Brent crude oil tests key resistance; industrial metals rebound

early weakness after the US announcement of additional tariff s on $200bn worth of Chinese imports. The broad-based recovery that followed in global stocks and currencies was driven by a combination of the US tariff s coming in at the lower 10% bracket and China, while responding with its own counter tariff s, announcing plans to cut taxes, lift consumption, and lowering its average tariff rate on imports from most of its trading partners as soon as October. While these developments may have helped sentiment, a proper de- escalation in China/US relations has yet to be seen. Given this, some caution is warranted unless the recent dollar weakness continues to provide support.

Growth-dependent commodities such as energy and not least industrial metals received a boost. Since June, when the trade war began, it has been worries more than actual data pointing towards a slowdown that has driven the negative sentiment. Any sign of easing tensions is therefore likely to trigger renewed

demand from consumers who had put off purchases in recent months. Brent crude oil tested key resistance after Saudi Arabia said it was comfortable with Brent above $80/ barrel. The Saudi comment was probably driven by the realisation that Opec members and Russia are unable to off set the ongoing slump in Iranian production; President Trump renewing his attack on Opec and high oil prices in a tweet failed to weaken the price. Trump’s sanctions against Iran are the main reason behind the elevated prices currently seen.

The European power market continued its wild gyrations with renewed strength in ECX Carbon emissions and rising coal prices driving a new surge in power prices across the region. Natural gas jumped the most since January and the near 7% rally on the week saw it return to face resistance once again at $3/therm. The rally was driven by lower than expected Chinese tariff s on LNG imports from the US and stocks being some 18% below the seasonal average with just a few weeks left before winter demand sets in. Rising US production this year has been met with rising demand and rising exports. HG copper jumped more than 6% on China’s spending pledge and the move helped support a recovery among the semi-precious metals – not least palladium and platinum with the latter seeing its discount to gold drop to a six- month low from a record just a couple of weeks ago. Gold took some comfort from the weaker dollar but struggled to keep up with headwinds arising from higher US bond yields, the September 26 Federal Open Market Committee meeting, and a weaker JPY against the dollar. Gold’s struggle to keep up with a recovery among other metals was seen through the lower ratios against both copper and platinum.

The battle for a shrinking global liquidity pool will heat up over the coming months and the US needs to attract an increased amount of funds to cover its growing deficit. The weaker dollar despite rising US bond yields this past week may indicate that investors worried about rising US funding

requirements no longer find the current yield levels attractive at the current dollar valuation. These developments may eventually see the greenback weaken, removing some of the recent pressure on emerging market countries struggling with their dollar debt at a time of rising interest rates. If this materializes, some profitable months may lie ahead for commodities as investors and funds turn short positions back into longs. Gold has been range-bound around $1,200/oz for the past month while its room for manoeuvring, as per the chart below, continues to narrow. At this point we maintain a neutral outlook while waiting for a trigger strong enough to take it out of the current range.

The combination of a record short and some dollar buying fatigue leads us to believe that the upside eventually will be challenged. Key levels to look out for to the upside are $1,212/oz, $1,224/oz and particularly $1,238/oz. A break back below $1,188/oz, however, could once again see the metal's resolve being tested. Crude oil remains supported and at risk of breaking higher as supply concerns intensify. Despite increased production from some Opec members and Russia together with robust US export sales of crude, the market is turning increasingly tight. Iranian exports have already witnessed a sharp reduction and are likely to fall further when US sanctions come into eff ect in November.

Opec and its allies meet in Algiers on September 23 to discuss oil market developments. This follows the June Opec+ meeting, which saw the production cap deal nearly abandoned despite Iranian objections. With Saudi Arabia, Iraq, and Russia producing at will, a contentious meeting high on politics and low on results await. The major factor here is Tehran, as Iranian leaders feel betrayed and have said they will veto any Opec decision that harms their country. President Trump's growing fondness for trying to impact markets via Twitter fell short of halting oil's ascent after he once again went on the attack against Opec saying that they "continue to push for

higher and higher oil prices”.

With Trump’s Iran sanctions expected to force a minimum drop of 1mn barrels/day there is little Opec and its allies currently can do to stem the risk of rising prices. The best they can hope for is that the short-term supply deficit will not push prices so high that it hurts the medium- to longer-term outlook for global growth and demand for oil. Ole Hansen is head of Commodity Strategy at Saxo Bank.

ECB on runway to rate liftoff considers what should happen next

European Central Bank officials are starting to discuss priming investors for the euro area’s first interest-rate increase since 2011, a conversation that could see them putting the U.S. experience of three years ago under the

microscope.

With the Governing Council indicating borrowing costs will stay at record lows “at least through the summer of 2019,” two of President Mario Draghi’s lieutenants are already talking about what happens after that. Executive Board members Benoit Coeure and Peter Praet want to communicate more on the pace of increases to avoid stirring up markets.

Concerns over the impact of tighter policy are likely heightened by the memory of the two increases in 2011 being swiftly undone as the euro zone tipped into recession. Officials insist the economy is now strong enough to face global risks from trade protectionism to Brexit, but also regularly cite market volatility as a risk. That makes a so-called dovish hike an attractive goal.

“What they are trying to communicate to investors is that the lift-off is going to be slow,” said Nick Kounis, head of macro and financial markets research at ABN Amro Bank NV in Amsterdam. “The ECB has learned its communication lesson from the Federal Reserve, and they want to make sure well ahead of time that markets are clear on their thinking.”

Policy makers aren’t all on the same page though. Governing Council member Ewald Nowotny, Austria’s central-bank chief, said on Sunday that officials should “ask if it’s really sensible” to lock in record-low rates for so long. Draghi may be quizzed on his view when he testifies to the European Parliament on Monday.

Under then-Chair Janet Yellen, the Fed was widely lauded when it raised rates in December 2015. After a rocky start in May 2013, when she was vice chair and her boss, Ben Bernanke, spooked investors by unexpectedly suggesting asset purchases might be tapered, the central bank successfully reached lift-off with barely a murmur of discontent in the markets.

