S&P Global Platts

Insight

December 2018

S&P GLOBAL PLATTS
GLOBAL ENERGY AWARDS
Celebrating 20 years

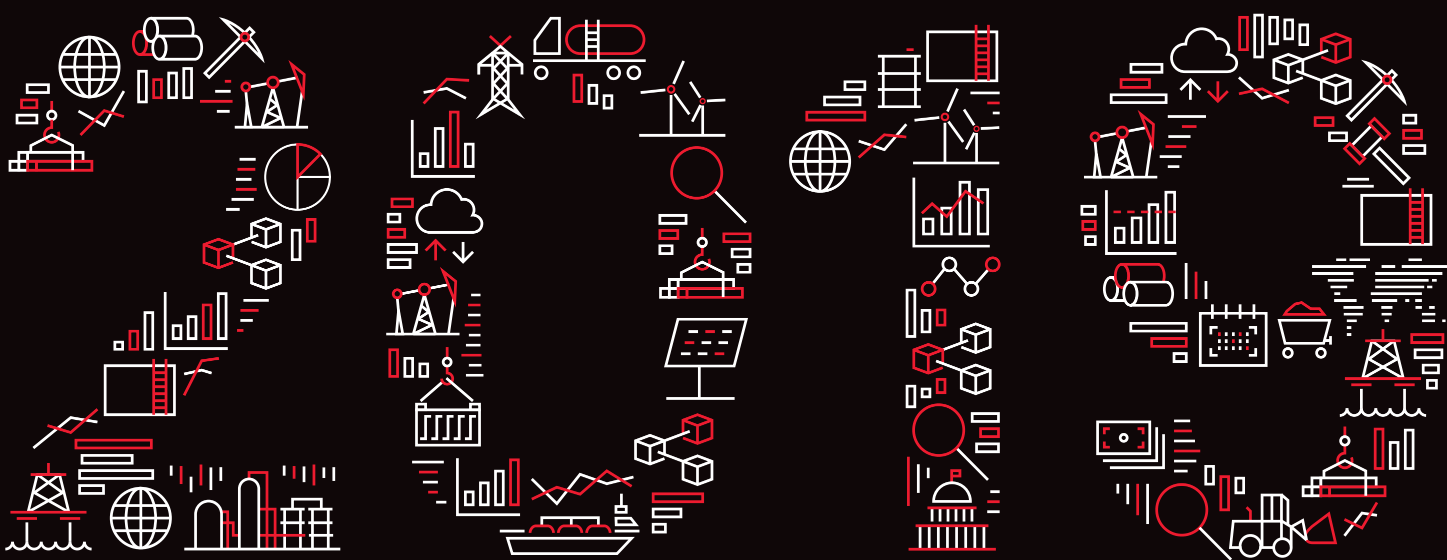
The five themes to watch next year

US midterm elections: energy impact

How blockchain could disrupt commodities

Disruptors, dealmakers and new developments

Looking ahead to



Nigeria's power struggles

Nigeria's oil sector is mired in economic stagnation, stalled reforms and a risk of rising militancy. But the appeal of its light sweet crude may yet herald a brighter future, writes Eklavya Gupte

"We are ready to bring it down. It won't drill a barrel of crude," tweeted Mudoch Agbinibo, the leader of the militant group Niger Delta Avengers, which in 2016 brought Africa's largest oil producer to its knees with brazen attacks on the Delta's oil facilities.

The tweet referred to the floating production storage and offloading unit of the 200,000 b/d Egina field, which is due to start up later this year, pushing up Nigeria's oil output by over 10%.

Mudoch's tweet came in February, as the Egina FPSO first reached the shores of Nigeria via a South Korean shipyard. This also happens to be the last time Agbinibo appeared on social media. The Niger Delta Avengers, a group of which little is known, have basically been dormant since then, barring for some apocalyptic threats.

Despite this hibernation by the group, the din in the Delta is gradually growing and the chances are high that the Avengers, along with a handful of other militant groups, will plan attacks on oil infrastructure. The government has so far also pledged to prevent fresh outbreaks of militancy and violence in the Niger Delta. It has found ways to keep the militants quiet through a cluster of promises on money and development, and a shaky amnesty program.

