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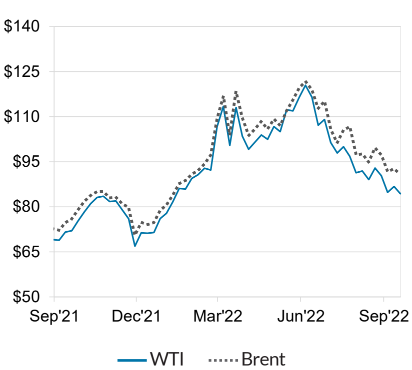

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THE BIG PICTURE

Russia's Sharp Escalation

- *Moscow's decision to partially mobilize Russia's military reservists marks the biggest escalation in the Ukraine conflict since it began.*
- *Russia's economy is holding up better than many expected, but hydrocarbon revenues are threatened by escalating Western sanctions later this year.*
- *Prospects of a peaceful resolution to the conflict, already dim, appear to be receding further.*

Russia has withstood the barrage of Western sanctions better than its adversaries had hoped. But some cracks are starting to appear. Russia's partial mobilization, announced on Wednesday, and plan to hold hasty referendums on four occupied Ukrainian territories joining Russia have been interpreted in the West as evidence that Moscow's war effort is being credibly challenged by Ukraine's Nato-backed military. The energy war is also entering a critical phase: Russia's "war premium" from higher oil and gas revenues is eroding, and pressure will increase with the planned introduction of EU oil sanctions from December. Western leaders keen to see the tide turn against Moscow have seized on these developments for encouragement.

The view from Moscow is somewhat different. Calls to intensify its military operations have grown louder since the Ukrainian army launched its eastern counter-offensive earlier this month. President Vladimir Putin says Russian forces are now fighting "the whole military machine" of the West. But he insists partial mobilization — a move that could undermine his strong popularity ratings at home — "is fully adequate to the threats" Russia faces. He will likely draw some comfort from his meetings last week with China's leader Xi Jinping and India's Prime Minister Narendra Modi, key allies in his efforts to withstand the West's assault on Russian oil exports, and from Europe's own vulnerabilities in the face of spiraling energy prices.

Putin's remarks to Xi, at the Shanghai Cooperation Organization (SCO) summit in Uzbekistan, that he understood Beijing's "questions and concern" about the Ukraine crisis triggered a wave of Western commentary about the de facto limits of their "no-limits" friendship. This was no surprise. Russia's alliance with China is pivotal in its confrontation with the US and Europe, and especially so in the escalating energy war. But Chinese state media did not report Putin's remarks, and the foreign ministry stressed that Beijing would work with Russia to help inject "stability into a world of change and disorder." Tensions between the US and China over Taiwan could push Beijing closer to Moscow. Meanwhile, Modi's comment to Putin that "this is not an era of war" was spun differently in Russia than in the West.

Raising the Stakes

What's clear, however, is that any annexation of the four Russian-controlled areas of Ukraine where referendums are due in the coming days — Luhansk, Donetsk, Zaporizhzhia and Kherson — will sharply raise the stakes. Western leaders have dis-

>> continued on page 2

missed the move as meaningless — "parody" plebiscites. But for the Kremlin, annexing these regions would cement its advances, make any future territorial compromise difficult, and present the West with the threat of a more serious conflict between Nato-backed forces and Russian forces defending "Russian territory."

Tensions are also being stoked by developments in former Soviet states. Kazakhstan's President Kassym-Zhomart reportedly angered Putin back in June by saying he wouldn't recognize the independence of the Luhansk and Donetsk. Then, clashes last week in the Caucasus and Central Asia raised questions about Moscow's ability to defuse tensions in its traditional sphere of influence while mired in the Ukraine conflict. The fighting between former Soviet states Azerbaijan and Armenia was the worst violence since their full-blown conflict in 2002, and Russia suspects a destabilizing hand at work. The clashes broke out two days before the SCO summit, fueling those suspicions, especially given the visit to the Armenian capital on Sunday by US House Speaker Nancy Pelosi, who became the highest-ranking US official to visit since its independence in 1991.

