

Egypt

Crisis in the energy sector

Despite large energy production potential, Egypt has become dependent on hydrocarbon imports due to the structural increase in domestic consumption and the stagnation of investment. The negative consequences are substantial: a deteriorating trade balance, swelling budget deficit and disrupted economic activity. Recent support from the oil producing countries has helped reduce short-term pressures. Thereafter, reforms will be needed to make investment in Egypt's energy sector more attractive.

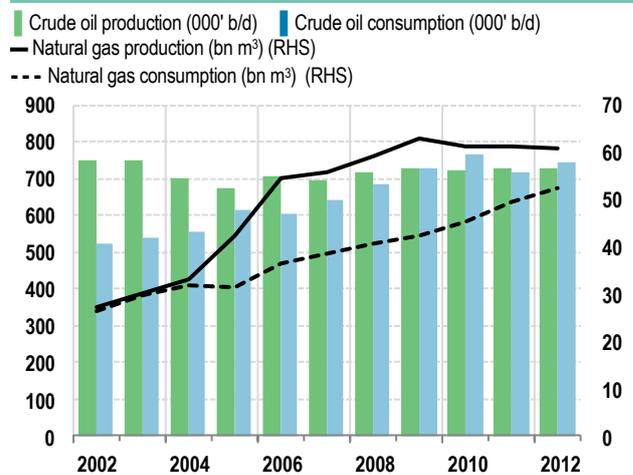
■ Growing imbalances

Egypt's hydrocarbon sector is extremely important. The country produces both natural gas and oil, and is Africa's second and fifth largest producer, respectively. On the whole, oil production has been stable for the past decade (0.73 mb/d in 2012). About 15% of oil production is exported. Development of the natural gas sector has accelerated, with production doubling since 2004 (61bn m³ in 2012). 18% of natural gas production is exported: until 2011, about a third was shipped via a gas pipeline to Israel and Jordan with the remainder marketed as LNG. The hydrocarbon sector is a non-negligible source of foreign currency (more than tourism revenues) and a key destination for foreign direct investment (40% of total FDI on average). Until year-end 2010, net energy exports generated a healthy surplus, which averaged \$4bn between 2004 and 2010.

This situation has deteriorated rapidly since 2011 due to the ongoing increase in the consumption of oil products and the stagnation in production. Primary energy consumption has increased at an average annual rate of 5% since 2000 (9% for natural gas), with natural gas accounting for 46% and oil, 41%. Several factors explain this rapid increase: industrial development, hydrocarbon extraction, the increase in the number of cars and demographic growth (1.6% a year on average). Moreover, a generous subsidy policy has facilitated the increase in consumption.

As to production, in addition to certain oil and natural gas fields that have reached maturity or are in decline, the lack of sector investment has prevented production from continuing to grow. In the natural gas sector, the gap between production and consumer needs continues to swell. Currently, natural gas production covers only an estimated 80% of consumption and export needs. At a time of swelling current account deficits and growing social-political unrest, the authorities are favouring domestic consumption over exports. Supplies carried by gas pipelines have been scaled back sharply, while LNG facilities are running at very low capacity and some have been shut down. Egypt is no longer in a position to meet its LNG supply commitments to international export companies. EGPC, Egypt's national oil company, has accumulated very high debts with international natural gas and oil companies, including a sharp increase in arrears since 2011. A low

1- Hydrocarbon production and consumption



Source: BP Statistical Review

estimate values this debt at \$6.3bn¹, practically a third of which consists of arrears. At a time of high oil prices and the growing use of energy supplies billed at market prices, EGPC has to bear the increase in the energy bill, since it faces restrictions on setting sales prices in the domestic market. Caught in a financial impasse, EGPC has seen a regular increase in its debt with international energy companies. EGPC's financial troubles, as well as those of the Egyptian government in general, have placed a heavy strain on the recovery of investment.

All in all, Egypt has become a net oil importer since 2010 and could become a net importer of natural gas as well in the months ahead.

■ Economic consequences

Higher import volumes and the drop-off in natural gas exports have strained the hydrocarbon trade balance, which became negative over the course of fiscal year 2012/13. Since 2010/11, the oil bill has increased by more than \$2bn a year. This trend is expected to continue in the years ahead given

¹ Middle East Economic Survey; 6 Sept 2013. The total is certainly higher than \$10bn (4% of GDP).

the time it takes to set up new investments and the constant increase in consumption.