The amnesty program began in 2009 by former President Umaru Musa Yar'Adua was meant to fight militancy in the Niger Delta by offering incentives to young people to give up on oil theft and sabotage. It briefly worked, but critics argue the program has now morphed into a money-for-peace model that is unsustainable. New militants have emerged over the past decade to replace the old ones, and the Delta remains just as fragile.

Nigeria's oil industry can best be described as mercurial. It produces probably the best quality crude in the world, yet this oil has created deep fractures in its society fueling militancy, corruption and mistrust that has thrived in a country beset by economic and regulatory uncertainty.

2019 elections

Now, the country faces a fresh challenge as it heads into a volatile presidential campaign season ahead of its February 2019 elections.

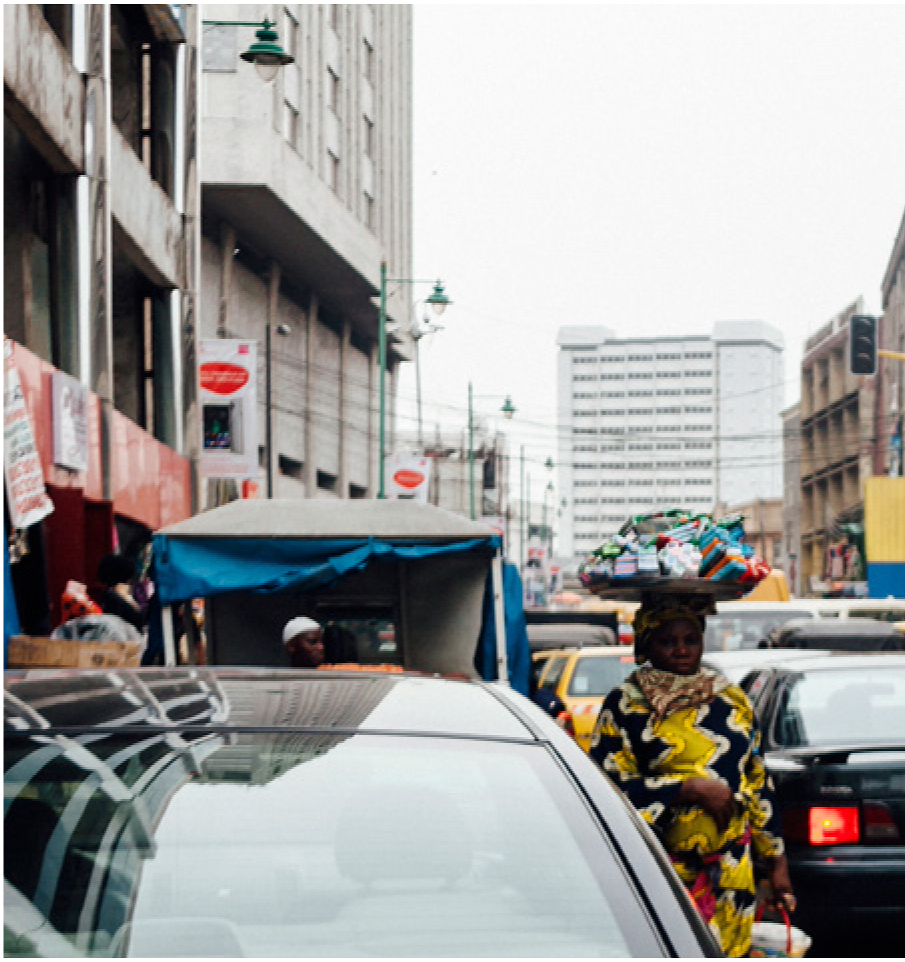
Popular export grades like Bonny Light and Forcados have been riddled with pipeline sabotage issues this year, but Nigeria has managed to restore some production after it fell to 30-year lows in 2016. Nigeria's crude and condensates output, which plummeted to 1.1 million b/d in mid-2016 due to renewed militancy in the Delta, has been climbing gradually and averaged just over 2 million b/d in September.

Maintaining production at full capacity of 2.2 million b/d has been a struggle for any government in the past decade, and it isn't going to get any easier. The quandary for President Buhari is that his political rivals have found common cause with militants in undermining Niger Delta security. Most analysts expect disruptions to Nigerian oil output of around 300,000 b/d leading up to the elections.