Incremental Steps

The strategy was a series of incremental language changes, ranging from subtle to blatant, that signaled a rate hike was getting closer. As asset purchases ended in October 2014, the Fed said rates would stay near zero for a "considerable time." That was dropped in January 2015 as the economy improved, though policy makers cautioned they'd remain "patient."

In March, they pinned a hike on "further improvement in the labor market." By July, a tweak to say the Fed awaited "some" further improvement in the labor market was a one-word addition that inched them toward liftoff. Officials finally teed up the decision in their October statement with an unusual reference to their "next meeting."

Praet, the ECB's chief economist, told an audience in New York on Thursday that communication on how to adapt policy beyond the first rate hike will become "increasingly important" next year.

Rate Path

Coeure, who is in charge of market operations and is a potential successor to Draghi in November 2019, said in Berlin that he would prefer to outline the economic conditions that justify higher borrowing costs.

He rejected publishing an expected path of interest rates, as Sweden's Riksbank does. The Fed uses a so-called dot-plot chart compiling anonymous predictions by policy makers for how fast they expect rates to rise.

The Norwegian central bank showed last week how the pace of monetary tightening can matter more for markets than the actual timing of the first move. The krone dropped after Governor Oystein Olsen raised rates for the first time in seven years and lowered his projection for how fast they'll

climb in the years ahead.

The Bank of England, which in August raised its benchmark rate to the highest since the financial crisis, takes a milder approach, colored by the uncertainties surrounding the U.K.'s departure from the European Union. It says future increases in the key rate will be "at a gradual pace and to a limited extent."

The process never stops. The Fed is currently wrestling with the question of where to end tightening, and Chairman Jerome Powell is considering how to change communication.

"If the ECB wants to be in control, the sooner they start talking about their plans the better," said Anatoli Annenkov, senior economist at Societe Generale SA in London. "There are sufficient reasons to believe that at times the communication is quite difficult and markets may not believe you."

New U.S. LNG projects, enough to double exports, on verge of launch

LONDON (Reuters) – New U.S. liquefied natural gas terminals with enough capacity to double U.S. exports have either begun commissioning their facilities or are waiting for approval from the energy regulator, a review of their documents showed this week.

Although long planned, the actual commissioning of plants has been a moving target in the past.

Yet the process not only kicks off a new era for the global industry as the United States turns into a significant exporter. It also opens the taps for large volumes to hit the spot market before long-term commercial contracts are formerly triggered.

The ramp up of U.S. LNG production comes just as U.S. President Donald Trump boasts of his country's energy dominance across the world stage but may also hit a wall of Chinese tariffs set on the super-chilled fuel earlier this week.

Activity at five terminals dotted mainly on the U.S. Gulf Coast means some production will start ahead of schedule with

two or three plants producing their first cargoes this year, one as early as November.

Analysts now estimate anywhere between 1.0 and 2.5 million tonnes of LNG will hit the spot market in the first quarter of next year, a significant amount in an industry still dominated by rigid multi-year supply contracts.

While China is the second largest LNG importer in the world, its purchases of U.S. cargoes is low at 5 percent of the total it buys. Japan and South Korea are the other top importers.

Based on regulatory filings and analysts' forecasts, the first LNG is expected in December from Kinder Morgan's Elba Island and Cheniere Energy's Sabine Pass train 5, and in the second quarter from Sempra's Cameron terminal and Freeport LNG's terminal.

Additionally, the pace of Federal Energy Regulatory Commission (FERC) approvals for Cheniere's Corpus Christi plant surprised the industry last month with Wood Mackenzie now seeing first LNG from the Texas terminal as early as November.

"We see somewhere between 2.0 to 2.5 million tonnes of additional U.S. supplies in the first quarter," said Trevor Sikorski, analyst at Energy Aspects. "We think probably, most of the 2.5 million will be put into the spot market."

Spot market volumes are not recorded but industry group GIIGNL calculates around 77.6 million tonnes, or 6.4 million a month, were traded on spot basis or in short-term contracts last year.

U.S. exports, at 15 million tonnes so far this year, have exceeded last year's of 14.3 million tonnes, according to Thomson Reuters data. U.S. capacity has been 23.3 million tonnes a year (mtpa) since March when the second LNG terminal in the country, Dominion Energy's Cove Point, came online.

DOUBLING EXPORTS

Cheniere, Sempra, Kinder Morgan and Freeport told Reuters their timetable for start-ups remained unchanged from their latest announcements.

The four new terminals and one extension will come onstream in stages over the next two years and at capacity they will constitute 60 percent of new supplies expected to be added to the global market by 2023. The first trains and one extension alone have a capacity of 19 mtpa.

Commissioning U.S. energy facilities involves a back and forth process with FERC which reviews and approves many stages of the start-up. The last major milestone before production is FERC's approval to inject feedgas that gets chilled into LNG.

Cheniere's Corpus Christi Train 1 and Sabine Pass Train 5 both received that FERC approval in recent weeks. At 4.5 mtpa each, the trains add 9 mtpa to U.S. capacity.

Privately-held Freeport LNG has been given permission to commission utilities at its 5 mtpa Train 1. It pushed back the start date of commercial activities to September 2019 leading traders and analysts to expect LNG exports to start in May.

Sempra has filed all its pre-commissioning documents for Cameron Train 1, with capacity of 5 mtpa, allowing it to move ahead with initial commissioning.

Kinder Morgan appears to be the furthest behind in the regulatory approval and commissioning process, the filings show. But traders say its modular design with much smaller units of 0.25 mtpa each means an initial cargo is possible this year.

OPEC, Russia rebuff Trump's call for immediate boost to oil output

ALGIERS (Reuters) – OPEC's leader Saudi Arabia and its biggest oil-producer ally outside the group, Russia, ruled out on Sunday any immediate, additional increase in crude output, effectively rebuffing U.S. President Donald Trump's calls for action to cool the market.

