Tom Whipple, Editor
Ray Long, Assistant Editor

ASPO USA PEAK OIL REVIEW
Association for the Study of Peak Oil & Gas USA

March 25, 2013

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1. Oil and the Global Economy

NY oil futures fell sharply on Tuesday then recovered by Friday's close to end the week up slightly at $93.71. Brent futures, however, continued to slip all week closing at $107.66 as the wrangling over the Cyprus bailout continued. Brent's premium to WTI closed out the week at $13.95, the lowest level in eight months. Over the weekend a deal was announced under which large depositors (over €100,000) will have 20 percent of their accounts taken to recapitalize the banks. This move will fall heavily on rich Russians and other foreigners who have been using Cyprus as a tax haven.

While the Cyprus crisis may or may not be under control, elsewhere in Europe the economic news is not good. The weather has been cold and Britain is nearly out of natural gas; German business confidence and PMI indexes are down; and business activity in France shrank in March at the fastest rate in four years.

In comparison to Europe small bounces in the US economy look pretty good. The American Petroleum Institute, however, says that US petroleum deliveries for February were at their lowest level since 1993 – down 4.1 percent since February 2012. The Institute notes that declining numbers for petroleum consumption "is not consistent with a robust recovery."

US natural gas prices continued to climb this week on colder weather across the US, at one point topping $4 per million BTUs for the first time since September 2004. Prices have now climbed 24 percent in the last five weeks, but many feel the rally is over. At this price level, power plants are switching back to coal, and the winter heating season is nearly over.

2. Middle East & North Africa

Iran: The six major powers gave Tehran more details of their proposal to settle the nuclear standoff last week and said they expect a response at the next political meeting to be held on April 5-6. Iran's supreme leader, Ayatollah Ali Khamenei, gave a lengthy speech last week suggesting that he is open to nuclear talks but he is not optimistic. The Ayatollah warned that Iran will raze Tel Aviv and Haifa to the ground should Israel attack and that the sanctions, while causing some harm have "failed completely."

The new round of sanctions seems to be having an effect on South Korean and India. Both these countries have cut imports substantially and India may be on the verge of halting Iranian oil imports entirely due to payment and insurance difficulties.

So far there is little evidence that the sanctions, while doing some economic damage, have persuaded Tehran to change its policies. Economic hardships have not reached the point where there have been widespread uprisings and the government has become quite good at keeping dissent under control.

Iraq: US Secretary of State Kerry visited Iraq over the weekend to underscore the seriousness with which the US views the deteriorating situation there and to pressure the government into changing some of its positions. The US says that the al Maliki government continues to allow the Iranians to fly and truck men and material across Iraq to support Assad in Syria. There is increasing concern that Sunni extremists from Syria are already extending the uprising there into Iraq by forming ties with Iraqi Sunnis. Baghdad's ties with Iran are not helping the situation.

While in Iraq Kerry urged the Sunnis that remain in the government to increase efforts to maintain a united Iraq . He also called al Maliki to rescind the decision to postpone parliamentary elections in two heavily Sunni provinces and cancel the arrest warrant for the Sunni Finance Minister.

Kerry also was to phone Kurdish leader Barzani and urge him not to move too quickly in breaking ties with Baghdad and building an oil pipeline into Turkey.

Syria: The two-year old uprising is morphing into a regional crisis, with even Israel and Turkey patching up their differences out of the realization that they may need each other to contain the chaos. The rebels seem to be making slow but steady progress in overrunning remote government bases, but at the same time, Iran seems to have stepped up its flow of supplies to the beleaguered Assad government and there may be still more Hezbollah fighters from Lebanon in the country. Fighting spread to the Golan Heights over the weekend as either rebel or government forces fired on Israel troops who returned the fire. The Israelis are becoming concerned that they will soon be confronting militant Islamists on the Golan rather than the Syrian Army that has been opposite them for nearly half a century.

Lebanon's Prime Minister resigned last week leaving the country leaderless as factionalism in the country grows with Hezbollah supporting Assad's forces and various Sunni groups supporting the rebels. There was a major bombing in Damascus which killed a leading Sunni cleric who was a supporter of Assad and 49 others.

The UN is investigating the use of chemical weapons near Aleppo last week. It now appears that an insurgent group may have built a homemade chemical rocket using industrial chlorine to attack an Army base rather than a more deadly gas taken from Syrian military stocks.

While there is no immediate threat to oil supplies in all this other than to the remaining Syrian oil production, the growing animosity between Sunnis and Shiites is likely to impact the region for many years or even decades.