Economic Pressure

Russia's oil exports have proven remarkably resilient so far, essentially holding up to prewar levels. But the outlook is starting to darken somewhat: Oil and gas revenues that spiked at the start of the conflict are now softening, due to lower exports of gas and refined product, and the $30/bbl fall in benchmark oil prices since June. This has seen the oil income "war premium" that Moscow enjoyed in the second quarter disappear in the third quarter, according to Energy Intelligence's estimate — although this year's total should still comfortably exceed last year's.

While market uncertainties abound, the economic pressure could intensify when the EU embargo, parallel shipping sanctions and planned G7 price cap on Russian oil come into force in December. Russian media report that the government is looking at budget cuts and could turn to the oil and gas sector next year for additional taxes. Emissions monitoring firm Kayrros says it has observed an unseasonably sharp fall in cement output in the past two weeks, in what it sees as a fairly clear indication of slowing economic activity. Western sanctions and export controls have hit key industries, including auto production, shipbuilding, metallurgy and defense.

US officials say these constraints have translated into real problems for the Russian army in Ukraine. "[Russia] has had to cannibalize its domestic industry in order to manufacture battlefield equipment it cannot procure on the international market," says Liz Rosenberg, assistant secretary at the US Treasury. "It's also compelled to look to international pariahs [like] Iran and North Korea in order to source some of its military equipment."

Friends in Asia

How China and India respond to the new oil sanctions will be a critical test of their relationship with Russia — and of the effectiveness of the West's efforts to squeeze Russian oil revenues. Despite its tensions with Washington, China has tended to play by the rules of Western sanctions. Kremlin spokesman Dmitry Peskov acknowledged on Sunday that the threat of secondary sanctions had a negative impact on bilateral cooperation. But, as he also noted, the overall trend is marked by growth. The consensus view among analysts is that, as Russia's close ally, China won't accept the price cap but may use it to negotiate bigger discounts on its purchases of Russian oil.

There is also a level of concern in Russia about becoming too dependent on China. But the SCO summit, for all the critical Western coverage, was seen as a success in Russia. Moscow can also point to real success in its efforts to diversify its non-Western alliances, boosting trade ties with India and certain Mideast and African countries. Heading into the winter, Russia has calculated that the pain in Europe from spiraling energy costs and reduced gas supplies will be greater than it own sanctions pain and will weaken the EU's resolve on Ukraine.

Good relations with China, India and others will help ease the pressure on Russia, both economically and geopolitically. The mobilization and referendums can be viewed as a sign of weakness. But they could also be seen as a move to stare down the West through escalation.

Simon Martelli, London

POLICY

US Permitting Overhaul on Shaky Ground

- *US Congress has its best shot in years at a sweeping overhaul aimed at streamlining approvals for pipelines, LNG terminals and other energy projects.*

- *Legislative reforms could help clear natural gas bottlenecks in the northeast US and the Permian, and ease sorely needed transmission buildout to boost clean electricity.*

- *Nothing is guaranteed, as locking in pipelines is an intensely divisive issue in Washington that is already seen fracturing the Democrats.*

The Issue

US midstream and pipeline companies have long eyed durable reforms to permitting to smooth regulatory obstacles and shorten environmental reviews that often span years and result in litigation. Democrat Sen. Joe Manchin put permitting reform in the political spotlight by making his support for the Inflation Reduction Act (IRA), which housed $369 billion in clean energy spending, contingent on it.

Manchin secured a commitment from the Democratic leadership and the White House to pass the permitting bill swiftly via a must-pass funding measure to avoid a government shutdown next month. But growing opposition from left-leaning Democrats and Republican resentment over the IRA passage poses a real threat to the legislation.

Gas Bottlenecks, Transmission Buildout

US producers insist permitting reform is needed to offer some midterm certainty on a role for oil and gas during a transition to clean energy, and for predictability in terms of upfront costs of large energy projects. Speaking to reporters on Tuesday, Manchin said "no matter what you want to build, whether it's transmission pipelines or hydropower dams, more often than not, it takes too long and drives up costs."

Equitrans Midstream's $6.2 billion Mountain Valley gas pipeline is the most immediate beneficiary of Manchin's legislation. The bill would direct the Biden administration within 30 days to issue the remaining government sign-offs for the embattled 303-mile line from Manchin's home state of West Virginia to markets in Southern Virginia, which would add 2 billion cubic feet per day gas capacity and is a major priority of the senator.