"I do not influence prices," Saudi Energy Minister Khalid al-Falih told reporters as OPEC and non-OPEC energy ministers gathered in Algiers for a meeting that ended with no formal recommendation for any additional supply boost.

Benchmark Brent oil LCOc1 reached $80 a barrel this month, prompting Trump to reiterate on Thursday his demand that the Organization of the Petroleum Exporting Countries lower

prices.

The price rally mainly stemmed from a decline in oil exports from OPEC member Iran due to fresh U.S. sanctions.

“We protect the countries of the Middle East, they would not be safe for very long without us, and yet they continue to push for higher and higher oil prices! We will remember. The OPEC monopoly must get prices down now!” Trump wrote on Twitter.

Falih said Saudi Arabia had spare capacity to raise output but such a move was not required at the moment and might not be needed next year as, according to OPEC’s projections, a stellar rise in non-OPEC production could exceed global demand growth.

“The markets are adequately supplied. I don’t know of any refiner in the world who is looking for oil and is not able to get it,” Falih said, adding that Saudi Arabia could raise output by up to 1.5 million barrels per day (bpd) if needed.

“Given the numbers we saw today, that (an output increase in 2019) is highly unlikely unless we have surprises on the supply and demand,” Falih added.

The statement from Trump, meanwhile, was not his first criticism of OPEC.

Higher gasoline prices for U.S. consumers could create a political headache for Republican Trump before mid-term congressional elections in November.

Iran, OPEC’s third-largest producer, has accused Trump of orchestrating the oil price rally by imposing sanctions on Tehran and accused its regional arch-rival Saudi Arabia of bowing to U.S. pressure.

On Sunday, Iranian Oil Minister Bijan Zanganeh said Trump’s tweet “was the biggest insult to Washington’s allies in the

Middle East”.

SHIFTING FOCUS TO 2019

A mid-term report released by OPEC on Sunday forecast that non-OPEC supply from countries led by the United States would rise by 2.4 million bpd in 2019 while global oil demand should grow by just 1.5 million.

It also steeply raised U.S. oil output growth estimates to 2023, predicting OPEC would lose further market share.

“Our attention is shifting to 2019. We have been briefed on the prospect of 2019 inventory builds which result from significant supply growth from non-member counties,” Falih said.

Russian Energy Minister Alexander Novak said no immediate output increase was necessary, although he believed a trade war between China and the United States as well as U.S. sanctions on Iran were creating new challenges for oil markets.

“Oil demand will be declining in the fourth quarter of this year and the first quarter of next year. So far, we have decided to stick to our June agreements,” Novak said.

Seeking to reverse a downturn in oil prices that began in 2014, OPEC, Russia and other allies decided in late 2016 to reduce supply by some 1.8 million bpd.

In June this year, however, after months of cutting by more than their pact had called for, largely due to involuntary reductions from Venezuela and other producers, they agreed to boost output by returning to 100 percent compliance.

That equates to an increase of about 1 million bpd, but the latest data shows they are some way from achieving that target.

IRAN SOFTENS STANCE

In August, OPEC and its allies cut production by 600,000 bpd more than their pact required, mainly as a result of falling output in Iran as customers in Europe and Asia reduced purchases ahead of the U.S. sanctions deadline.

OPEC put Iran's current production at 3.58 million bpd, down some 300,000 bpd from the start of the year, according to OPEC's secondary sources such as researchers and ship-trackers.

Iran's OPEC governor Hossein Kazempour Ardebili insisted on Sunday that Iranian production was steady at 3.8 million bpd but appeared to soften his stance on potential increases in OPEC output.

“If there is a fall not only from Iran, but anybody else, it is the responsibility of OPEC and non-OPEC to balance the market,” Kazempour told reporters.

Falih said returning to 100 percent compliance was the main objective and should be achieved in the next two to three months.

Although he refrained from specifying how that could be done, Saudi Arabia is the only oil producer with significant spare capacity.

“The biggest issue is not with the producing countries, it's with the refiners, it's with the demand. We in Saudi Arabia have not seen demand for any additional barrel that we did not produce.”

The OPEC/non-OPEC monitoring committee next meets on Nov. 11 in Abu Dhabi, followed by a full OPEC gathering at its Vienna headquarters on Dec. 6-7.

Sonatrach plans expansion in most areas of energy except for crude

Bloomberg Algiers

Africa's biggest oil and natural gas producer plans to expand in most areas of the energy industry except for crude, shunning US President Donald Trump's latest Twitter directive for Opec members to reduce oil prices.
Algeria's state-owned Sonatrach Group plans to develop onshore and offshore gas fields, start a trading business, revamp and build refineries and expand output of petrochemicals, chief executive officer Abdelmoumen Ould Kaddour said in an interview. While Sonatrach could boost oil production by 200,000 bpd, there is no need for an imminent increase in supplies, he said.
Algeria is the third-biggest gas supplier to the European

Union.
The Organisation of Petroleum Exporting Countries gave a tepid response on Sunday to Trump’s tweet last week insisting that the group “must get prices down now!” Opec, along with allied producers, said it would boost output only if customers requested additional oil. The producers are halfway toward their June pledge to pump an extra 1mn bpd of crude.
“Trump tweets are disturbing, but fortunately this time he did not have an impact on the Opec decision,” Kaddour said. “The price of oil is subject to many variables.”
The “right price, the fair price,” for both consumers and suppliers is between $70 and $80 a barrel, Kaddour said.
Algeria spearheaded the effort by Opec and allies including Russia to push prices higher by cutting production. The cuts took effect in January 2017, though producers changed course in June and committed to increase output to make up for losses in Venezuela and Iran.
Sonatrach could produce an additional 200,000 bpd if necessary, Kaddour said. Algeria pumped 1.07mn bpd of oil in August, and production has declined from a peak of 1.41mn bpd in December 2007. Output including gas is equivalent to 3mn bpd, making it the biggest combined producer of oil and gas in Africa, according to data compiled by Bloomberg.
The government is working on a law to entice foreign investors and reduce taxes and bureaucracy, and it may take effect by early 2019, he said.
Sonatrach expects to enter into a joint venture agreement with Exxon Mobil Corp, and will form a partnership with Total SA to build a $1.5bn petrochemical plant by the end of the year, Kaddour said.
Sonatrach is also in discussions with 14 companies, including Chevron Corp, Total and Vitol SA, to form an oil and gas trading joint venture, he said. “We are looking for new ways of trading our products,” he said, though the company hasn’t decided whether to partner with an oil producer or a trader.