Egypt: Supporters and opponents of the Muslim Brotherhood are blaming each other for the clashes that injured dozens this week outside the Brotherhood headquarters. President Morsi is now threatening a crackdown. The IMF negotiations which have been dragging on for two years continued last week as the country's currency reserves continue to dwindle. It is running out of the hard cash it needs to import food and fuel.

The IMF is demanding an early end to subsidies which take a third of the country's budget. The government is reluctant to move remembering that in 1977, the last time it tried to cut the subsidies, the food riots were so bad the army had to be called to restore order and the subsidies had to be restored. The country has 90 days of food stocks left and even smaller fuel reserves. We should know how all this turns out before summer, and it is not likely to be pretty.

3. China

With its new leadership firmly in place, China is embarked on another decade that is likely to be very different than the ones it has recently experienced. After 30 years of double digit growth during which the country became the center of world manufacturing and on its way to becoming the leading economic power, various kinds of reactions are setting in. Inattention to the environment has led to China's air, water, and soil becoming disasters that are threatening to impose serious hindrances to economic development in coming decades.

Falling water tables in the north coupled with floods and rising sea levels in the southeast could in the long run threaten the country's political stability as food shortages develop.

China's leadership was much taken by the collapse of the Soviet Communist Party and is obsessed with not letting the same fate befall their Party. Their top priority is to maintain their legitimacy by maintaining rapid economic growth rates. This goal is now clashing with the need to do something about their increasingly dangerous environment which almost by definition must slow ambitious growth plans especially for fossil fuel consumption.

The recent bout of extremely dirty air in Beijing resulted in prompt passage of new regulations to improve fuel standards, but such regulations have been passed before and little has happened as the regulations are widely ignored by powerful state industries. Little monitoring of compliance is done and there is little serious enforcement. Outsiders looking at China's current development plans say that the environmental situation is likely to get much worse. Coal consumption will increase if the country is going to increase its electric power production by 7.5 percent this year and some estimate that China will increase its fleet of passenger cars to 400 million by 2030 from the current 90 million.

Last week, after more than a decade of talks, Beijing and Moscow signed a gas and oil deal that will result in a major increase in the natural gas flowing into China from Russian gas fields. Annual deliveries are to reach 38 billion cubic meters in 2018 and this could grow to 60 billion in the long run. In comparison, the Germans, which are Russia's largest customer, currently buy 33 billion cubic meters a year. In addition Russia will double the amount of oil it supplies China to 31 billion tons a year.

Price has long been the issue in a China-Russia gas deal. Although the final price does not seem to have been settled as yet, Moscow is facing more competition and less demand from Europe pushing Beijing and Moscow closer together. It is possible that the recent pollution crisis in China has made it more willing to pay higher pries for a cleaner source of fuel that could be available relatively quickly.

It is impossible to say where China goes in all this. If the air pollution problem across northern China becomes endemic leading to widespread illness and social unrest then it seems likely that somewhere along the line cleaning up the air will have to trump economic growth – but that day is not here yet.

Somewhere in all this China's demand for oil will be affected. There is already talk of a carbon tax in China and an end to subsidies for fuels. The key seems to be just how much bad air the Chinese people are willing to stand.

Quotes of the week

- "Peak oil was never about 'running out.' That's a straw man argument. The word "peak" in peak oil simply refers to the maximum production rate of oil... While oil producers constantly trumpet new discoveries and rising reserves, they tend to avoid talking about production rates. But reserves are meaningless if they don't amount to an increasing rate of production. If you had a billion dollars to your name, but could only withdraw $1,000 a year, would you be worried about running out of money or paying your bills?"

  \- Chris Nelder

<u>The Briefs</u> (clips from recent Peak Oil News dailies are indicated by date and item #)