Capacity constraints to meeting US southeast demand have long been a complaint of Marcellus Shale producers in the northeast. And while a cadre of newly built pipelines and expansions in the Permian to US Gulf Coast ports have helped to boost takeaway capacity for crude, there are still limitations on gas transport that could be helped by the legislation.

The legislation includes several provisions aimed at smoothing pipeline approvals, such as new checks on the ability of US states to block major gas pipelines over water quality concerns, as New York and other Democratic-led states have done.

There are new curbs on the ability of environmental organizations to bring lawsuits over major energy projects and time constraints holding environmental reviews to a two-year window, compared to Trump-era data indicating average review times of about four-and-a-half years.

Additionally, the legislation is expected to improve government permitting authority to ease buildout of transmission lines — long a hindering factor in shifting more clean energy to the US grid. The transmission provisions are intended as a sweetener for Democrats resistant to the idea of locking in oil and gas infrastructure, though they fall short of the transmission tax incentives some of them have sought.

Drawing Progressive Fire

The bill, which Manchin released publicly on Wednesday, has been none too popular with left-leaning Democrats and environmentalists. They see it as cementing reliance on oil and gas when the US has just made major strides toward low carbon energy and have opposed Manchin's agreement with the Democratic leadership to attach the bill to the funding measure.

To date, more than 75 Democratic lawmakers and more than 600 green groups have written to the House leadership asking Democrats to bar the permitting language from the funding legislation, arguing that it would gut bedrock environmental protections in federal law. Democratic chair of the House natural resources committee Rep. Raul Grijalva penned a Newsweek op-ed urging the Democrats to steer clear of the permitting reform bill.

Progressive Sen. Bernie Sanders, who usually votes with Democrats, has pledged to withhold his vote from any bill that "makes it easier to destroy the planet," saying that included approving the Mountain Valley Pipeline. Another prominent Democrat, Sen. Ed Markey, has also raised concerns about tying permitting reforms to the must-pass funding bill, flagging potential environmental justice implications for communities disproportionately impacted by large energy projects.

Environmental justice is a hot button issue with progressive Democrats, and Markey's concerns could sway other Democratic lawmakers to side against the permitting bill. The Democratic fissures mean leaning more heavily on additional Republican votes to pass the bill — but Republican support is unclear, given lingering Republican resentment over the IRA bill.

Political Question Marks

Attaching the permitting measure to the funding legislation was meant to offer assurance to Manchin. Failure to pass the funding bill by Sept. 30 means the possibility of a government shutdown, a politically hazardous prospect for Democrats ahead of midterm elections. Last week, House Speaker Nancy Pelosi hedged on linking the permitting bill to the funding resolution, saying she would wait to see what happens in the Senate.

But US Senate Majority Leader Chuck Schumer has stood by the agreement with Manchin, pledging to add the bill to the funding measure. But the spending resolution needs 60 votes to clear the Senate. Democrats hold only 51 total votes, and Republican support for the permitting measure is a serious question mark despite Republican lawmakers pushing for years for streamlined energy approvals.

West Virginia's other senator, Republican Shelley Moore Capito, put forward a more industry friendly, competing permitting reform bill last week that garnered 46 Republican supporters, though Manchin has dismissed it as "messaging" and accused Senate Republicans of "revenge politics." A smaller handful of Republicans had said they would wait to decide on their support for Manchin's bill before they had a chance to digest the language. Several Republican senators have political equity in the Mountain Valley approval, so that language could give Manchin the extra votes needed to pass the legislation. But it looks poised to come down to the wire — especially if any more Democrats back away from the legislation.

Bridget DiCosmo, Washington

COUNTRY RISK

Brazil's Energy Sector Awaits Tense Election

- *Rancorous electioneering makes it uncertain that President Jair Bolsonaro will accept the result if he loses.*
- *The fate of state energy giant Petrobras has figured prominently in debate between the candidates.*
- *Petrobras' fortunes have continued to improve despite the polarized political climate.*

The Issue

Brazil's presidential election next month, where polls have shown former President Luiz Inacio Lula da Silva consistently leading current President Jair Bolsonaro, has proved a polarizing contest between the left and right wings of Brazilian politics, with a worrisome whiff of violence in the air. Brazil's state energy giant Petrobras, which figures in the myth-making and political identities of both men, has emerged as a flashpoint in a contest that has put much of the sprawling South American country on edge.