Oil prices jump 2% to hit 4-yr high

Reuters New York

Oil prices jumped more than 2% to a four-year high in early trading after Saudi Arabia and Russia ruled out any immediate increase in production despite calls by US President Donald Trump for action to raise global supply.
The Organisation of the Petroleum Exporting Countries and non-Opec states, including top producer Russia, gathered in Algiers on Sunday for a meeting that ended with no formal recommendation for any additional supply boost to counter falling supply from Iran.
“The market’s still being driven by concerns about Iranian and Venezuelan supply,” said Gene McGillian, director of market research at Tradition Energy in Stamford. “The failure of the producers to address that adequately this weekend is creating a buying opportunity.”

Brent crude hit its highest since November 2014 at $80.94 per barrel, up $2.14 or 2.7%, before easing to $80.62 by 11.05am EDT (1505 GMT). US light crude was $1.43, or 2%, higher at $72.21.
Opec lead member Saudi Arabia and its biggest oil-producer ally outside the group, Russia, on Sunday effectively rebuffed a demand from Trump for moves to cool the market.
“I do not influence prices,” Saudi Energy Minister Khalid al-Falih told reporters on Sunday. Trump said last week that Opec “must get prices down now!”, but Iranian Oil Minister Bijan Zanganeh said yesterday Opec had not responded positively to Trump’s demands.
“It is now increasingly evident, that in the face of producers reluctant to raise output, the market will be confronted with supply gaps in the next three-six months that it will need to resolve through higher oil prices,” BNP Paribas oil strategist Harry Tchilinguirian told Reuters Global Oil Forum.
Commodity traders Trafigura and Mercuria said that Brent could rise to $90 per barrel by Christmas and pass $100 in early 2019, as markets tighten once US sanctions against Iran are fully implemented from November.
JPMorgan said US sanctions on Iran could lead to a loss of 1.5mn bpd, while Mercuria warned that as much as 2mn bpd could be knocked out of the market.
A source familiar with Opec discussions told Reuters on Friday that Opec and other producers have been discussing the possibility of raising output by 500,000 bpd. “We expect that those Opec countries with available spare capacity, led by Saudi Arabia, will increase output but not completely offset the drop in Iranian barrels,” said Edward Bell, commodity analyst at Emirates NBD bank.
The market has looked to softening demand from trade tensions between the US and China to offset the production cuts from Iran. Absent signs that trade tensions have eroded Chinese demand, the market will continue to surge, Tradition’s McGillian said. “That is one of the reasons we have cruised toward $80,” he said.

US commercial crude oil inventories are at their lowest since early 2015 and although US oil production is near a record high of 11mn bpd, subdued US drilling points towards a slowdown in output.

Iraq's Next War

Rival Shiite Factions Could Be Headed Toward Disaster

When Iraq and the international community liberated Mosul last year, the Iraqi government declared victory: the three-year conflict against jihadist terrorists who had seized much of the country's north was over. But the declaration was premature. ISIS remains a major threat, not only because of its own acumen as an insurgent movement but because Iraq's ruling elites have failed to address the conditions that enabled ISIS in the first place. Their failure to address the basic needs of a deeply destitute and conflict-weary population, to remedy political and social divisions, and to

forge a common national framework that unifies the country could soon pave the way for yet another devastating civil war as rival groups compete for control of the Iraqi state.

After the parliamentary elections in May 2018, Iraq was supposed to turn the page to a new, post-ISIS, even post-sectarian chapter, in which politicians would remedy the country’s polarization, endemic corruption, and violent instability. Yet things are getting worse, not better, for Iraq. Iraq’s weakened Prime Minister, Haider al-Abadi, who came in third in the elections, put forward a series of tokenistic anti-corruption initiatives that failed to convince Iraqis who are impatient with piecemeal, symbolic reforms. Corruption can take years to remedy, Iraq’s politicians explain—patronizing a population that has already waited more than fifteen years for reform.

The elections were followed by mass demonstrations in much of southern Iraq, including Basra, where protestors burned provincial council buildings and the Iranian consulate and stormed the offices of political parties. Iraq’s security forces and government-sanctioned Shiite militias responded with deadly force and human rights abuses. Basra holds Iraq’s largest oil reserves, accounts for 80 percent of the country’s oil exports, and provides more than $7 billion a month to the government coffers. It should be Iraq’s richest province, but it is among its poorest. Like much of Iraq, the city lacks clean water, electricity, and jobs.

The combination of a frustrated population and a government that lacks both the credibility and the capacity to assuage it makes for a perilous situation. Iraq has all the makings of a country that is susceptible to conflict relapse, and rather than turn a new chapter it could find itself in another civil war. Beyond political and social polarization, it suffers from the inexorable accumulation of weapons and military organizations, the absence of viable institutions, and multiple alternative authorities that supplant the Iraqi

state. Many areas are beyond the influence and control of the government, including the predominantly Shiite south, where power is distributed diffusely among parties, militias, tribes, and clerics.

Since 2003 large-scale conflict in Iraq has been between Arab Sunni and Shiite communities. But in the coming phase, conflict in Iraq will most likely be between the powerful, resource-rich, and battle-hardened Shiite rival factions that dominate the government.

