East Africa’s Fate As Oil Crisis Worsens

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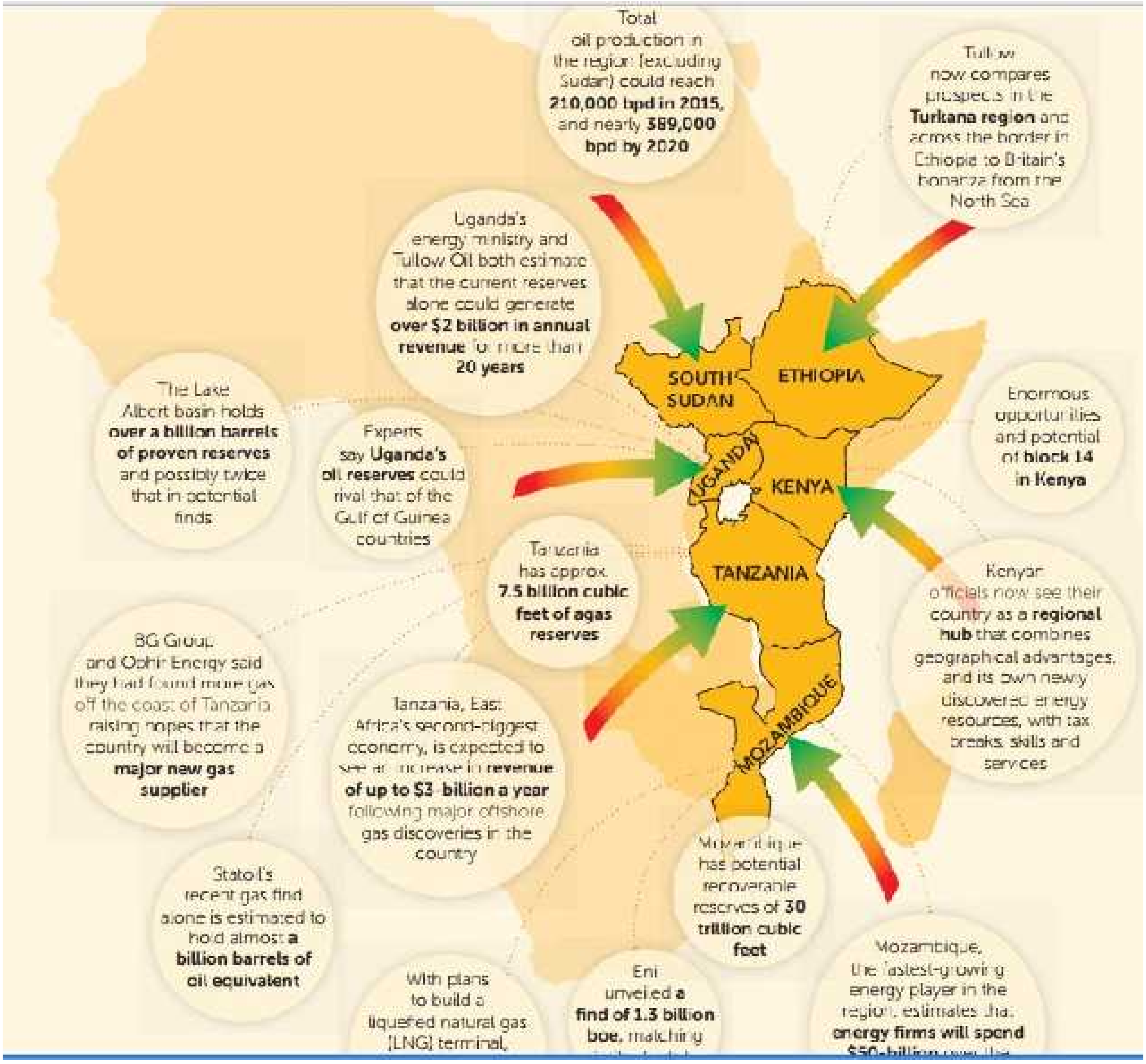
November 30, 2014

VENTURES AFRICA – Recent oil and gas finds across the East Africa region has positioned it as a lucrative investment destination in Africa. Research has shown that discoveries in the last few years are more than that of any other region in the world, and the boom is expected to continue for the next five years. This impressive position is however becoming less significant as global oil prices continue to fall. A continued decline threatens the region’s economic prospects.

