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1. Oil and the Global Economy

Oil prices rose slowly last week, reaching nearly \$97.63 in New York and 103.50 in London before falling back to close at \$96.56 in NY and \$102.13 on profit-taking Friday. Driving the market higher last week were flooding in Alberta which slowed the flow of oil coming into the US from Canada and a growing consensus that the Federal Reserve will not slow quantitative easing in the near future. Turmoil in the Middle East and growing US involvement in Syria continues to support oil prices, as well as tentative indications that the US economy may be strengthening. A stronger dollar, however, helped keep NY oil futures from topping \$100 during the recent rally.

The EIA reported that US crude production for April was up by 17 percent over last year to 7.35 million b/d. The 1 million b/d increase over the past year has led to a 10 percent drop in oil imports which were at their lowest for April since 1995.

The EIA also says that OPEC production for June was down by 300,000 b/d on unrest in Libya and Nigeria. OPEC exports are expected to increase, however, by 450,000 b/d in the next few weeks as the summer demand for driving fuels hits a peak around the world.

US gasoline prices continued to fall last week with the US national average now at \$3.49, down from \$3.57 the week before. Prices in the Midwest fell nearly 20 cents a gallon after falling 13 cents the week before last on news that the refineries are coming out of maintenance and inventories are rebuilding. The advent of the summer driving season has stimulated the demand for gasoline. Refinery utilization last week reached 90.2 percent, the highest level of the year. Although the demand for gasoline in the US is lackluster with the AAA predicting slightly less traffic on the road for the 4th of July holiday, the demand for diesel exports continues to be strong.

Natural gas prices fell sharply last week and are now down 20 percent from the highs reached in April. At the close on Friday, futures were at \$3.57 per million BTUs which is getting into the price range where natural gas becomes more economical than coal for power plant operators who can switch fuels. The use of natural gas in power plants in April was down 22% from last year, however, as prices rose well above the \$3.50 coal-gas switch point.

Cooler weather in the Eastern US and higher-than-expected injections into storage caverns were responsible for the decline. Weather forecasts for the first two weeks of July call for milder temperatures in the East while in the Southwest record highs are expected.

2. The Middle East & North Africa

Syria: The peace talks proposed by Russia and the US seem to be going nowhere and are unlikely to be held in the foreseeable future. For now both sides only want to discuss the surrender of the other so there seems to be nothing to talk about. The government's offensive against Homs and Aleppo continues with Damascus reporting some progress. The debate over arming the rebels continued. Most of the discussion focuses on the possibility of shoulder-fired surface to air missiles falling into the hands of radical groups where they could someday be used to shoot down civilian aircraft. While the US has been very careful in delivering weapons to the rebels, the Gulf Arab states have been less so. The US, however, seems to be in the process of supplying modern anti-tank weapons to selected rebel groups. Given enough time, and adequate training, these weapons could neutralize the government's advantage in armor forces, but this is still months away.

With Syria's economy is all but gone and under heavy western sanctions. Moscow, Beijing, and Tehran, however, have stepped in to keep the government functioning. They are delivering \$500 million a month in oil and are extending credit lines for whatever the government needs. It is this financial support that has given the government the confidence to go on the offensive against the rebels.

Rhetoric concerning the Syrian war is increasing. Gulf Arab governments are outraged at the Iran/Hezbollah intervention against the Sunni rebels and are supplying increased aid to the rebels. Tehran is warning the west that by supplying arms to Syria, it will turn the nation into a safe haven for al Qaeda.

It was a bad week for Lebanon which now hosts some 600,000 Syrian refugees including many requiring medical treatment. The country is a major source of supplies and manpower for both sides. Sporadic fighting between Sunnis and Shiites continues and last week 12 government soldiers were killed in a battle with a Sunni group. Lebanon too, seems on the verge of coming apart.

Iraq: Terrorist bombs continue to go off daily killing dozens each week while the political deadlocks between Baghdad and the Kurds/Sunnis continue. The government announced its new energy strategy which calls for the investment of \$620 billion over the next 17 years to develop its oil fields. Baghdad hopes to bring in \$6 trillion in revenue during the period and to have oil production increase to 10-12 million b/d from the current 3.2 million b/d. Many are skeptical as the country shows every sign of breaking apart, and cannot even agree on new oil law after nearly a decade of trying. Iraq's exports in May declined to 2.48 million b/d from 2.62 in April. Bad weather and attacks on the northern export pipeline were blamed for the decline

In the meantime, Kurdistan's regional government is planning to get its exports up to 1 million b/d by 2015 which is a more realistic target given the relative political stability of the region.

Iran: Iran's President-elect says his election was a vote for change and constructive interaction with the outside world. He has promised to lower the rhetoric and find areas of compromise on the nuclear issue while preserving Iran's right to enrich uranium. It is too early to tell about how this will turn out as it is wrapped up with the Syrian situation. There may be room for optimism, however, as the hardest of the hardliners were soundly defeated in the election.