INTRA-SHIITE RIVALRIES

When ISIS rose in 2014, it filled a political and ideological void that still exists today. It capitalized on feelings of marginalization among Iraqi Sunnis, as well as discontent with the corruption and dysfunction of the Baghdad government. These deep-rooted resentments are still present, but Sunni Arabs are unlikely to mobilize for the foreseeable future. They are too bruised, bloodied, and fatigued as a result of countless wars against enemies internal (ISIS, al Qaeda in Iraq, tribal infighting) and external (the United States, the Shiite-dominated Iraqi armed forces, and sectarian Shiite militia groups).

Instead, Iraq’s next war will likely be a civil war between Shiite Islamist rivals. These groups have dominated Iraq’s most powerful government posts and its security institutions since 2003. They have deployed or co-opted militia groups to secure substantial state resources. Collectively, Shiite militias are more powerful than the Iraqi armed forces, which collapsed in the face of the ISIS offensive in 2014.

Shiite militias do not submit to government control, but they are entrenched within state institutions and exploit state resources. Iraq’s most powerful and oldest militia, the Badr Brigade (formed in the 1980s in Iran), commands the federal police and has headed the Interior Ministry since 2003. After

the fall of former dictator Saddam Hussein, the Badr Brigade fought bloody battles with anti-West cleric Muqtada al-Sadr and his Mahdi Army militia. Prime Minister Abadi’s Islamic Dawa Party does not have its own militia but has abused its control over the armed forces to suppress its rivals. It has also mobilized and armed tribal factions.

Rivalries among the Shiite factions predate the 2003 U.S. invasion of Iraq. Since 2003, bloody conflicts among Iraqi Shiites have required intense mediation by political and religious leaders, including, in some cases, those from outside powers, such as Iran. In 2005, Grand Ayatollah Sistani, the leading Shiite clergyman, was forced to mediate between rival Shiite groups amid a deadly Sunni insurgency. Iraq has avoided a full-scale, internal Shiite conflict so far because it has been occupied with the Sunni insurgency, al Qaeda in Iraq, and then ISIS. These threats still lurk in the background but are not the imminent, existential threats they once were for the ruling Shiite community.

The contestation over state resources, including the high-stakes, dispute-ridden government formation process (that determines the ruling class’s share of the Iraqi state and its resources) is rapidly turning into a zero-sum game. Unlike in the past, Iraq’s Shiite factions cannot continue to get away with carving up the state among themselves while they deliver empty promises to a discontented population. The popular demand for reform is so urgent and so great that even the Shiite religious establishment has intervened to insist that the government address it. Yet the real risk that a single faction will weaponize government coffers and exploit the reform process in the coming years renders these political conflicts potentially existential ones to the groups involved.

Iraq’s political and security landscape has changed substantially since 2003. On paper, the 100,000-strong umbrella militia organization known as the Popular Mobilization Force (PMF), formed after the collapse of the

Iraqi army when ISIS seized Mosul, is a state institution that submits to government control. But in reality it is led and dominated by a plethora of autonomous Iran-aligned militia groups who do not answer to the government and who have a history of violently confronting the Iraqi military. The PMF is ascending so rapidly that it could soon subsume Iraq’s conventional armed forces.

Tensions have intensified between Abadi (the commander in chief of the armed forces) and the Iranian-backed leadership of the PMF. Hadi al-Ameri, head of the Badr Brigade and de facto head of the PMF, has allegedly warned U.S. Special Envoy Brett McGurk that he would topple any government formed as a result of U.S. interference. Amid incessant threats against the United States from Iran-aligned militias, on Thursday, multiple mortars were reported to have targeted the U.S. embassy in Baghdad’s fortified Green Zone. In Basra, Iranian proxies fired rockets at the U.S. consulate located in the city’s airport.

Already, the PMF has warned the Iraqi military against interfering in the divisive politics that has engulfed the country. The Iraqi military would almost certainly lose a fight with the PMF and its Shiite militias, which are now amalgamated under one banner and are no longer disparate and ragtag groups as they were a decade ago. These groups have made a radical transformation into viable, credible, and battle-hardened sociopolitical movements. The PMF ran candidates in the elections for the first time and came in second, beating rivals with decades of political mobilization and experience. The PMF is not only better trained and disciplined than the military but, critically, it enjoys far more legitimacy and support from the population on account of its battlefield successes and grassroots origins. The army, by contrast, is heir to a tainted history and widely perceived as corrupt and ineffective.

SAVING IRAQ

Structural conditions in Iraq are such that political rivalries and long-standing grievances have every chance of escalating into civil conflict. Social unrest like the protests in Basra could trigger yet another war between rival factions who have contested and exploited the riches and spoils of the country since 2003.

But Iraq may still have one last option for peace, in the form of a more proactive and interventionist role from Ayatollah Sistani. Since 2003, Sistani's declarations and fatwas have helped contain sectarian conflict. In 2014, when ISIS seized Mosul, Sistani forced former Prime Minister Nouri al-Maliki out of office, which paved the way for Abadi's premiership and mobilized volunteers to stop ISIS from expanding. He has already intervened in the recent conflict by effectively ruling that Abadi should step down. In accordance with centuries long Shiite religious tradition and practice in Iraq, the Ayatollah intervenes only reluctantly, and when he does, it reflects the magnitude of the crisis. Ignoring or pushing back against Sistani would further shift Shiite popular opinion against Abadi and would galvanize and unify his rivals. Few leaders in Iraq's history picked a fight with the clerics in Najaf and emerged unscathed.

The cleric and the religious establishment that he presides over may be uniquely positioned to credibly enforce the changes and reforms that Iraq needs. Sistani's unparalleled influence and support and his vast social and religious networks could be harnessed to establish a safe zone that protects and empowers Iraq's more moderate politicians and civil society leaders—the ones that have been silenced by those with guns and cash. Reforms, reconciliation, and resolution of outstanding disputes will require a sustained, forceful effort on the part of the religious establishment that comes with its own risks. But Iraq has few other options if it is to avoid yet another civil war.