Petrobras Awaits its Fate

When Lula and Bolsonaro stood on the debate stage for the first presidential debate of the season last month, held in Sao Paulo and broadcast on Brazilian network Band TV, the charges and countercharges flew fast and furious between the two men, leaving the other candidates on stage as practical afterthoughts.

Making several references to the Operation Car Wash scandal, which revealed widespread corruption in a variety of public institutions, including Petrobras, and resulted in a number of prominent political figures being jailed, including Lula himself, Bolsonaro repeatedly referred to his predecessor as "the former prisoner" who had led "the most corrupt" administration in the country's history. Lula, who was released in 2019 after serving 19 months and whose convictions was later nullified, responded by saying "there was no president of the republic who did more to investigate corruption" than he did, and noted various corruption scandals impacting Bolsonaro's own cabinet. Offstage, as the candidates debated, Bolsonaro's former environment minister Ricardo Salles and Andre Janones, a federal deputy supporting Lula, nearly came to blows and had to be physically separated from one another.

A frequent target of Bolsonaro due to high fuel prices, Petrobras has churned through four CEOs during his time in office, and the president has made no secret of his desire to privatize the company. He has said that he has authorized Minister of Mines and Energy Adolfo Sachsida to explore the potential privatization of the state firm if he is re-elected in October. Lula has said that he would keep the company state-controlled and work to position it for a transition to renewable and green energies. He has also suggested Petrobras needs to diversify from an over-reliance on the offshore pre-salt fields and "go back to being an integrated energy company," with more emphasis on biofuels.

Brazil: Country Risk Assessment

Political risks in Brazil are rising, as tensions flare. Scores have been killed or wounded in election related violence. Bolsonaro is questioning the electoral voting system, raising concerns about what would happen if he and his supporters don't recognize the election. These dynamics are weighing on the energy sector with NOC Petrobras particularly hard hit. Bolsonaro is churning through CEOs and seeking to increase state control over the firm to change its fuel pricing policy to boost his popularity. Meanwhile, a Lula win would lead to major changes in the firm's strategy and new focus on renewables. As a result, Risk Research downgraded Brazil's Political Volatility risk factor score from 6 to 7, marring what has otherwise been a very attractive investment destination in recent years.

Risk Score:	4.4 (29th of 71)
Risk/Reward Score:	2.6 (13th of 71)

Country Risk Assessments are provided by Risk Research, the Research & Advisory unit of Energy Intelligence's Risk Service. Our Country Risk Index assesses aboveground Risk on a scale from 0 (least risk) to 10 (greatest risk), and Rewards from 0 (lowest rewards) to 10 (greatest rewards). The resulting Country Risk Index Risk vs. Rewards scores range from -10 to +10 (positive scores = rewards outweigh risks).

In July, it was announced that, in addition to cutting fuel prices, the Petrobras board of directors will now "supervise" the company's pricing structure on gasoline and other fuels — a move seen as giving Bolsonaro more of a say over company policy. Speaking at the UN General Assembly in New York this week, Bolsonaro continued has attacks on Lula, claiming before assembled world leaders that "between 2003 and 2015 alone, when the left ruled over Brazil, Petrobras' indebtedness due to mismanagement, political subdivision, and deviations reached $170 billion."

Democratic Dangers

This year's presidential campaign marks perhaps the most acrimonious one since civilian government returned to Brazil in 1985 after 21 years of military rule. According to a poll by TV program "The Face of Democracy," more than half of Brazilian voters fear a wave of political violence in the country if Lula is elected president in the first round, while 40% fear the same if Bolsonaro is. The Observatory of Political and Electoral Violence of the Federal University of the State of Rio de Janeiro says 40 people have been killed in the context of political violence in Brazil so far this year. Ironically, the most high-profile victim of Brazil's political violence in recent years was Bolsonaro himself, who was stabbed while on the campaign trail in September 2018 in the southern state of Minas Gerais.