In the meantime, the oil sanctions continue with mixed results. India and South Korea have pledged to make substantial cutbacks, while exports to Japan doubled in May from a year earlier although Japanese imports since January are down 17 percent since last year. Japan is concerned about the possibility of US sanctions so is unlikely to let its imports rise substantially.

Chinese imports from Iran of heavy fuel oil used in power plants and small oil refineries climbed to a five-year high. China imported 2.4 million tons of crude from Iran in May, up 4 percent from a year earlier.

Egypt: Numerous massive demonstrations, some numbering in the hundreds of thousands took place in Cairo and many other Egyptian cities over the weekend with the aim of driving President Morsi from power. At the

root of the confrontation is the crumbling Egyptian economy which now has 50 percent of the population below the poverty level of \$2 per day.

The motor fuel situation in Egypt remains critical and has worsened in the past week despite government denials there is a problem. Long lines formed at gas stations out of fear that shortages will only get worse. There are reports that Egypt's petroleum minister told a Turkish newspaper that the country will be out of fuel reserves shortly.

The government now says that the fuel control system it plans to introduce in July for diesel and August for gasoline using smart cards will not be a "rationing" system as announced in March. The new plan seems to be one where vehicle owners obtain a "smart" card that will entitle them to about 475 gallons of subsidized fuel annually after which they will have to buy fuel at market rates. Owners of diesel powered vehicles are to go to designated distribution points to pick up a card, while gasoline powered vehicle owners will have to register at an online website for a card.

The government hopes to save millions of dollars through restrictions on subsidized fuel; the success of all this may depend on whether there is fuel available to sell in the quantities demanded. In the meantime the food and fuel shortages, and the ongoing political crisis, are threatening to turn Egypt into a "failed state" with unknown but obviously serious consequences for the region.

3. China

Concerns are growing that all might not be as well with China's economy as its 7.7 percent growth rate in the 1st quarter would seem to indicate. At the root of the problem is the \$2.5 trillion worth of economic stimulation that Beijing used to keep its economy growing in the wake of the 2008 economic slowdown and export slump. Most of this spending went to economically dubious projects such as high-speed rail lines paralleling regular tracks, bridges, airport terminals and condo buildings that still stand empty. The loans for these projects undertaken by local authorities are still on the books and may never be paid back. A recent book points out that China's economy may really be growing at closer to 2-3 percent when you strip out all the empty condos and redundant rail lines.

The most reliable indicator of Chinese economic growth is electricity consumption which only increased by 2.9 percent in the first quarter. As GDP growth usually runs at 85 percent of electricity growth China may in reality have only grown on the order of 2.5 percent in the 1st quarter.

Beyond its outsized debt, China has the problem of near-lethal pollution to deal with. The new government is pledging to improve environmental quality and there are hints that it may be willing to adopt an absolute cap on CO₂ emissions in the near future rather than simply cutting emissions per unit of economic growth without regards to what actually goes into the air. The goal of cleaner air will require reductions in the consumption of coal, which will likely lead to less power generation, less growth, and ultimately less demand for imported oil.

The recent Chinese interest rate spike may only be a symptom of more problems ahead despite statements from the Central Bank that all is well. From a peak oil perspective, China's oil consumption may not continue to grow by 500,000 or so barrels per day every year for the indefinite future.

4. Quote of the Week

- "I am sure China will have a total emission target during the 13th Five-Year Plan." [Ed. The move could enable an achievement that has eluded the world's major nations for years: a binding international agreement on carbon caps that includes both the developed economies of West and East Asia and rising economic powers like China and India.]