Multiple Oil and gas discoveries, better economic prospects

The ongoing market integration by the East African Community (EAC), which comprises Burundi, Kenya, Rwanda, Tanzania and Uganda, has contributed to the region becoming an attractive investment destination. But the recent oil and gas finds in Kenya and Tanzania have also made its prospects even better.



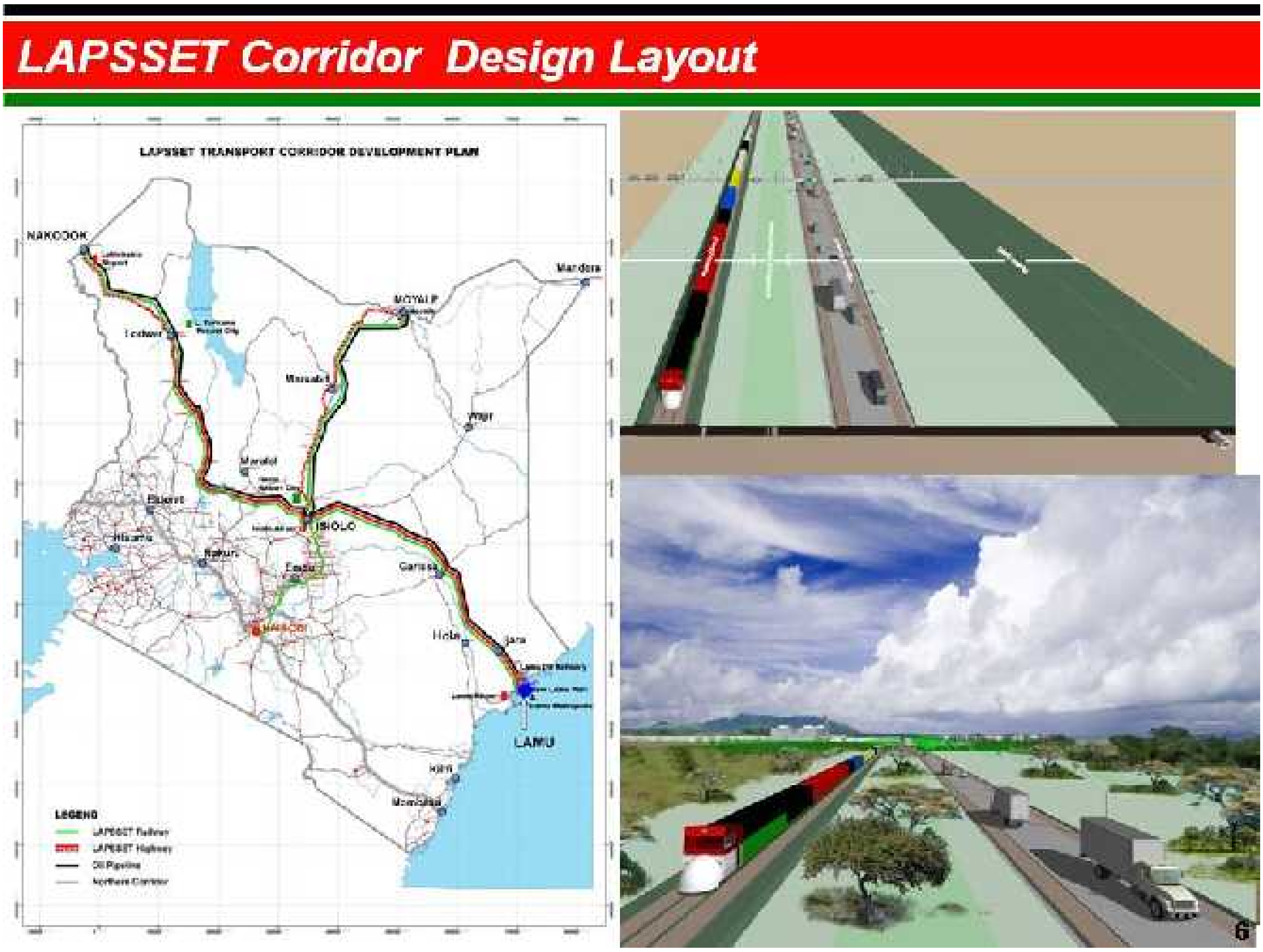
East Africa Oil map
source: paixetdeveloppement.net

