COP 28 – An opportunity for Qatar

As the sad events continue to unfold in Palestine and Israel, global energy markets have once again shifted from concerns about supply disruption to energy demand and whether OPEC plus discipline will falter in a slower global economy. Against this backdrop and a summer of somewhat chaotic climatic events, the mood music for the GCC in the run up to COP28 was somewhat downbeat as many criticised the emphasis on increased hydrocarbon production at the expense of net zero targets. Arguably, this presented an opportunity for Qatar as it is actually well placed to counter such criticisms given its heavy emphasis on positioning LNG as a clean fuel and addressing emission levels in the context of its own renewables strategy.

Prior to the Ukraine war and previous COP meetings there was emerging consensus, in some circles, that gas could be ‘transitioned out’ of the global energy mix and replaced by renewables and other energy sources over perhaps a decade or two. Major consumers believed they could easily rely on buying at depressed spot prices in an always over-supplied market as they transitioned away from hydrocarbons. A few years ago, it could be safely assumed that many of the existing global long-term LNG contracts of 10 years or more that expire this decade would effectively role into low margin spot purchases with a consequent higher risk proposition for producers. Qatar was a leader and beneficiary of some of these contracts during the early development of the North Field 20-25 years ago.

We are now clearly in a very different world where strong and likely growing demand for gas will extend for at least 30-40 years and probably well beyond. A high and growing component of demand from developing nations will be taken up by LNG as coal and heavy fuel oil power generation capacity is steadily replaced and added to. Qatar is in the front seat in terms of witnessing this structural market change. Already over a quarter of the expected increase in production from the North Field has been tied to longer term contracts now extending as far ahead as 27 years. China seems to be at the forefront of setting and securing these very long-term contracts. Reflecting this confidence and the increasing demand for longer term contracts, QatarEnergies has recently further expanded production capacity targets from the North Field following the announcement of a freeze on new US export licenses.

Interestingly, many of these longer-term contracts are being signed by developing countries in Asia with some ‘developed’ countries still hanging onto the belief that they can ‘dip’ into the spot market, when necessary, to cover energy needs when the wind ‘does not blow’ or reserves need replenishing. Again, this prevailing consensus is likely to be tested in the foreseeable future as already we are starting to witness longer term contracts being signed between part Qatari-owned facilities in the US and at Ras Laffan. Even Germany signed a 15-year contract and the trend is for these to grow as re-initiated coal generating electricity capacity there is replaced to meet their own stringent emission targets. This is consistent with a presumption that increasing Russian LNG imports to the EU will need to be further displaced given ongoing hostilities in Ukraine which seem unlikely to be resolved in the immediate future.

Qatar remains in an enviable position during this global energy transition and has somewhat benefited from field development at a time of lower inflation and capital costs. Through its 70% production share of the Golden Pass facility in the US and the now three phases of production increases from the North Field, Qatar will dominate global production increases over the next 5-7 years. Longer term, this could rise further as QatarEnergies develops and acquires both upstream and downstream assets, which is part of its stated mandate. There is a further opportunity to secure premium pricing for its principal export as greater emphasis is placed on monitoring and eliminating emissions from the complete supply chain. There is increased scrutiny of emissions in the export supply chain as these will inevitably be increasingly taxed on a cross border basis during the green transition. The new processing capacity at Qatar's Ras Laffan will be serviced entirely by solar, for example.

Qatar is fully cognisant of the necessity to drive tighter environmental standards and targets. It has set very ambitious targets of cutting carbon emissions by 25% over a time period when production is increasing by over 80%. Following COP28, all the GCC countries, including Qatar, will be at the forefront of reducing methane emissions through the entire supply chain as LNG becomes a critical part of the clean energy transition alongside renewables. Carbon sequestration targets are being raised and downstream petrochemical expansions are only being considered in conjunction with decarbonisation targets. Qatar is ideally placed to increase Blue and even Green Hydrogen capacity which in turn can be used to bring forward carbon-neutral targets. This is a trend that that contrasts with slippage we are now witnessing across major G7 economies which are struggling to execute renewable targets given higher capital costs. The UK, for instance, has seen a recent slippage in wind power infrastructure build-out targets which will inevitably increase shorter term demand for gas in its own energy transition strategy.

It is now well recognised that Qatar is in an enviable position in terms of building on the next stage of its economic development. Even in the high spending year of the World Cup, the country generated a sizeable budget and a current account surplus. The bulk of major onshore basic infrastructure spending to support its current population has been completed and the emphasis will now turn to upstream and downstream developments surrounding the North Field and the beginnings of a transition to a knowledge-based economy. The building blocks for the latter are being put in place through initiatives such as the new Qatar Free Zones (QFZ) with ambitions to develop investment incentives in areas such as Fintech, Clean Energy Technologies and relevant applied academic research. New emerging sectors in due course will increase employment ecosystems which should thrive in a country with excellent infrastructure and services, attractive financing and importantly, low debt and low inflation.

This emerging theme can already be recognised in the evolution of new listings on the Qatar Stock Exchange (QSE), which will remain at the centre of this anticipated economic transition. Recently listed companies include Meeza which provides a suite of services such as Data Storage and Cybersecurity to existing multinational and government clients as well as new entrants into the QFZ. Al Faleh Education, through its collaboration with Aberdeen University, is offering science and management degrees of the same standard as its U.K. counterpart to Qataris. Under the guidance of Sheika Aisha bint Faleh Al Thani, a new expanded campus is planned in Lusail offering an extended range of Engineering degrees as well as the opportunity to study at a new campus in London, U.K. This group is also expanding into private school-level education with a best-in-class suitor. The QSE will effectively become a 'shop window' as the economy transitions into its next phase of growth and blue-collar workers are replaced by home grown and imported knowledge workers.

The largely moribund performance of the QSE over the past year reflects a year of transition, particularly for the banking sector which makes up around half of the index. The rush to complete property and hospitality capacity in the run up to the World Cup has created some issues in this sector at a time when the government has continued to pursue a policy of self-reliance regarding offshore funding. A lull in credit growth prior to the next phase of North Field expansions combined with a more competitive deposit landscape and pressure on some customer cash flows has created some temporary pressure on profitability for some banks. This may well lead to a further opportunity to rationalise the sector and further enhance balance sheet strength in both corporates and banks. Fortunately, in a world of deteriorating financial strength and stability, Qatar stands out as a sovereign which is readily able to make these types of adjustment.

If capital markets are a gauge of economic and financial position the QSE continues to offer an attractive proposition as a benchmark for future growth opportunities. There has been an emerging disconnect between asset valuations and longer term projected economic performance, particularly in relation to the deteriorating economic outlook elsewhere. Even the banking sector this year in Qatar has enjoyed overall growth despite a steady fall in share prices. Arguably, Qatar started a process of corporate deleveraging, balance sheet clean-up and self-reliance at an earlier stage than other countries and is now almost uniquely positioned. Higher global interest rates should be beneficial to a cash and asset rich country like Qatar which can now target investment opportunities across growth sectors in which it has a competitive advantage.