"While large attacks of oil infrastructure remain unlikely, the volume of oil theft and minor disruption is likely to increase... and may push IOCs to declare force majeure on Nigerian crude streams," consultancy Rapidan Energy said in a recent note.

Nigeria needs to find innovative ways to market its crude to new buyers, particularly countries or regions where oil demand is on the rise, such as China

The attacks are also likely to fan the flames between the Christian south and Muslim north, reinforcing a popular narrative that Buhari is doing more to grow the oil sector in the north rather than in the Delta, which remains the heart of the oil sector. This narrative has been supported by recent announcements by the Nigerian National Petroleum Corporation that it will start oil exploration in the Lake Chad basin, along with plans to build a new refinery near the Niger border.



Despite the oil potential in the north, the region remains dominated by the Boko Haram insurgency, limiting these prospects. Supported by Vice President Yemi Osinbajo and oil minister Emmanuel Kachikwu, Buhari pushed for a 30% increase in amnesty program payments this year, along with a sizable increase to the budget of the Niger Delta ministry – part of a charm offensive to keep militants on side.

In the past two years, President Buhari and his government have found ways to keep the militants quiet through promises of development, money and the amnesty program. But they face a stiffer challenge as the country heads into a volatile presidential campaign season.

Light and sweet

Despite all the unrest, the appeal of Nigeria's crude, which is light and sweet, and of high quality, could face a brighter future. This crude is largely low in sulfur and yields a generous amount of diesel, jet fuel and gasoline, which are the profit-making products for global refineries.

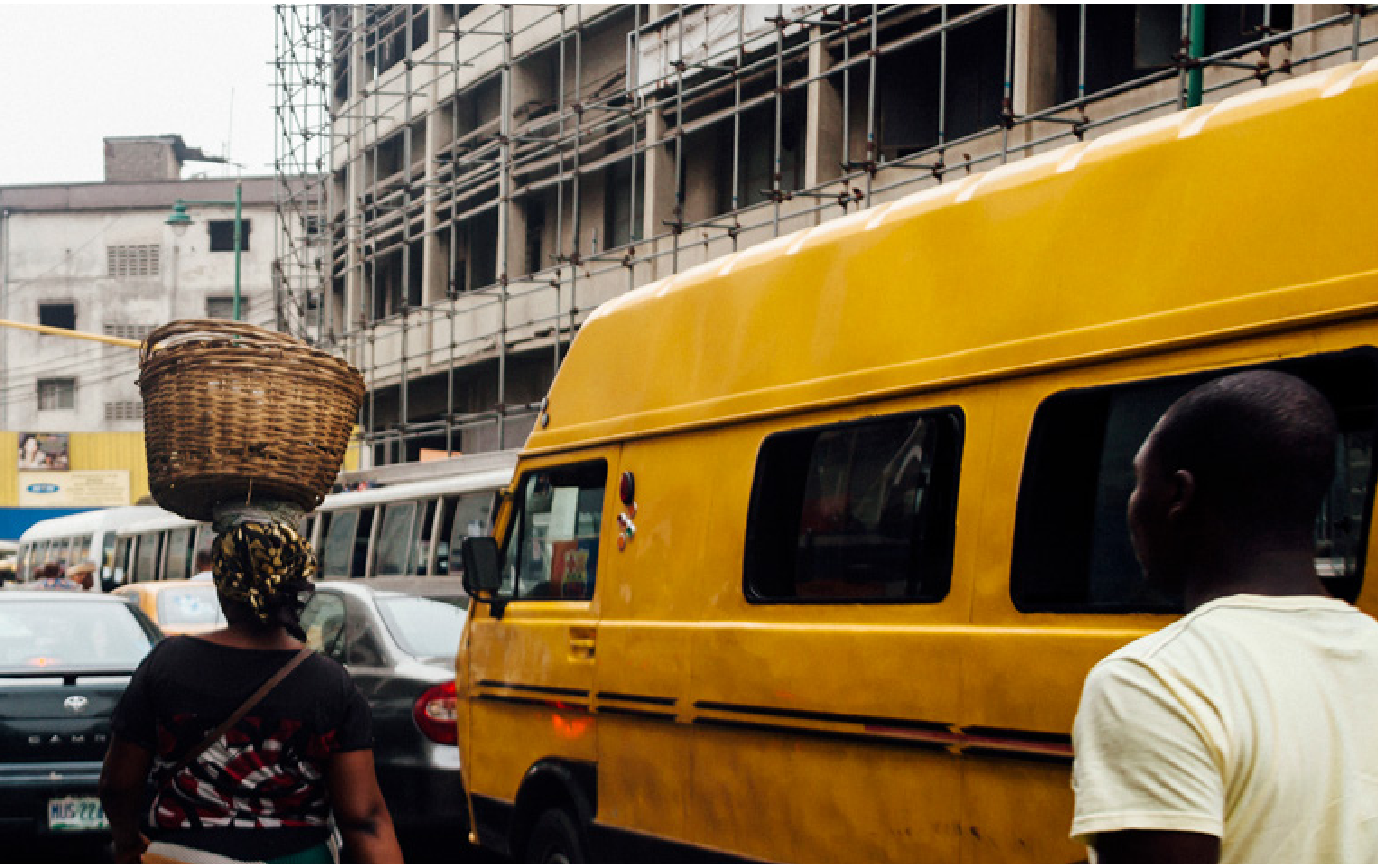
The Nigerian light sweet barrel – until almost a decade ago, every refiner's most sought after barrel – was one of the biggest casualties of the US shale revolution. US shale oil is extremely similar in quality to light sweet Nigerian crude, and as more and more shale basins were discovered in its own backyard, the US, which used to be the largest buyer of Nigerian crude, did not need any more oil from Africa's largest producer.