British exploration firm, Tullow Oil and its partner, Africa Oil have found more than 600 million barrels of oil in Kenya, and has discovered over 8 commercially viable oil wells since the first oil find in 2012. Uganda also has 6.5 billion barrels of oil deposits discovered over the last eight years. Tanzania’s natural gas discovery has topped 50.5 trillion cubic feet. Albeit not a member of the EAC, Mozambique is another country in the East African region that has found gas. It has a reserve of about 200 billion cubic feet. The natural gas finds in Tanzania and Mozambique are among the largest in the world.

Uganda and Kenya are expected to commence commercial oil production by 2017, while Mozambique and Tanzania's natural gas projects are expected to come online in 2019. The discoveries are very important to the region, as they have the potential of hastening economic growth via investments in road, rail and other infrastructure. Whatever bright hopes the region may have before as regards economic growth from oil revenue, has now been lulled by the falling oil prices. Production has not even begun.

Recouping its massive investments in infrastructure just got harder for East Africa

Kenya, Uganda and Tanzania are particularly hopeful to lure investors to key infrastructure to further exploit their oil and natural gas. The region is already investing in infrastructure. Several projects have commenced, one of them is the **LAPSETT project** valued at $23 billion. It includes the construction of a network of roads, railways and pipelines linking Kenya, Ethiopia and South Sudan.



source: vision2030.co.ke

Kenya is expected to increase its spending on infrastructure by 15 percent by 2015. The government also plans to fast-track the construction of a pipeline to export crude.

Uganda has signed an agreement with France's Total, Britain's Tullow Oil and China National Offshore Oil Corporation (CNOOC) to develop oil fields and a pipeline linking them to the coastal port of Lamu in Kenya for export. The country is also considering bids from companies including Japan's Marubeni Corp. and a group of investors led by China Petroleum Pipeline Bureau to build a 60,000-barrel-per-day refinery.

With a loan from the Export-Import Bank of China, Tanzania hopes to complete construction in 2014 of the $1.2-billion Mtwara gas-pipeline project stretching to Dar es Salaam on the coast. Norway-based Statoil and London-based BG Group are also considering a liquefied natural gas (LNG) export plant on the Tanzanian coast.

However, the free fall of global oil prices is beginning to raise fears on whether the region will be able to recoup its massive investments on infrastructure, as investors have become less optimistic. Toronto-listed explorer Africa Oil, whose interests span across several African states such as Kenya and Ethiopia, said this month that its plans in Kenya might be brought into question if the long-term outlook saw prices dropping below $70 a barrel. The company has already put up part of its stake in Kenya up for sale.

Oil legislation

The region's future economic growth seem to have been tied to its oil boom, as legislations aimed at milking the new found cash cow is being effected across East Africa.Even Rwanda whose hope of striking oil is just being kept alive by the success of its neighbours, have put an exploration policy in place ahead of its anticipated discovery. The upstream petroleum law is also currently being drafted.

