

1 **Egypt's energy quagmire could sink Sisi**

2 BY MAGGIE FICK

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5 Egyptian Army chief Field Marshal Abdel Fattah al-Sisi arrives for a
6 meeting with Russian President Vladimir Putin at the Novo-Ogaryovo
7 state residence outside Moscow, February 13, 2014.

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9 (Reuters) - Egypt's army chief, Field Marshal Abdel Fattah al-Sisi,
10 won vast popularity by crushing the Muslim Brotherhood, but even a
11 man seen by his followers as invincible may be unable to fix the mess
12 in the politically sensitive energy sector.

13 Sisi, who toppled Islamist leader Mohamed Mursi in July and
14 promised to bring calm to Egypt, is expected soon to stage a triumphal
15 run for the presidency in elections due within months.

16 His first big challenge is likely to be power cuts and fuel shortages -
17 the same issues that plagued Mursi and helped spur mass protests that
18 enabled the army to oust him.

19 "Sisi is still very popular, but he realizes that Egyptians can go to

1 Tahrir Square tomorrow if his administration is seen as not being as
2 efficient as promised," said Justin Dargin, a Middle East energy expert
3 at the University of Oxford.

4 Cairo's Tahrir was the hub of protests that ended three decades of
5 one-man rule by President Hosni Mubarak in 2011.

6 To many Egyptians, Sisi is all-powerful, but industry experts, foreign
7 oil and gas companies and Western diplomats doubt he can take bold
8 steps to tackle Egypt's energy nightmare.

9 Successive governments have failed to develop a sound strategy to tap
10 major natural gas reserves even as an exploding population boosted
11 demand for the fuel.

12 Egyptian gas exports began in the mid-2000s, but more than halved
13 from 2008 to 2012. They have now slowed to a trickle, contributing to
14 a global decline in liquefied natural gas (LNG) supplies.

15 Production from maturing gas fields is declining. The government
16 forecast this month that consumption will outstrip output for the first
17 time in the fiscal years starting in July.

18 The army-installed government is in a bind.

19 Gulf Arab donors have propped it up with aid that includes \$4 billion
20 in oil products from Saudi Arabia, Kuwait and the United Arab
21 Emirates, but their diesel is not compatible with Egypt's gas-based
22 power plants and big factories.

23 NOWHERE TO TURN

24 Qatar bailed out Egypt with extra gas during Mursi's rule, but his
25 ouster badly soured ties with Cairo. Like its predecessor, the interim
26 government has failed to secure a means of importing LNG directly,
27 so Egypt has nowhere to turn for gas.

28 A tender for a floating LNG import terminal has been pending since
29 October. Even if it was in place, experts say nothing can match the
30 favorable swap deal Qatar gave Egypt last year.

31 "We have enough installed capacity but the problem is with fuel," said
32 Aktham Abouelela, spokesman for the Electricity Ministry. "It is not
33 good for power plants to run on diesel."

34 Egypt's energy troubles are rooted in fuel subsidies that cost the

1 government \$15 billion a year, a fifth of the state budget. The money
2 keeps pump prices well below market values, giving Egyptians no
3 incentive to curb their consumption.

4 The subsidies, in place since the era of socialist President Gamal
5 Abdel Nasser five decades ago, drains foreign currency that could
6 instead be used to pay off debts to foreign energy companies and
7 improve payment terms to encourage investment.

8 Ask any Egyptian minister about the subsidies, and he will say they
9 must be reformed. But fuel, along with food, is a powderkeg issue in
10 the most populous Arab state. In 1977, a cut in bread subsidies ignited
11 riots against President Anwar Sadat.

12 People power has helped topple two presidents since 2011.

13 Like others, Sisi may take stop-gap measures to get through the hot
14 summer months, when demand for fuel soars - although outages are
15 now occurring even in winter. Fearful of public anger over blackouts,
16 the government will probably reduce gas feedstock to
17 energy-intensive cement and steel factories.

18 "The situation is one of duress, of survival," said Dargin, predicting
19 Sisi will maintain the costly status quo even if it means breaking
20 international commitments.

21 Companies forced to cut output in periods of peak electricity use in
22 recent years will "have to consider if it's even profitable to stay in
23 Egypt for the long term", he said.

24 Industry experts also predict that Sisi will keep breaking contracts
25 with foreign companies such as BG and diverting gas promised for
26 export to satisfy domestic demand.

27 BG's problems in Egypt have affected its LNG unit so much that it
28 issued a profit warning last month. Blaming political turmoil in Egypt,
29 BG cut production forecasts for the year and served "force majeure"
30 notices to affected buyers and lenders.

31 SUPPLY SHORTAGES

32 Since the beginning of this year, Egypt has been diverting the
33 maximum amount of natural gas produced by BG and its Malaysian
34 partner Petronas based on pipeline capacity constraints, said Martijn

1 Murphy of Wood Mackenzie.

2 "The government priority will be on guaranteeing power generation,
3 which accounts for the bulk of supply, so it will try and minimize
4 shortfalls to this sector," said Murphy.

5 "Industry is likely to bear the brunt of supply shortages."

6 Companies will not press ahead with new development unless they get
7 guarantees on future export volumes.

8 Egyptians expect miracles from Sisi. Foreign companies will look for
9 signs he is willing to reform the energy sector.

10 The stakes are high.

11 If Egypt can't persuade companies to exploit its gas reserves, it will be
12 forced to spend more hard currency on energy imports, creating the
13 same dilemma it faces with wheat.

14 Egypt is the world's biggest importer of wheat because inefficiency
15 and corruption undermine farming along the Nile.

16 Oil Minister Sherif Ismail hopes Egypt can satisfy its ever-growing
17 energy demand from own resources, but acknowledges the
18 government will have to resort to imports.

19 Until Egypt deals with issues obstructing gas output by foreign firms,
20 it "will have to cover all its energy needs with imports, either gas or
21 crude oil", he told Reuters last week.

22 Doing so while keeping prices artificially low domestically will doom
23 attempts to improve Egypt's finances. Although foreign reserves have
24 been boosted by Gulf aid, they are only half pre-2011 levels, limiting
25 the government's scope to buy fuel.

26 Energy imports would also send a discouraging signal to foreign
27 companies, which are becoming increasingly reconciled to the
28 prospect of LNG exports halting entirely this summer, said Peter
29 Hutton, an analyst with RBC Capital Markets in London.

30 He said Egypt was locked in a vicious circle given its inability to
31 import LNG. "If you can't get gas in, some tough choices will have to
32 be made. The easiest is not to export.