But the country's light sweet crude could stage a comeback, as the International Maritime Organization's 0.5% sulfur cap on marine fuels comes into effect in 2020. The regulation is expected to drive demand for lower sulfur products, triggering stronger demand and increasing the profitability of crudes that are low in sulfur.

A big focus for Nigeria's government and oil marketers is to broaden the popularity of Nigerian crude. Currently, the bulk of Nigerian crude goes to Europe and India. Europe's oil demand is largely stagnant and it is awash with so many different types of crudes that it is tough to compete with cheaper, heavy sour varieties. So Nigeria needs to find innovative ways to market its crude to new buyers, particularly countries or regions where oil demand is on the rise, such as China, the world's largest crude oil importer.

The West African country has taken some steps to broaden its customer base, but these are not enough. NNPC's 2018/2020 crude oil term contracts, which came out earlier this year, were handed to more than 60 recipients – the largest list Nigeria has ever allocated. Officials have cited this as a demonstration of NNPC's efforts to broaden its customer base and include more domestic companies, which may help Buhari ahead of the elections.

Many of the winners of the coveted contracts were domestic Nigerian companies that are new to the world of international oil trading. A lot of these firms have no experience in oil trading and will be transferring their allocations to bigger trading companies that have greater familiarity with end-consumer markets. The allocations might mean there is a larger pool of people involved in Nigeria's crude oil term contracts, but it also means the murky oil business, already riddled with corruption, could get messier, especially ahead of the elections.



Reforms needed

Nigeria's oil sector is in urgent need of a complete overhaul, but this looks unlikely to happen given the current political climate and February elections.

The Petroleum Industry Governance Bill is intended to bring order to the country's oil sector. It seeks to change the way upstream agreements, fiscal terms and production sharing contracts are handled, while splitting NNPC into three different entities: an upstream and downstream company, as well as an independent regulatory commission.

Given the level of corruption in Nigeria, the passage of the PIGB has been looked on as the first step for the country to overhaul its industry and achieve its long-term oil production targets. However, it has been stuck in parliament for more than eight years, held up by political wrangling and objections from foreign oil companies that have said the significantly higher fiscal terms envisaged in recent drafts were unacceptable. Most recently, Buhari withheld his assent of the bill in August and sent it back to the National Assembly for review.

A provision of the PIGB includes curbing the powers of the Nigerian president and oil minister to award lucrative contracts on a discretionary basis and also to run the three new entities to be created from the state-owned NNPC. This is cited as one of the reasons Buhari has stalled the progress of the bill, showing how central oil is in Nigeria's corridors of power. Some steps to address these issues will need to be a priority for the next administration.

Despite these challenges, Nigeria remains one of the key crude oil exporters globally, and the nature of its vast oil and gas reserves means it will continue to be a crucial player in energy markets. ■

This article is forthcoming in Oxford Energy Forum, the quarterly journal of the Oxford Institute of Energy Studies