

## Strata Insight Risk Highlights

15 May 2018

*Cyprus faces a number of risks that could affect the operations of oil and gas companies in the region in the coming months and years. We have briefly outlined the key risks below. If you would like our independent insight into these risks, or information about our full product range, including **Stakeholder Mapping, Situation Updates** and our bespoke **Risk Assessment Model**, please do not hesitate to contact us using the contact details at the end of this report.*

*Strata Insight offers a unique combination of qualities, giving you unrivalled depth and analysis from an independent source. We have an unbeatable network of contacts among the political and energy policy players in government, opposition and the international community. We are on the ground and speak the languages yet we enjoy the objectivity of non-locals. We have a long record of analyzing and anticipating developments in Cyprus and the region for international clients. And we have regional associates so that we can fold Israel, Turkey, Greece, Lebanon or Egypt into our analysis.*

### 1. Rising tensions with Turkey over maritime borders

- Turkey has stepped up protests against offshore natural gas exploration activities in the Cyprus Exclusive Economic Zone (EEZ) in recent months, using naval forces in February 2018 to prevent Italy's ENI from drilling in Block 3, and announcing plans to conduct its own drilling.
- How far will Turkey's governing AK Party, now in alliance with the ultra-nationalist MHP, go to protect what it says are its own and Turkish Cypriots' interests? If talks to resolve the Cyprus problem do not resume, what is the likelihood that Turkey would resort to the use of military force to prevent offshore drilling or actual production?

### 2. Prospects for resolving the Cyprus problem

- A settlement of the Cyprus problem could have a major impact on gas exploitation opportunities but UN-facilitated talks to resolve the longstanding Cyprus problem collapsed in July 2017 amid mutual recriminations.
- How seriously engaged are the parties on and off the island to seeking a settlement? If talks do resume, what are the prospects of a positive referendum vote from both communities? What is the likely timeline of implementation if a settlement is reached?
- On the other hand, what is the appetite of the international community to remain engaged if the situation continues to stagnate and what are the risks to the energy sector?

### 3. Israel relations and gas exports

- The Republic of Cyprus government has been saying for some months that it is close to a deal on exporting gas to Egypt from the Aphrodite field in Block 12. However, it is facing a challenge from the holders of the Ishai licence on the Israeli side. At the same time, the partners in Aphrodite are reportedly trying to renegotiate terms in order to increase their share of the take.
- How serious is the challenge from Ishai and will it hold up exports to Egypt? How serious are the negotiations on price and can a deal be struck that is favourable to all parties?
- The government is also pursuing the East Med pipeline option for gas exports. What is the government's long-term plan, who is really running energy policy and what is the thinking behind official statements?

### 4. Risks to macroeconomic stability

- The economy returned to growth in 2015 after a severe banking crisis in 2013. However, non-performing loans remain stubbornly high and the regulatory authorities are forcing radical measures on the banks, starting with the Cyprus Cooperative Bank. At the same time, Russian sanctions are raising questions about bank ownership. How easily will the banks be able to navigate these challenges and which bank is most exposed to regulatory and international pressures?
- How vulnerable is the Cyprus economy to external shocks, such as action by Turkey against economic interests or a hard Brexit? Would Cyprus be vulnerable to default if this occurred? Separately, what are the economic challenges and opportunities relating to a settlement of the Cyprus problem?

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