The president has made frequent allusions to not accepting the result if he loses, saying last month at a rally in Sao Paulo that "power only emanates from the people when they choose correctly" and accusing Lula of wanting to set up a leftist dictatorship. In reality, the former president stepped down after his 2003-10 term in office. Lula remains comfortably ahead of Bolsonaro in most polls, leading him 44% to 34% in a Genial/Quaest Research poll published this week.

Upstream Resilience

Despite the political headwinds, Petrobras itself remains in relatively good shape. In an earnings update last month, the company continued the industry trend of making massive profits from higher commodity prices, reporting a net income of 54.3 billion reals ($10.5 billion) in the second quarter of 2022, up 27% from a year earlier, and a record 87.8 billion real dividend payout. Petrobras CFO Rodrigo Araujo Alves said the results showed "the resilience and solidity of the company."

The upstream outlook is favorable too. Petrobras said it had confirmed a gas discovery at the deepwater Uchuva-1 exploration well on the Tayrona Block offshore Colombia that could open up a new producing region in the country, while also noting several major projects offshore Brazil that are due to start up this year and next. Its strategic plan foresees production growth of around 500,000 barrels per day of oil equivalent, hitting around 3.2 million boe/d by 2026 after divestments. The company in fact reported a 5.1% drop in second-quarter production, year on year, to 2.65 million boe/d. But there is clearly still appetite among foreign investors for involvement in Brazil's energy sector. Last December, Brazil's oil auction saw France's TotalEnergies, Shell, Malaysia's Petronas and Qatar Energy pile in, along with Petrobras, to the tune of nearly $2 billion, a much stronger response than a similar bid round held two years earlier.

Among the minefields the next president may have to navigate is Petrobras' plans to drill off the coast of northern Amapa state, near the Brazilian border with French Guyana and the mouth of the Amazon river. Environmentalists strongly oppose the project, citing the potential harm it could do to the region's fragile and unique ecosystem.

Michael Deibert, Washington

COUNTRY RISK

Mozambique Grows Impatient Over Major Gas Delays

- *Mozambique's President Filipe Nyusi is pressing TotalEnergies to lift force majeure on the $20 billion Mozambique LNG project that it imposed in April last year due to militant attacks in the province of Cabo Delgado.*
- *Nyusi says security in the volatile northeast region is improving, but outbreaks of violence in surrounding areas suggest Maputo's grip on the country as a whole is weakening.*
- *Total has launched a "massive" campaign to provide humanitarian help to Cabo Delgado, aware that a purely military solution will never bring peace.*

Mozambique's aspirations to become a gas and LNG powerhouse hinge more than ever on the long-term stability of Cabo Delgado, the northeast region that is as far from the capital Maputo as Paris is from Kyiv, and contains all of the country's giant deepwater reserves. At a conference this month in Maputo, President Nyusi voiced his frustration at the lack of progress with ongoing LNG projects around the two big concessions — Areas 1 and 4 — and said security in Cabo Delgado was improving.

But the Western majors overseeing the LNG projects struck a more cautious note, not least Total. "We're not there yet' was the message from the project manager of Mozambique LNG, Stephan Le Galles, who declined to say when work on the project would resume. The chief Mozambique representative of Exxon Mobil, Jos Evens, gave no inkling of when the company would announce a final investment decision on the $23 billion Rovuma LNG project that has been on hold since 2020.

Floating Ahead

The one piece of good news for Mozambique is that the Eni-led Coral South floating LNG project, that will cost around $7 billion and have a capacity of 3.4 million tons per year, is just months away from start-up. This is of particular interest to Europe, which is desperate to secure new sources of gas supply as it slashes its intake from Russia. But commerce, not politics, will dictate where the LNG goes, with all of the offtake committed under a long-term contract with BP. When the project's FID was taken in 2017, it was assumed that most of the gas would end up in Asia, especially the Far East.