Syria's Idlib Wins Welcome Reprieve with Russia-Turkey Deal

After weeks of escalatory rhetoric, Russia has partnered with Turkey in a deal to avert an all-out assault on Idlib, the last stronghold of Syria's armed rebellion. International actors seeking to end the Syrian war should embrace the agreement.

Turkish President Recep Tayyip Erdoğan and Russian President Vladimir Putin have unveiled an agreement to forestall a Syrian regime offensive in the country's north-western Idlib governorate. Per Putin and Erdoğan's announcement of the deal, signed following bilateral talks in Sochi, on Russia's Black Sea coast, by 15 October the two sides will establish a demilitarised zone along the line of contact between Idlib's rebels and regime forces. By 10 October, rebels' heavy

weaponry must be withdrawn from the zone, which will also be cleared of what Putin called “Jabhat al-Nusra” (now Hei’at Tahrir al-Sham, or HTS) – who exactly will do the withdrawing and clearing remains unclear. Russian and Turkish forces will patrol the zone. By year’s end, Idlib’s main highways will also be reopened to normal transit.

Crisis Group welcomes this announcement, which would appear to prevent a new deadly round of conflict with tremendous human cost. But implementing the agreement likely will be difficult, and its collapse cannot be ruled out. Turkey seems as if it may have to shoulder the heavy burden of partially disarming rebels inside the zone and emptying it of jihadists, a step those militants seem inclined to resist. Still, insofar as the deal avoids – at least for now – what could have been a truly shocking spectacle of violence and death, even by the standards of Syria’s brutal civil war, the agreement warrants broad international support.

Idlib is the last major redoubt of Syria’s armed rebellion. Its rebels include thousands of jihadist militants, among them HTS, the latest iteration of former Syrian al-Qaeda affiliate Jabhat al-Nusra. Yet Idlib and surrounding areas also hold nearly three million people, nearly all civilians, almost half of whom are internally displaced, including from elsewhere in Syria. If conflict consumes Idlib, most have no apparent refuge. Their only possible destinations would be the Turkish border, now closed, or Turkish-held areas to the north of Aleppo, which are already overcrowded. For its part, Turkey has also been determined to prevent a wave of displacement toward its border, which would likely include militants who could threaten Turkish and international security.

A refugee camp in Idlib from Crisis Group’s illustrated commentary “Voices of Idlib”.CRISISGROUP/Titwane

Since September 2017, Idlib has been covered by a “de-escalation” agreement announced jointly by Turkey, Russia and

Iran in the Kazakh capital Astana. Under the terms of this agreement, Turkey deployed troops to twelve observation points along the front line separating rebel from regime forces between October 2017 and May 2018. At this line they are tasked with monitoring the de-escalation and guaranteeing a ceasefire. These observation posts were subsequently matched by ten Russian and seven Iranian posts on the regime side of the line. Turkey also committed – alongside its co-guarantors – to dealing with Idlib's jihadists. It has worked to do so through nonviolent means, using political engagement and economic entanglement to separate what it characterises as more pragmatic Syrian fighters from a transnational jihadist hard core, who will have to be isolated and eventually eliminated.

Yet Turkey has been unable to bring a full halt to militants' provocations, including drone attacks on Russia's main Syrian air base of Hmeimim apparently launched from Idlib. Turkey has also made only limited progress in demobilising or neutralising Idlib's jihadists.

The agreement announced by Presidents Erdoğan and Putin was possible because, in theory, it meets the interests of the various protagonists. By forestalling a Syrian regime and Russian assault on Idlib, it averts the massive flow of refugees (including, inevitably, a number of jihadists) toward Turkey that Ankara had dreaded. It also has the potential to at least halt – or limit – cross-line attacks by militant groups, which, Russia claims, pose a destabilising threat to the de-escalation. In addition, and while Damascus was not present at the Sochi negotiating table, if the memorandum is implemented in full and Idlib's main highways are secured, it offers benefits to the Syrian regime by further reintegrating Syria economically as Damascus positions itself for post-war stabilisation and reconstruction.

Pressure, both direct and indirect, from Ankara and its allied European capitals likely played a part in producing the

accord. They wisely communicated to Moscow that a gruesome battle for Idlib would have come at a price. It would have undermined Turkish-Russian bilateral relations and cooperation on Russia’s Syrian political initiatives, including a recent push for organised refugee return. European resistance to contributing to Syria’s reconstruction without the start of a credible political transition would have hardened further in the face of mass atrocities. Turkey further demonstrated its commitment to preventing an offensive by sending reinforcements to its observation points, putting Turkish lives on the line for Idlib’s ceasefire.

The agreement as outlined by Presidents Putin and Erdoğan roughly parallels the formulation advocated by Crisis Group earlier this month. But more important than the specifics of this compromise is the achievement of any compromise at all, which – by virtue of accommodating Turkey’s bottom-line needs – necessarily means postponing a full-bore attack on Idlib and thus providing more time to fashion nonviolent solutions to the jihadist challenge.

That said, the success of this latest agreement remains a long shot. HTS personalities are already reacting angrily online, refusing to surrender their arms and autonomy. In addition to jihadist spoilers, Damascus may be dissatisfied with an international agreement that, in its view, keeps Syrian territory out of Syrian hands. The regime may seize on Idlib’s jihadist presence as justification to attack, or initiate a confrontation in hopes of drawing in its Russian ally on its side. Whether Turkey will ultimately eliminate Idlib’s jihadists and remove this pretext remains an open question.

Ultimately, this agreement may still prove only a temporary reprieve before a final confrontation in Idlib. Still, it represents at least some hope – however fleeting and fragile – of averting a genuine humanitarian catastrophe. International actors who seek to end the conflict in Syria should explore

whether Russia’s seeming reversal after weeks of escalatory rhetoric signals a new and broader shift by Moscow away from military solutions and toward more consensual negotiated settlements for those parts of Syria still beyond Damascus’s control.

