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Uganda: Oil Price - Are Uganda's Oil Dreams Dashed or Merely Delayed?

By Mark Keith Muhumuza

The reality check for Ugandan technocrats is that throwing around dates on when the country will first get oil has to be slowed down. Just like the projections by the government have swayed from 2016 to 2017 to 2018 to 2019 to 2020, depending on which one you pick, global oil prices have also been equally volatile. It was not the case when oil was discovered in 2006, with oil reserves growing to 6.5 billion barrels of which only 1.5 billion is recoverable.

Last week, there was a recovery in the oil price that rose to its highest price of \$35 (about Shs121,000) in the last three months. Two years ago, that price was \$110 (Shs382,000) a barrel and the prospects for Uganda's oil were indeed positive. When the price was this high, the government was accused of going slow in approving production licences for oil companies. The grumbling from the companies is that they have been denied an opportunity to reap the benefits of higher crude oil price.

The tone from the technocrats has not changed much even with the rather gloomy outlook for oil producing countries. The phrase often heard from the Energy ministry officials is: "We have seen lower oil prices before."

Ministry of Energy had not responded to our comment request by press time.

The sector has, however, witnessed headwinds, which can be partly attributed to the low oil prices. Globally, oil companies have laid-off an estimated 258,000 workers (according to Bloomberg), and some have cut back on expenditure on new exploration sites. In Uganda, oil companies, Total, Tullow and CNOOC all sent some of their workers home partly because of the low oil prices and limited activity in the sector.

In a recent Operational Trading Statement, Tullow announced it will cut expenditure on exploration by nearly Shs700m to \$1.1b (Shs3.8 trillion) in 2016 due to a reduction in oil prices. Tullow did not disclose planned expenditure for Uganda but it revealed that in East Africa, operational expenses will be \$250m (Shs868.2b) this year.

Many governments that are reliant on oil are already running budget deficits as a result of the low prices. For instance, Nigeria relies on 70 per cent of oil revenue to finance its budget. By the end of the third quarter of 2015, revenues were down 30 per cent. Additionally, this has triggered a currency crisis and a depletion of foreign reserves by \$9b (Shs31 trillion), according to The Economist.

According to the Financial Times, sovereign wealth funds, where cash is stashed away for investments on behalf of oil producing countries, had been depleted by \$19b (Shs66 trillion) in January 2016 as governments seek extra money to finance their expenditure.

As Uganda prepares for production, there is a brave face being put on some oil companies. In a recent interview with Daily Monitor, Adewale Fayemi, general manager Total E&P Uganda insists Uganda's oil is still competitive despite the low crude oil price.

"It is the cost of development. At the end of the day, it comes down to how much it costs you to produce a barrel. When you consider the resources used to produce oil in Uganda and compare to places that need deep off-shore facilities, it is not the same price. That is why it would still be competitive," he said.

According to estimates from the World Bank, for Uganda to make a considerable profit from its oil, the oil price should be about \$60 (Shs208,000) a barrel.

Another estimate from Standard Chartered Bank indicates that the price should be about \$70 (Shs243,000) a barrel. Currently, prices are much lower than that, which places oil production prospects uncertain - at least for now.

In its September 2015, the World Bank released the Uganda Economic Update. At the time, oil prices were hovering just above the \$40 (Shs139,000) per barrel. The warning in that report was that the potentially low oil price could complicate negotiations for infrastructure projects like the oil pipeline and refinery.

"If oil prices take longer to recover from the current levels of \$40 (Shs139,000) per barrel, compared to the estimated break-even price of \$60 (Shs208,000) per barrel for its production in Uganda, it may even require different choices with respect to the phasing of refinery and pipeline investments," the report reads.

Infrastructure delays

A little over 10 months ago, Uganda announced it had picked consortia led by Russia's RT Global Resources to be the lead investor in the \$4b (Shs13.8 trillion) oil refinery. That deal is yet to be completed and several sources indicate details on the financial modeling, contribution and guarantees from the government have protracted the negotiations.

At a time when oil prices are this low, investors are also rethinking where they put their money. It is an unpleasant situation for Uganda as almost all the required funds for the big pocket project require the country to borrow money.

The concern, according to Razia Khan, chief economist at Standard Chartered Bank Plc, is Uganda plans for increased public infrastructure are limited by the large deficits it is currently running.

On top the refinery, which is a government project, other expected infrastructure includes pipelines and storage facility in the outskirts of Kampala. The oil pipeline negotiations are still ongoing although two of the companies, Total and Tullow have disagreed on the route of the pipeline causing delays in the financing model. It is expected that the oil companies will partly finance the oil pipeline construction but in the face of low oil prices, the companies will assess the viability at the moment. The estimated cost of the pipeline is \$3.5b (Shs12 trillion).

"The longer the volatility continues in the global market, the more it will prolong the benefits for Uganda. It is a concern at the moment,"

Khan pointed out at a recent meeting with Ugandan journalists in Kampala.

Adding, "The oil majors are all cutting back on expenditure. We also know that whatever the assessment for the breakeven price for Uganda's oil, it may slow down the achievement for first oil."

Short-term pain

The optimism is that prices will recover but the recovery could only just close or be below the breakeven point for Uganda's oil. The projections are also both gloomy and upbeat but no one seems to know where prices will be by the end of this year. Investment banks like Credit Suisse, RBS, Morgan Stanley and Bear Stearns have projections that the price could hit even below \$10 (Shs34,000) a barrel, sending further shockwaves to the market. The last time oil prices were around the \$10 low was in 1998, at the height of the Asian financial crisis.

However, some other banks like Standard Chartered are predicting that the price will have recovered by the end of 2016.

"Eventually, the market is going to correct upwards," Khan says. It is a sentiment shared by Total E&P's Fayemi, who is quick to point out that oil in Uganda is a long-term project that will not be derailed by the temporary low oil price regime.

Uganda is not yet an oil producing country partly because the government has taken its time to issue new production licences. The low crude oil price, Dr Fred Muhumuza, an economist explains, works as a "lesson for planning in the future to avoid being hit by such volatility."

Related projects

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VAT on equipment scrapped

Last year one of the hurdles to exploration, VAT on equipment, was scrapped by the government. Total E&P's general manager Adewale Fayemi, commenting on that matter, said VAT exemption is one of the key enablers government has undertaken.

"When it comes to incentives to promote investment, the door is never closed. In some cases, this is mostly driven by the situation especially on how it can facilitate investment. We are engaging the government so that we see how further we can promote the development of the industry by facilitating investment," Fayemi added.

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