- **India** is now the world's fourth largest energy consumer of oil and petroleum products after the US, China and Russia, a new analysis by the EIA says. India's primary energy consumption has more than doubled from 1990-2011. (3/22, #15)
- **Oil at $100** a barrel is a "reasonable" price that won't choke global economic growth, Saudi Arabia's Oil Minister Ali Al-Naimi said. "Prices will stay at these current levels in the foreseeable future." (3/19, #2)
- Royal Dutch Shell ended curbs on crude exports from its Bonny oil terminal in **Nigeria** after repairs were completed following a leak on its Nembe Creek pipeline. (3/23, #8, 9)
- Sen. Ron Wyden (D. Ore.) is laying the groundwork for a broad-based **energy bill** that could impose new restrictions on natural gas exports and create additional oversight for hydraulic fracturing. The bill represents the first serious attempt by Senate lawmakers this session to modernize US energy laws following a surge in natural gas production. (3/23, #12)
- Forty US House members signed a letter asking President Obama to urge his administration to complete an environmental impact statement for a proposed seismic assessment of oil and gas resources on the US Atlantic **Continental Shelf**. (3/23, #16)
- The number of energy **rigs** in the US declined this week to the lowest level in almost two years, according to Baker Hughes. The count fell by 30 to 1,746 and was the lowest since March 2011. (3/23, #18)
- **Schlumberger** warned on that North American activity was coming in lower than expected in the first quarter, as fewer rigs were going back to work than it had expected. (3/21, #9)
- **India's crude-oil production** fell 4 percent on year in February and natural-gas output continued its declining trend. Crude output fell to 2.87 million metric tons, or 750,000 barrels a day. (3/22, #16)
- **Airfares** to some of the most popular US and international destinations rose by 25 percent or more last year, and June was the most expensive month to travel. (3/22, #18)
- Newly released court documents show gas drilling company **Range Resources** and other defendants paid $750,000 to settle claims that its activity ruined a western Pennsylvania family's property. (3/22, #20)
- It's going to take at least five years to start commercial development of **shale gas in Saudi Arabia**, a former executive from Saudi Aramco said. In an annual report published in 2011 Saudi Aramco said there were 286.2 trillion cubic feet of natural gas in the country. Baker Hughes puts the shale potential at 645 trillion cubic feet. (3/18, #6) (3/19, #8)
- A labor strike at the Gialo oil field in **Libya** left 120,000 barrels of crude oil per day off the market. The government was considering the use of force to quell oil demonstrations. (3/19, #10)
- Russian state oil firm Rosneft and **Venezuela**’s PDVSA have agreed to form a partnership to exploit an oilfield with estimated reserves of 40 billion barrels. For 1.5 billion dollars, the Russian company will take over 40 percent of a project at a Venezuelan deposit expected to produce 400,000 b/d of crude in five years’ time. (3/19, #13)
- **India**'s Ministry of Petroleum and Natural Gas said it has set up a committee to suggest ways to enhance domestic oil and gas production and reduce dependence on imports. (3/19, #18)

- The **Colonial Pipeline Co**. will expand a pipeline bringing gasoline, diesel and other fuel to the Northeast from the Gulf Coast by at least 100,000 b/d. The expansion is one of the steps the company is taking in response to the hurricanes in the past decade. (3/19, #20)
- Recent pipeline expansions have helped the **Marcellus shale play** reach a production rate of more than 7 bcfd to become the largest US gas-producing play, according to a new IHS Herold Marcellus Shale Company Play Analysis. (3/19, #21)
- Oil production in the **Gulf of Mexico** is expected to increase in 2013, the first such increase in four years. The financial firm Raymond James said that offshore oil production beyond 2020 is expected to increase at a faster rate than onshore production. (3/19, #22)
- **Crude oil transport by rail** in the United States is expected to hit the 700,000 b/d mark by the end of the year. The Association of American Railroads reports that US weekly carloads of petroleum products increased 46 percent for the week ending March 9 year-on-year. Much of that increase is fed by oil production in North Dakota, where output has surpassed existing pipeline capacity. (3/19, #23)
- **Petroleos Mexicanos** posted a gain in its proven reserves for a second year, supported by discoveries in the Gulf of Mexico and onshore. Mexico's reserves rose 0.4 percent to 13.868 billion barrels as of Jan. 1 from 13.81 billion a year earlier. (3/18, #8)
- Tokyo Electric Power said it detected a record 740,000 becquerels per kilogram of **radioactive cesium** in a fish caught in waters near the crippled Fukushima Daiichi Nuclear Power Station, equivalent to 7,400 times the state-set limit deemed safe for human consumption. (3/18, #11)
- The **EPA** released its annual report summarizing key trends in carbon dioxide emissions, fuel economy, and CO2- and fuel economy-related technology for gasoline- and diesel-fueled personal vehicles sold in the United States, from model years (MY) 1975 through 2012. (3/18, #12)
- Fracking isn't just for shale. In **Russia**, producers are importing techniques from the U.S. to squeeze billions of dollars of extra oil from Soviet-era fields. TNK-BP, Russia's third-largest producer, will use hydraulic fracturing combined with horizontal drilling in almost half the wells it sinks this year, a six fold increase in just two years. (3/18, #15)

Commentary: Awash in Misinformation: America's Domestic Tight Oil 'Bump'

(*Note: This commentary originally appeared in the Huffington Post Blog.*)

By Daniel Davis, Lieutenant Colonel, U.S. Army

On March 4, David Frum, a former special assistant to President George W. Bush, published an article on CNN.com titled "Peak Oil doomsayers proved wrong" in which he not only claimed there was no danger of a shortage of oil, but also that "our oil problem is that we're producing so much of the stuff that we are changing the planet's climate." Mr. Frum is only the most recent contributor to a growing list of luminaries to declare that we need not worry about any future shortage of crude oil. The only problem with these reassuring proclamations is that the physical evidence does not support them, and does in point of fact, warn of a looming imbalance between supply and demand with troubling implications for the U.S. economy.