--Jiang Kejun, National Development and Reform Commission, China

5. The Briefs

- The **UAE** is planning to increase its oil production capacity to 3.5 million b/d by 2018, from current 2.8 million. The previous Minister of Energy, who was recently replaced, revealed early this year that the country fell short of meeting its target to raise oil production to 3 million b/d by the end of last year. (6/24 #12)
- Gulf Keystone, a London-based company, said last week it started drilling its first exploration well in **Kurdistan's** Shaikan oil field. It said the entire field could hold as much as 10.5 billion barrels of oil. Production for 2018 is targeted at 250,000 b/d. (6/28 #9)
- If the **Nigerian** oil industry is going to reverse the decline caused in part by regulatory uncertainty over the fate of the Petroleum Industry Bill, it will need additional investment in its deep-water oil fields. Failure to pass the controversial bill, which would replace all of Nigeria's existing oil and natural gas laws, could cause the country's oil production to fall 20-40 percent by 2020. Oil represents 75% of Nigeria's exports. (6/27 #10)
- **In Nigeria**, contractors working for Shell have been arrested as alleged accomplices in the theft of oil that led to a pipeline fire. (6/24 #13)
- State-owned **Chinese** oil companies have paid \$1.5 billion for a stake in an Angolan oil field and bought a \$4.2 billion share in an offshore Mozambique gas field in recent weeks, part of a \$100 billion global spending binge by Beijing since 2009 to secure foreign oil resources. The Chinese spent a record \$35 billion in 2012 alone on joint ventures and outright purchases. (6/27 #12)
- According to Platts' calculations, demand for fuel oil in **China** rose 11.9% year on year from January to May this year, totaling 17.66 million mt, or close to 760,000 b/d. (6/28 #16)
- The Shah Deniz group developing new gas reserves in Azerbaijan said it selected the **Trans-Adriatic Pipeline**, or TAP, as its delivery route to Europe. The choice of TAP over rival pipeline Nabucco West capped the battle to deliver Azerbaijan's gas to the European Union, a key part of the region's plans to diversify gas supplies away from dependence from Russia. (6/28 #24B)
- A string of new **Russian deals** with Asian customers marks the beginning of a major shift away from the country's traditional markets in Europe. (6/27 #21)
- **Ugandan and Kenyan** leaders announced plans to construct an oil pipeline that would stretch to the Lamu Port on the eastern shores of the Indian Ocean. The report gave no indication of the volume of oil planned for the pipelines. (6/27 #5)
- **Record flooding near Calgary** has left the downtown core of [Canada's](#) oil capital empty while forcing three oil pipelines to close and causing as much as \$4.8 billion in damage to homes and offices. (6/27 #20)
- Due to the floods around **Calgary**, Enbridge's shutdown of Alberta pipelines capable of moving 1.17 million barrels a day toward U.S. markets is shrinking output and boosting US crude to the highest level against Europe's benchmark oil since 2011. (6/26 #4)
- The **US rig count** declined to the lowest level in two months this week, according to Baker Hughes. The total count fell by 11 to 1,748. Oil rigs dropped by 15 to 1,390, a nine-week low. Gas rigs rose by four to 353, the first increase in six weeks. (6/29 #21)
- While the potential of **shale oil** and gas production is global, the only significant quantities of shale oil and gas that have been produced so far have been in the United States. Elsewhere the industry's potential remains theoretical. (6/27 #22)
- Ray Perryman, director of the financial analysis company The Perryman Group, **the Cline shale** reserve areas in western Texas could be more lucrative than Eagle Ford. "The information coming out on the Cline shale indicates up to 30 billion barrels of recoverable oil, which is substantially larger than other large plays." (6/28 #21)

- Magellan Midstream Partners' Longhorn pipeline began shipping oil from **West Texas** to Houston in April—the first of at least seven pipeline projects that could send as much as two million b/d from oil-saturated choke points in Oklahoma and the interior of Texas to the largest concentration of refineries in the country. (6/25 #9)
- Oil and gas exploration off **US coasts** would be expanded under legislation the House of Representatives passed over the threat of a presidential veto. The measure would require the Obama administration to conduct additional sales of oil and gas leases off the coasts of Virginia, South Carolina, southern California and Alaska over the next five years. (6/29 #15)
- The US may produce **five million barrels of shale oil per day by 2017** and may become the largest global oil producer with up to 16 million barrels of oil (shale, conventional, LNG, and biofuels) per day in just a few years, according to a new report from Harvard's Belfer Center authored by Leonardo Maugeri. (6/28 #27)
- **Jordan** is pushing ahead with plans to build the Middle East's first shale oil-fired power plant, a major step toward achieving energy security by the resource-poor Hashemite kingdom. Its fragile economy had long been held back by dependence on imported energy. (6/28 #12)
- A British oil services company said it expects to resume full operations at an **Algerian** natural gas facility attacked by militants earlier this year. Militants sympathetic to al-Qaida in the Islamic Maghreb stormed the In Amenas natural gas facility in eastern Algeria in January. Foreign workers with BP and Norwegian energy company Statoil were among the dead in the attack. (6/27 #8)
- **India's cabinet** agreed to double natural gas prices to industrial and retail consumers to help fund investment in exploration and reverse declining domestic output, which would ultimately help in reducing the hefty energy import bill. (6/28 #17)
- The **British** energy sector is eager to secure more supplies of natural gas from Russian energy company Gazprom, the British energy minister said. Energy Minister Michael Fallon met in St. Petersburg with Gazprom chief Alexei Miller to discuss expanding ties in the energy sector. (6/24 #19)
- In the **UK**, hopes of replicating the U.S. shale-gas boom received a boost as an estimate of the country's reserves increased significantly, although how much of it can be produced remains uncertain. A new study from the British Geological Survey estimates that 1.3 quadrillion cubic feet of natural gas lie trapped in shale rock beneath northern England, significantly more than current proven UK gas reserves. The U.K.'s shale-gas industry currently has no commercial production. (6/28 #26)
- The **US** recorded the world's highest increase in natural gas consumption and production in 2012, while also witnessing the highest drop in coal use. (6/29 #20)
- Outside the US, production of **natural gas** is not likely to move as fast as in the US because the laws that govern resource development in other countries are far more restrictive than in the United States. (6/27 #23-b)
- President Obama's **climate action** plan announced last week directs the EPA to limit the amount of carbon dioxide that power plants may produce (currently 40% of the US total). The president also ordered the strengthening of fuel-economy standards for vehicles; offered \$8 billion in loan guarantees for the deployment of technologies that make fossil fuels less harmful to the climate, such as carbon capture; and promised to promote renewable power by encouraging the construction of wind farms and solar arrays on federal lands. (6/29 #24)
- With no chance of US Congressional support, President Obama is staking part of his legacy on the risk that he can substantially reduce **greenhouse gas emissions** by stretching the intent of a law decades old and not written with climate change in mind. The push, which doesn't require congressional approval, faces years of political and legal challenges. (6/27 #16)
- President Obama's long-awaited plan to combat climate change with new standards for US power plants will cause a spike in **natural gas demand**, a former key Obama energy adviser said Tuesday. (6/27 #19)