Eni and its fellow Area 4 concessionaires — Exxon Mobil (25%); China National Petroleum Corp. (20%), Mozambique's state oil company ENH (10%) and Korea's Kogas and Portugal's Galp each with 10% — are looking at another FLNG that would be completed quicker and more cheaply than Coral and give Mozambique another opportunity to monetize its gas reserves. What is not in question is Area 4's ability to supply the gas. The concession has proven reserves of some 85 trillion cubic feet, of which just 5 Tcf has been set aside for Coral South. Though not on the same scale as Qatar's North Field or Iran's adjoining South Pars reservoir, Area 4 alone could transform Mozambique into one of the world's largest LNG exporters, with multiple FLNGs and onshore projects. And there is still scope for further discoveries to be made.

From Mozambique's point of view, FLNGs are far from ideal, as they are physically detached from the mainland and do little to foster local development. "It makes people think the oil companies don't care about the country, and are only motivated by profit", a Western oil executive who works closely with state oil company ENH says. The Rovuma LNG project, which would involve building two LNG trains with a combined capacity of 15.2 million ton/yr, will probably get built "in one form another" because the world needs the extra gas. In addition, the very low CO2 content from Area 4 production makes it more appealing to potential financiers, he adds. "It could take another decade to get done, but the building blocks are already there."

Managing Expectations

The Mozambican leadership, from the Frelimo party that has won every election since the first multi-party vote in 1994, needs to get the gas flowing to bolster its credibility among the population and foster economic growth. Ranked one of the poorest countries on the planet, with a GDP per capita of $500 last year according to the World Bank, Mozambique has also suffered from bad governance and corruption among the ruling elite.

In 2016, the IMF discovered that the government of former President Armando Guebuza had secretly taken out $2 billion in loans to finance security and fishing projects, on which alleged bribes were paid to senior Frelimo members — including President Nyusi, who was then the defense minister. Though Mozambique is now back in the IMF's good books, there is little confidence that the government has the mechanisms in place to handle future LNG revenues, despite pledges to set up a sovereign wealth fund on the "Norwegian model."

President Nyusi and his Frelimo stalwarts appear reluctant to tackle the situation in Cabo Delgado head-on, and are instead relying on a 1,000 strong Rwandan-led military force deployed last year under the auspices of the Southern African Development Community (SADC) to restore peace. The Rwandans have recaptured key areas from the militants, including the strategic port of Mocimboa da Praia that was ransacked over two years ago. A Total executive said he visited the town in early September, and described the situation as peaceful.

Total Quandary

Total is hoping to restart Mozambique LNG in the first half of next year, but needs cast-iron assurances from the government and private security advisors that it is safe to do so. Helping the local communities is one thing that needs doing, and Total says it is working with several NGOs to provide services to the region from which as many as 800,000 people have been forced to flee.

But tackling militants loosely affiliated to with Islamic State who target civilians is quite another. Both the US and EU are stepping up military assistance to Maputo, fearing that Cabo Delgado and other areas could become magnets for jihadists. "Total are in a very tricky position," says a European diplomat. "The government seems to be saying: 'it's up to you to sort it out', and that's a really tough ask. There needs to be close collaboration."

Paul Sampson, Maputo

COUNTRY RISK

Egypt Eyes Gas Riches as Economy Struggles

Egypt looks set to play a pivotal role as a supplier of gas and renewables to Europe with its prolific geology, infrastructure and geographic position. But its economy remains fragile and vulnerable to external shocks. It is still unclear how much gas Europe can expect to come from this emerging East Mediterranean gas hub and how stable a supplier Cairo will prove to be in replacing Russian volumes. With another IMF lifeline pending and swift Gulf Arab support earlier this year the economy has survived amid a sudden outflow of foreign investors in March, yet structural problems persist.

• Egypt's potential role as a gas hub has taken on greater importance as Europe seeks to replace Russian gas.

With a provisional deal in place since June between the European Commission, Egypt and Israel to supply Europe with LNG, Egypt's gas infrastructure could play a central role. Its existing liquefaction plants at Idku and Damietta have long been touted as the most cost-effective means to monetize Israeli and Cypriot fields by sending gas by pipeline to one of them and re-exporting it as LNG. Egyptian Petroleum Minister Tarek el-Molla admitted in Milan this month that the deal is "very preliminary" but insisted that "discoveries are there, the market is there — we just need to take the decision and tick this project off."