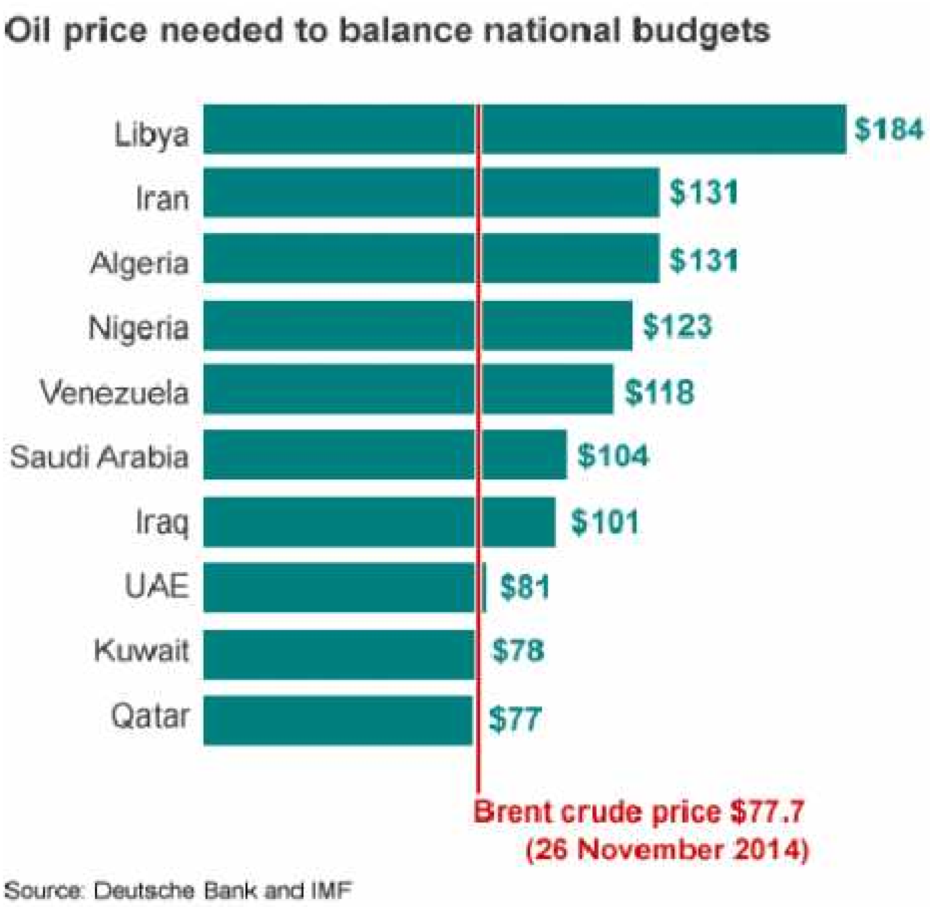
Kenya has raised the capital gains tax for oil and gas related transactions to 37.5 percent. Analysts have however said it will have a negative impact on the development of the exploration industry still in its early stage. This will include potential barriers to entry for new investors and erosion of present investor confidence. When Kenya announced its capital gains tax plans in September, the shares of Canadian firm Africa Oil, one of the major exploration companies working in the country, dropped. This shows how far-reaching the effect of the new tax regime can be.

Kenya has licensed 41 out of its 46 oil and gas blocks to 21 companies, showing the country's eagerness to start making money from oil. Its Petroleum Bill is also expected to be passed by Parliament this month. The bill proposes, among other things that petroleum production be managed under the Energy Regulatory Authority; it stipulates how the revenues from future oil and gas extraction should be shared.

There also contains in the bill, a proposal to establish the Kenya National Sovereign Wealth Fund. The fund would build a portfolio of investment in Kenya and abroad, and it will consist of a stabilization fund, a future generation fund and an infrastructure and development fund. However, with the continued decline in oil prices, Kenya may have to wait close to a decade to actualize these plans.

East Africa gets a wake-up call

The multiple oil finds in the region may be good news for East Africa, but it is coming at a bad time. The present oil glut which is making prices fall seem set to continue, as the much awaited meeting of OPEC ended with the cartel maintaining its output at 30 million barrels per day. Some analysts have said that oil prices could fall to as low as $60 per barrel if OPEC does not agree to a significant output cut.



With oil-based economies struggling under the impact of the price fall, it is unlikely that prospective oil producers will get any new investments in the mean time, as investors hold back to see where the oil market heads in the coming months.

Although the current trend in the oil market is not expected to play on for too long, East Africa might have just gotten a wake-up call. It has to ensure it does not get carried away by the natural resources boom and fall into the Dutch disease risk. The region should continue its market integration and focus on strengthening its manufacturing and agricultural sectors.