- The beleaguered **US coal** industry, bracing for the possibility that no more coal-burning power plants will ever be built on U.S. soil, is teaming up with other business groups to blunt the impact of President Obama's climate-change agenda, while also shifting its business focus to exports. (6/27 #14)
- **US** coal production totaled about 19.4 million tons in the week that ended Saturday, 1.6% lower than the previous week's estimate and 0.9% below the output estimate for the comparable week in 2012, EIA said. (6/28 #23)
- **India used 10.2 percent more coal** in 2012 vs. 2011, their fastest rate of increase in 31 years, helping power an economy that expanded 5 percent last year. That rate of coal consumption reversed three years of slower gains. India imported 20 percent of its coal requirements in the year ended March 31. Coal-fired power stations provide about 59 percent of India's electricity. (6/29 #14)
- The Secretary-General of the **Arab League** pointed out that the Arab region was still undergoing divergent demographic challenges such as unemployment, marginalization, low income, and immigration despite Arab states' efforts to strengthen and employ development opportunities. (6/26 #7)
- HSBC Holdings said it is considering selling its majority stake in Dar Es Salaam Investment Bank, which has made it **Iraq's** main international lender. (6/27 #10)
- **Canada's** National Research Council reported that heavy crude oil to be carried by the proposed Keystone XL pipeline poses no greater risk of a spill than other types of oil. (6/26 #20)
- An unforgiving article in the latest Foreign Policy magazine lays out how conservative Canadian Prime Minister Harper has been aggressively pursuing development of the **Alberta oil sands** and remaking the country. His government has spent \$100 million since 2009 on ads to convince Canadians that exporting this oil is "responsible resource development." (6/26 #22)
- The US Supreme Court refused to hear a legal challenge to the US Environmental Protection Agency's program introducing gasoline with a **15% ethanol blend** to the domestic marketplace. (6/25 #211)
- Halliburton and others are adapting acoustic technology used by US submarines to record sounds made deep in the earth that can guide engineers in finishing a well and predicting how much oil will flow. The ability to hear inside a well enables producers to fine-tune hydraulic fracturing. The technology is targeted at an estimated \$31 billion that will be spent this year on fracking wells that yield less-than-optimal results. (6/25 #23)
- During a media event in Wolfsburg, Germany, **Volkswagen** provided details of its two-seater XL1 Super Efficient Vehicle diesel plug-in hybrid. The lightweight XL1 (1,753 lbs.) delivers NEDC fuel consumption of 261 mpg and an all-electric range of 31 miles (50 km) as well as a total range of 310 miles (499 km). (6/24 #23)
- **Qatar:** In an era when the handover of political power in the Middle East has typically been accompanied by mass civil unrest, or even outright war, Qatar has bucked the trend. The emir of the small, super-wealthy Gulf state ceded power to his 33-year-old son Tuesday. (6/26 #6)
- The EIA said **global shale oil** and shale gas resource estimates in their recent report are highly uncertain and will remain so until they are extensively tested with production wells. The report estimates shale resources outside the US by extrapolation based on the geology and resource recovery rates of similar shale formations in the United States. Hence, the EIA concedes that the extent to which global technically recoverable shale resources will prove to be economically recoverable is not yet clear. (6/24 #22)
- Global expenditure on drilling **deepwater** oil and gas exploration wells is expected to almost triple to \$114 billion by 2022 from \$43 billion in 2012, Wood Mackenzie said in a statement Thursday. (7/1 #5)