The energy situation has a major impact on government accounts. Public subsidies of basic goods – 80% of which are energy related -- account for about a third of total government spending and are one of the main causes of high budget deficits. Moreover, EGPC's very deteriorated balance sheet can only be corrected through major government support.

Growing energy dependence and the economic disruptions triggered by the political upheavals of 2011 have had a significant impact on economic activity. There has even been some petrol rationing, notably for individuals and farmers. The Egyptian government is also trying to encourage the transfer of some oil consumption towards the use of natural gas for power generation. Initially, it is increasing natural gas consumption to the detriment not only of international partners, but also of local industries using natural gas or its derivatives as a raw material, such as the chemical industries (fertilizer production).

■ Outlook

This situation is clearly unsustainable in the medium term, except at the price of rapidly swelling external and budget imbalances. In the short term, the situation is sustainable thanks to the support of the Gulf countries. In July, Saudi Arabia, Kuwait and the UAE pledged to provide up to \$12bn in support for Egypt. About a quarter of this amount is provided as oil supplies. Qatar also supplies LNG, part of which offsets the shortfall for international companies now that Egypt has virtually halted its LNG exports. In general, we estimate this support could limit energy supply tensions over the next 6 to 12 months.

Beyond next year, the situation looks very uncertain. Priority is placed on the development of the natural gas industry (mainly for power generation). Yet the Egyptian authorities' capacity to develop natural gas production depends on their relations with

international companies. The new authorities have shown their determination to gradually pay off EGPC's debt with these companies, which should facilitate the resumption of energy sector investments.

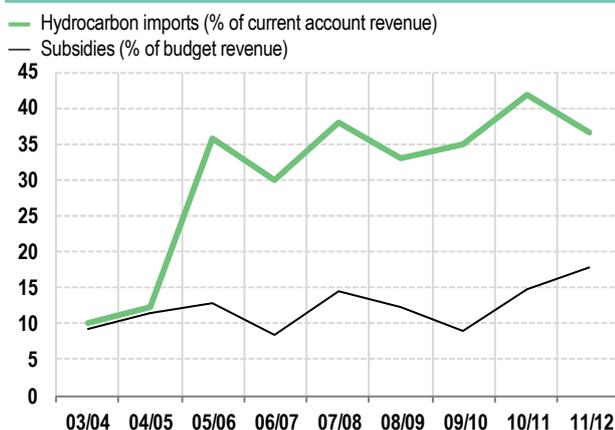
In terms of demand, the solution is well known but hard to implement in the current environment. Market deregulation including a decline in subsidies (and their targeting of low-income families) would enable prices to be set closer to market prices. For several years, this has been on the agenda of successive governments. This kind of reform can only be introduced gradually given the current political climate. Moreover, it would severely handicap the competitiveness of the industrial sector, and we cannot be sure that energy consumption would actually decline. Population growth, a high urbanisation rate and economic development needs are all powerful factors behind the increase in primary energy consumption.

All in all, the outlook is rather negative. Egypt will probably increasingly resort to imports (at market prices) to satisfy its domestic needs and to honour at least part of its natural gas export commitments. The price will be heavy, though, in terms of greater pressure on the trade balance and public accounts.

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2- Energy bill and macroeconomic imbalances



Sources: Mdf, BNPParibas

Forecasts*

	2011	2012	2013f	2014f
Real GDP growth (%)	1.8	2.2	2.0	3.0
Inflation (CPI, year average, %)	11.1	8.6	8.2	11.0
Gen. Gov. balance / GDP (%)	-9.8	-10.7	-13.8	-11.0
Gen. Gov. debt / GDP (%)	77.0	80.0	84.0	84.0
Current account balance / GDP (%)	-2.6	-3.1	-2.5	-2.5
External debt / GDP (%)	21.0	16.0	21.0	23.0
Forex reserves (USD bn)	24	12	12	16
Forex reserves, in months of imports	4.2	2.0	1.8	2.5
Exchange rate EGP/USD (year end)	6.0	6.4	7.03	7.0

(*) Fiscal years T-1/T (June-July)

f: BNP Paribas forecasts