 81.2%, deficit of 12% and debt of 57.7% of GDP
- Defence expenditure fell by 32.3% in 2014 and 37.7% in 2015
- Exposure to open markets has been reduced by its relationships with China and Russia




**CURRENT OUTLOOK:**
**NEGATIVE**
Massive real terms cuts to defence expenditure since 2014 are expected to continue to 2017, although significant growth is not expected to return until after 2020.

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