There is growing political pressure on Chevron from the East Mediterranean Gas Forum to take a final investment decision on developing the 4 trillion cubic foot Cypriot Aphrodite field and a phase two development of its 22 Tcf Israeli Leviathan field. The forum comprises Egypt, Israel, Jordan, Cyprus, Greece, Italy, France, and the Palestinian Authority. But it is difficult to quantify how much future gas could come to Europe.

Egyptian LNG exports to Europe are rising — from January to August they increased over four times compared to the same period in 2021, to 2.69 million tons, according to data analytics firm Kpler. And since April, Eni, which operates the Damietta LNG plant, has agreed with state-owned Egas to export up to 3 billion cubic meters this year to Italy. The original Aphrodite development plan envisaged production of 600 million-700 million cubic feet per day (around 6.7 Bcm/yr). But how much will be earmarked for the gas-hungry Egyptian market and how much left over for export is unclear.

Rising Egyptian gas demand and a depletion rate at key fields running between 10%-15%, according to El-Molla, means Egypt will need to make some more discoveries like Eni's 30 Tcf Zohr field in the future to be able to satisfy local demand and provide a regular gas bridge to Europe as it transitions to a low carbon economy by 2050.

• Foreign investor outflows totaling $14.8 billion over January to March were only alleviated by short-term Gulf Arab deposits amounting to $13 billion.

For Saudi Arabia, the United Arab Emirates and Qatar, which between them deposited $13 billion earlier this year, Egypt remains too big to fail, both politically and economically. Outflows accelerated in February but even before, interest rate hikes by the US Federal Reserve were already resulting in foreign portfolio outflows from emerging markets like Egypt. "Portfolio investment in Egypt shifted from a net inflow of $16 billion to a net outflow of $17.2 billion, mainly during January-March 2022, which witnessed net outflows of $14.8 billion," Egypt's central bank said in a recent report.

Those investor flows are unlikely to return until the IMF approves an extended fund facility for Egypt which appears to be at an advanced stage, says an Egyptian banker. The situation is not as acute as 2016, when the IMF approved a $12 billion loan reform package. "But most investors are asking: 'when is the money coming from the IMF, when will the currency be devalued and import controls at ports improved?'" he says. Investors looked at Egypt's reliance on Ukrainian wheat imports and tourism revenues from Russia and Ukraine and pulled out.

But others believe those fears were overplayed. Egypt as a major buyer enjoys significant leverage in the global wheat market. Debt servicing costs represent more of a threat to the economy and the government than the risk of bread riots resulting from higher food prices, argues David Butter, associate fellow at Chatham House.

With Europe suffering gas shortages and sanctions impacting Russian gas exports, Egypt's cheaper domestic gas production has actually provided a competitive advantage to local industries such as fertilizer, petrochemicals, steel and aluminum producers.

Doubts remain over Egypt's ability to follow through on long-promised structural reforms and there is deep frustration over its inability to list a number of state companies it had promised to privatize in recent years. In the hydrocarbons sector, foreign direct investment declined over July 2021-March 2022 with net outflows of $1.7 billion which the central bank blamed on cost recovery related to E&P operations.

• As host of the COP27 climate conference, Egypt has the chance to attract a wave of investment in its renewables sector and play a lead role in demanding Western countries honor pledges to mitigate the impact of climate change.

Cairo aims to generate 42% of its electricity from renewables by 2035 and is hoping to boost this to 60% by 2045. Overall, Cairo is targeting emissions reductions of 33% for electricity, 65% for oil and gas, and 7% for transportation by 2030. But a lot of Egypt's energy transition foundations have yet to be built. El-Molla remains skeptical on green hydrogen technology, but more positive on blue hydrogen production combined with carbon capture and storage. Eni is considering investment opportunities there.

Meanwhile, as Egypt looks beyond gas, the 2,000 megawatt EuroAfrica Interconnector is taking shape, which will run under the Mediterranean, from Damietta to the Kofinou power station in Cyprus and then to Crete. In June, Saudi renewables developer Acwa Power signed a deal in Egypt for the Middle East's largest onshore wind project. Suez Wind will generate 1.1 gigawatts and cost around $1.5 billion.