Saudi Arabia’s sovereign wealth fund: Borrowing money to make money?

Saudi Arabia’s sovereign wealth fund (SWF), the Public Investment Fund (PIF), has taken an unusual approach to fund its investments: taking out an $11 billion bank loan.

The PIF is the centerpiece of the Kingdom's Vision 2030 diversification plan. While the effort to list shares of the state oil company, Aramco, in an IPO has been all but abandoned, new efforts to raise revenue for the fund have emerged. This is most recently reflected in the decision to sell the PIF's share in the state petro-chemical firm SABIC to the state-owned oil company Aramco, which would put about $70 billion in the PIF's hands to invest abroad. As I've written recently, feeding the PIF has becoming a national economic priority.

Saudi Arabia's Crown Prince Mohammed bin Salman attends during the 29th Arab Summit in Dhahran, Saudi Arabia April 15, 2018. Bandar Algaloud/Courtesy of Saudi Royal Court/Handout via REUTERS

The PIF is now a stark departure from traditional Gulf sovereign wealth funds. It's more like a private equity fund. The problem is that its investors, or owners, did not sign on for risk or additional debt. That's if you think of Saudi citizens as its owners.

SWFs across the Gulf Cooperation Council, with the exception of the Kuwait Investment Authority, are relatively new. Most were created in the early 2000s, when oil wealth created surplus revenue that could be placed abroad to grow. These SWFs were used to signal prestige acquisitions in Western brands, from high end retail and banks to auto manufacturers. Other SWFs focused on domestic development and placing state funds in new sectors like renewable energy, which helped the states economically diversify from oil-based economies. All of the SFWs, however, have the purpose of safeguarding and growing national wealth, like an intergenerational savings account or a collective nest egg.

Not all sovereign funds are based on natural resource wealth, but in the Gulf states they are exclusively the product of oil and gas revenues. Foreign reserve assets, or traditional

reserves in the Gulf, are also products of oil and gas sales abroad. But these funds may be managed more conservatively and are generally like cash savings, meant to stay liquid and easily transferrable.

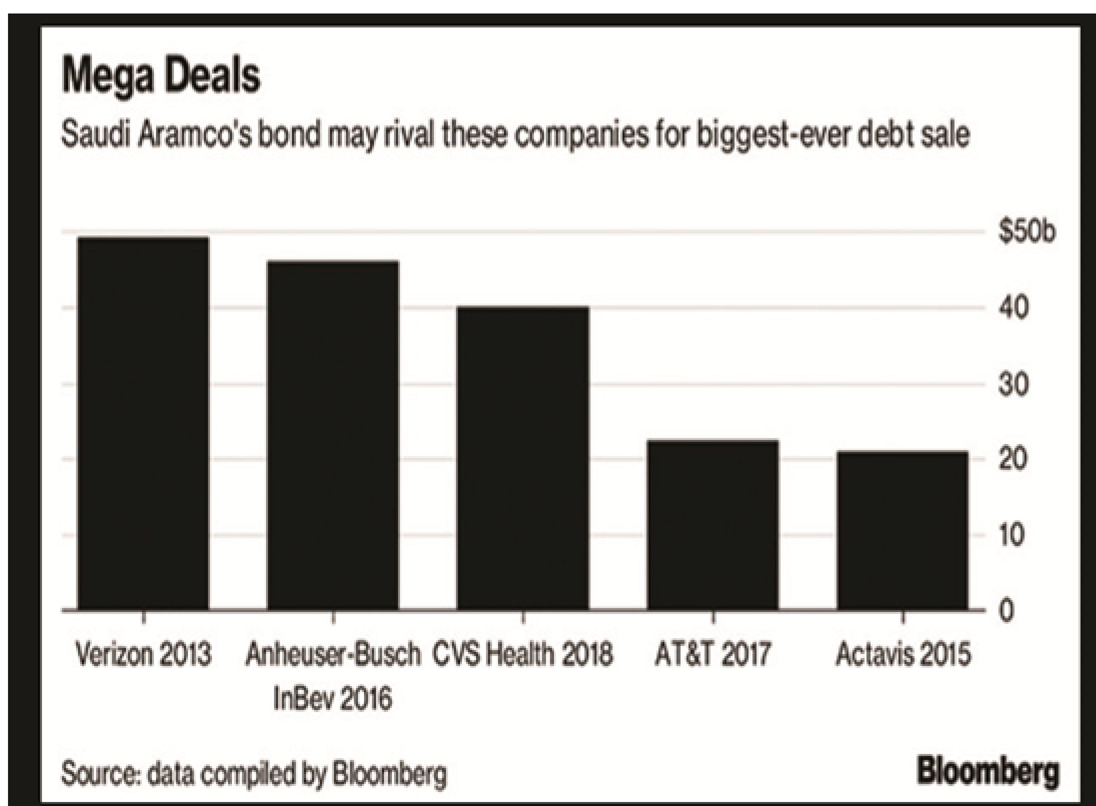
The Saudi government's management of the PIF demonstrates how leadership perceives a time horizon for meeting development goals. A willingness to borrow signals the SWF is more of an active investment fund, or a hedge fund, rather than a safe deposit of shared wealth. A higher risk tolerance in investments of the sovereign wealth fund can indicate a state's perception of threats to its domestic legitimacy – perform and deliver now, or risk unrest and an unsatisfied population at home.

The shift in Saudi Arabia from the conservative Saudi Arabian Monetary Authority to the new PIF is a repurposing of existing institutions to create a system of new state organizations. This is the Crown Prince's parallel Saudi state, with its own agenda for economic growth and a very strong hand against internal dissent and alternative ideas about the appropriate role of private enterprise. The other characteristic of the new PIF is its accelerated pace of investments and expansion of the institution itself. The horizon for growth is short. The imperative is to demonstrate quick returns and opportunities for citizens now. The long-term growth horizon is hazy.