Last month, the standard-bearer for those arguing the U.S. will soon be awash in domestically produced oil testified before the House Energy and Commerce Committee. Daniel Yergin, Chairman of Cambridge Energy Research Associates, told Members of Congress in his prepared remarks, "Owing to the scale and impact of shale gas and tight oil, it is appropriate to describe their development as the most important energy innovation so far of the 21st century" and "the unconventional oil and gas revolution has already had major impact in multiple dimensions. Its significance will continue to grow as it continues to unfold."

Yet the Energy Information Administration (EIA) and independent analysis confirm that far from the "energy revolution" of the century, the increase in domestic oil production represents a temporary bump in production that will be short-lived. If we recognize the probability the impressive increases we've seen in shale gas and "tight oil" production are of limited volume and duration and set policies accordingly, we can reap great benefit; pretend these increases herald a new and ever-increasing permanent condition and we risk setting ourselves up for an avoidable economic contraction when the expected drop in production occurs. Geologist David Hughes, a 32-year veteran of the Geological Survey of Canada, recently conducted a detailed examination of the years-long performance of 65,000 shale gas and tight oil wells. The results were telling.

In the February 21 issue of *Nature Magazine*, Mr. Hughes reported that "much of the oil and gas produced [in shale formations] comes from relatively small sweet spots within the fields. Overall well quality will decline as sweet spots become saturated with wells, requiring and ever-increasing number of wells to sustain production." More ominously, he notes, "high-productivity shale plays are not ubiquitous, as some would have us believe. Six out of 30 plays account for 88% of shale-gas production, and two out of 21 plays account for 81% of tight-oil production." Even the typically optimistic EIA echoed the concerns about sweet spots and the likelihood high levels of production cannot be sustained.

In a little-noted press release last December, the EIA projected there would be a considerable increase in tight oil production in the next few years, but then conceded, "The growth results largely from a significant increase in onshore crude oil production, particularly from shale and other tight formations. After about 2020, production begins declining..." But as Mr. Hughes points out, evidence is growing that the production is not likely to rise as high as hoped, and his analysis indicates the drop in production could begin by 2017.

In late February, the EIA reported that "Saudi Aramco's CEO Khalid al-Falih warned that rising domestic energy consumption could result in the loss of 3 million barrels per day (bbl/d) of crude oil exports by the end of the decade if no changes were made to current trends." *The New York Times* reported that Chinese consumption by 2020 could be almost two-thirds greater than it was in 2011, resulting in a 6 million barrels per day (mbd) increase. Thus, viewed in context evidence indicates that U.S. domestic oil production could max out as early as 2017 and then begin a slow decline -- just as Saudi Arabia could be exporting 3 mbd less and China could be needing 6 mbd more. The consequences to the U.S. economy of such a confluence could be drastic.

The idea of oil "independence" understandably appeals to Americans. It is likewise understandable that individuals and groups who have a financial interest in the American oil industry would argue and lobby for the investment in the means of producing energy for the U.S. that would most benefit them. But at some point America's leaders must recognize the physical evidence indicates the alleged "energy revolution" is likely to be merely a relatively short-term bump. If we fail to acknowledge the likely realities, we may be setting the stage for an energy crisis in the near term that might have been minimized. The consequences of such a failure are difficult to predict, but given the already weakened health of the U.S. economy, they would likely be severe and long-lasting.

__Daniel L. Davis__ is a lieutenant colonel in the U.S. Army and a member of ASPO-USA's Advisory Board. He has served combat duty in Iraq during Operation Desert Storm and Operation Iraqi Freedom, and in Afghanistan during Operation Enduring Freedom. He was awarded the Bronze Star for Valor in 1991. He is a frequent contributor and commentator on energy and national security issues, and has been published in the Washington Times, International Herald Tribune, European Stars and Stripes, Defense News, Armed Forces Journal, Army Times, Air Force Times, and other publications.