Tom Pepper, London

CLOSING ARGUMENTS

Iran Joins Regional Bloc, Greece and Turkey Face Off

Iran: A Geopolitical Game Changer

After 17 years of waiting, Iran last week became a full member of the Shanghai Cooperation Organization (SCO). The announcement, made at the organization's 22nd summit in the Uzbek city of Samarkand, represents a diplomatic breakthrough for Iran. The political and economic benefits of joining the world's largest regional organization in geographical terms cannot be understated. Having been subjected to economic sanctions in one form or another for more than 40 years, Iran has put itself on the path to becoming virtually sanctions-proof. And while the SCO is not a military alliance, by joining the organization, Tehran will be able to strengthen its regional military posture by forging closer ties with nations, including two permanent members of the UN Security Council. Exactly what full SCO membership will mean for Iran remains to be seen. But its new status is a game changer for the country and its relationship with the rest of the world.

Iran's new status as a full member of the SCO strengthens its hand immeasurably when it comes to the diplomatic impasse in negotiations to revive the 2015 Iran nuclear deal, or Joint Comprehensive Plan of Action (JCPOA), that the US unilaterally withdrew from four years ago. The US negotiating position has hinged on its ability to leverage Iran's desire to see US economic sanctions, which carry the threat of secondary sanctions against any party deemed to be in violation, lifted. SCO membership, however, brings with it the prospect of sanctions-proof economic relations that greatly reduce the pressure on Iran to do a deal. Likewise, as the world fractures into competing blocs, Iran's SCO status cements its geopolitical pivot east, leaving the US and EU facing the real prospect that Iran may opt to let the JCPOA lapse altogether rather than agree to conditions that it finds objectionable.

Iran has already shown surprising resilience in the face of US sanctions targeting its energy sector. SCO membership could bring additional benefits for Iran's energy sector. China and Russia have both signed multi-billion-dollar accords on future energy cooperation, most recently when Russian President Vladimir Putin visited Tehran in July, and new deals with other SCO members could now follow. Likewise, military-to-military contacts within the SCO framework will strengthen Iran's security posture, paving the way for expanded military exercises and arms deals like the one recently concluded with Russia to supply drones. In short, any nation seeking to confront Iran, including the US, Israel and Saudi Arabia, must factor in Iran's new status as a full SCO member.

Turkey-Greece: Tensions Within Nato

Just when Nato unity is seen as a prerequisite for containing Russia, the trans-Atlantic alliance is being tested by disharmony between two of its members, Turkey and Greece. The two countries have a long history of tension. But the level of rhetoric on the part of both sides, taking place as it does in the context of heavily contested elections in both Turkey and Greece, has heightened the risk of conflict which, if it occurs, could rupture the facade of Nato unity at the worst possible moment.

Greco-Turkish animosity predates Nato by centuries. The hope that bringing these two historic enemies together in a military alliance would help overcome their troubled history proved fleeting, as demonstrated by the Turkish invasion of Cyrus in 1974 and ongoing disputes over the Aegean Sea. Recent Turkish moves regarding the establishment of a maritime border with Libya, and its aggressive posture on oil and gas exploration rights off the coast of Cyprus, has only exacerbated the tensions.

The dispute that could prove to be the straw that breaks the camel's back revolves around the status of Greek-controlled islands off the coast of Turkey. Turkey claims the post-World War I agreements that transferred control of the islands to Greece was predicated on Athens agreeing to never place military forces on them. Turkey claims Greece has done just that, meaning the legality of the transfer of control is no longer valid, returning ownership to Turkey. Greece disagrees, of course, noting that irrespective of its military presence, the islands will always belong to Greece. Turkish President Recep Tayyip Erdogan has notched up the rhetoric, warning Greece that Turkey could seize them at any moment, and advising Greece to "not forget Izmir," a reference to Turkey recapturing the city, known in Greek as Smyrna, in 1922, after three years of Greek occupation.

The question now is whether Turkey or Greece are actually willing to fight. Logic suggests not. With their respective leaders both facing difficult re-election campaigns next year, there is a tendency on both sides to resort to base nationalism and magnify external threats to rally domestic political support. Once their respective electoral cycles have run their course, however, relations between the two countries should cool off a bit — at least from boiling to hot. Hot is still dangerous, but it does not threaten a conflict that could tear Nato apart.