For the citizens of Saudi Arabia, the benefits are meant to satiate immediate needs for job growth, and to show demonstrable signs of diversification. This means new entertainment venues, theme parks, and the infrastructure of a changed society and service economy. Whether these investments provide long-term productivity growth or steady returns on investment become secondary priorities. Because the Crown Prince is concerned with a young constituency, his directives to the PIF are largely short-term in scope and equally high risk. He wants results (and returns) now – what remains of the

PIF in twenty or thirty years is less of a public policy priority.

After shelving biggest-ever IPO, Saudi faces a tough bond sale



Aramco needs to raise up to $70bn, but bond investors could prove tough customers

Two months after Saudi Arabia pulled a share sale that could have raised $100bn for its sovereign wealth fund, the kingdom faces a tough sell in convincing bond investors to pick up the tab.

Saudi financial engineers are cooking up a plan to raise as

much as $70bn for the Public Investment Fund by having state oil giant Aramco buy PIF’s entire stake in sister company Sabic. That could include a bond sale the likes of which the world has never seen.

Problem is, this year’s selloff in emerging markets has sent borrowing costs surging and new debt issuance has dried up, with offerings down 14% from last year.

And yet Crown Prince Mohammed bin Salman needs to flood PIF with cash so it can accelerate a buying spree that’s seen it snap up stakes in Tesla Inc and Uber Technologies Inc since 2016. His vision is that by 2030, PIF will control $2tn in assets just as oil’s dominance worldwide starts waning.

Since shelving plans in July to sell 5% of oil giant Aramco to the public, the prince has shifted gears and now wants to keep ownership in the kingdom’s hands with the Sabic deal. As Aramco met bankers in London last week to figure out how to pay for the acquisition, the question on everyone’s mind is: Can the Saudis pull it off?

1) How much could Aramco feasibly raise in the bond market?

Aramco’s issuance could conceivably be the biggest corporate bond sale if it surpasses the $49bn Verizon Communications Inc raised in 2013 to buy a stake in Verizon Wireless Inc. Bond brokers are divided on how much appetite there will be. Some say Aramco won’t be able to raise more than $10bn at the price it wants; others think it can pull off $50bn or even $70bn.

That may be ambitious. Once person with direct knowledge of the financing talks said Aramco is likely to arrange a short-term bridge loan with a group of banks of potentially $40bn. Bankers would then aim to raise at least part of that amount in the bond market.

To be sure, Saudi Arabia isn’t afraid to go big. Since Prince Mohammed first unveiled a plan to transform the kingdom’s economy in 2016, the sovereign has raised upwards of $50bn on international bond markets, including the biggest-ever EM sale of $17.5bn that year.

2) Can the market absorb a mega Saudi bond?

Markets are in a different place now than they were in 2016. It’s not as compelling for investors hunting for yield to venture into emerging markets when US interest rates are on the rise. Add to that concerns that major developing economies are either facing slowing growth of entering recessions, and the argument in favor of taking on EM risk has fallen apart.

“It’ll be a big stretch on the market, if they want to do more than $20bn by year-end,” said Pavel Mamai, the co-founder of hedge fund Promeritum Investment in London.

3) Who is likely to buy the Aramco bond?

Given that Saudi Arabia is an investment-grade issuer, some of the world’s biggest sovereign wealth funds are likely to back the Aramco offering nonetheless. This is especially true because the notes are likely to be eligible for inclusion in the JPMorgan Emerging Market Bond Index tracked by $360bn of investors. That said, since Aramco may be deemed a quasi-sovereign issuer, loading up on this much debt could prompt ratings companies to reconsider their grades. Since 2016, the three major ratings firms have knocked down Saudi Arabia’s at least one notch.

4) Why might traditional
emerging-market investors hesitate?

Demand could be capped because investors have plenty of options in EM. The yield on Saudi Arabia’s $5.5bn of 10-year debt sold in 2016 is now at 4.14% — almost two percentage points less than the average for sovereign Eurobonds on the Bloomberg Barclays Emerging Markets Hard Currency Aggregate Index.

Buyers are better off in places like Argentina, Russia and Turkey — where 10-year debt yields as high as 10%, according to Lutz Roehmeyer, chief investment officer at Capitulum Asset Management in Berlin. “So many bonds get completely destroyed in the recent selloff that you can pick up now so many cheap bonds that high grade issuer will face little crossover inflows.”

5) But those issuers are junk-rated surely investors chasing high-grade debt will be keen on Aramco?

True, Saudi Arabia offers investors seeking stability a place to park their cash. The sovereign holds an A1 rating at Moody's Investors Service, the fifth-highest investment grade. Oil prices are up 18% this year and the Saudi central bank has almost $500bn in foreign assets.

Aramco isn't rated though, and investors may not be keen to hold long-term debt in a pure oil play when oil demand is forecast to increasingly be replaced by renewable energy. There was also a broad selloff in investment-grade debt in the past year, with companies like Apple Inc offering 3.57% yields on notes due in 2026.

Saudi Arabia will have to give a competitive first-issuer premium to woo this segment of buyers. Angad Rajpal, a senior fund manager at Emirates NBD Asset Management, said anywhere from 25 basis points to 40 basis points above equivalent-maturity Saudi sovereign debt would do the trick.

6) Where does this leave banks?

If Aramco can pull off a mega bond sale, it could mean a fee bonanza for bankers reeling from the cancellation of the IPO, according to Jeff Nassof, a director at Freeman & Co in New York. If it can raise $70bn of bonds to fully fund the Sabic purchase at a fee rate of 0.1%, for instance, banks could get a $70mn windfall, the largest underwriting fee ever paid in the Middle East.

But that's a big if. Whatever Aramco can't raise in bonds it will presumably need to borrow in loans, which means more Saudi risk on bank balance sheets. Lenders have already extended tens of billions of dollars in loans to help the kingdom weather the downturn in oil since 2014.