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## 1. Oil and the Global Economy

Concerns that a US strike on Syria would lead to a wider war in the Middle East faded last week as the US and Russia negotiated a deal to neutralize Syria's stocks of poison gas. News of the negotiations sent oil prices down by \$4-5 a barrel early last week, only to recover a dollar or so later on concerns about the upcoming Federal Reserve decision and the Libyan supply outage. At week's end, NY oil closed at \$108.21 and London at \$112.78 – about \$4 a barrel less than at the height of the crisis.

The IEA and EIA reported that production outages in August tightened the global oil markets with disruptions reaching 2.7 million b/d during the month. Nearly 2.1 million b/d of disruptions took place in OPEC states which was the highest level since 2009. Near record production by Saudi Arabia was not enough to make up for the loss of Libyan oil; however increasing US production is helping keep prices under control.

Global demand is forecast as increasing by 1.3 million b/d by the EIA this year but only by 895,000 b/d by the IEA. Non-OPEC production is supposed to make up for the shortfall between supply and demand with North American oil providing most of the production growth. With Libyan exports down drastically, European refineries are having trouble finding the light crude they are designed to process. Some of the shortfall is being made up by US refineries, which are running at the highest level for this time of year since 2006, producing oil products for export. The IEA reports that global stockpiles, which have been falling in recent months, are now about 65 million barrels below the five-year average. The high pace of refining is quickly draining away the glut of crude at Cushing, Okla. that forced the NY-London spread to very high levels last winter.

US natural gas prices crept up last week closing at \$3.67 per million BTUs. Smaller than expected stocks increases; concern about the hurricane season; and some late-season hot weather in the mid-West were seen as reasons for the increasing prices. At these price levels, natural gas no longer has much attraction for the electric power industry which should reduce demand this fall.

## 2. The Middle East & North Africa

**Syria:** The deal to neutralize the Assad government's stocks of chemical weapons removes the issue from the list of factors driving oil prices for the immediate future. With Moscow, Assad's chief foreign patron, behind the deal it seems likely that at least the first steps of the agreement will be undertaken. Although many hope that the chemical weapons accord will be only the first step of an eventual political solution to the Syrian civil war, this seems unlikely as passions on both sides are much too deep.

Refugees are still streaming out of Syria destabilizing life in Lebanon, Jordan, Turkey and Iraq. Syria's economy hardly exists anymore and the country is having an increasingly difficult time feeding itself. Although the fighting has subsided recently as government forces prepared for the possibility of US strikes, little has

changed on the ground. The US and Saudi Arabia have stepped up military aid to selected rebel forces and the situation continues to deteriorate.

Syria has long since ceased to produce much oil so the issue becomes how and where the conflict will spread to neighboring countries that are major producers. The turmoil in Lebanon wrought by the influx of refugees has already tabled efforts to begin exploiting natural gas fields in Lebanese waters. Large numbers of Syrian Kurds have fled to Iraqi Kurdistan and the movement of Jihadists back and forth across the Syria/Iraq border is raising concerns. This war clearly has many months or even years to go before there is any light at the end of the tunnel. The chances seem good that Syria soon will be a failed state with serious implications for her neighbors.

**Iraq:** Bombings of both the suicide and car bomb variety continue to take place daily across Iraq. So far there have been minimal political repercussions to the carnage. Iraqis seem to have accepted the casualty counts as a fact of life in much the same manner that the deaths from motor vehicle accidents are accepted as a necessary evil across the globe. The civil war that many feared does not seem to be forming at present.

Iraqi Kurdistan has asked the oil companies drilling in the province for \$50 million to help provide support for the 200,000 Syrian Kurds that have fled to the province in recent months.

BP has agreed to help the Iraqi government revamp its giant Kirkuk oil field, potentially paving the way for the UK-based company to obtain a longer-term development deal. For now the contract is for consulting only. Kirkuk, located in a disputed part of northern Iraq, was discovered in 1927. Production there has declined to 260,000 b/d from 900,000 b/d in the early 2000s after years of injecting water and the dumping of unwanted crude and other oil products in the field's reservoir.

The IEA has raised new doubts as to whether there is enough skilled manpower in Iraq to ever raise the country's oil production to 6 or 8 million b/d as the government would like to do.

**Libya:** The oil workers strike continued last week, virtually halting the country's exports and costing the government some \$130 million per day in lost revenue. The government announced it has issued arrest warrants for strike leaders, but has little power to enforce its decrees. The impetus for continuing the strikes is coming from two groups. In the East, the self-appointed Cyrenaica Council, which is seeking more autonomy from Tripoli for the three main regions of the country, is leading the strike. In the West, the Zintan militia, which is based in a mountain town and is seeking more influence over Tripoli, is responsible for the strike.

The Cyrenaica Council is demanding that the headquarters of Libya's National Oil Company be moved to Benghazi in the province where the bulk of the oil is located; and that religious and military power in the country be decentralized. There are also concerns about corruption in Tripoli and the illegal selling of oil.

Over the weekend, there was a newspaper report that negotiations between Benghazi and Tripoli had been successful and that the strikes at several export terminals in the East were being called off but so far there has been no corroboration that this is taking place.

The strikes are only one of many problems facing the government. During the week it was reported that militias loyal to the memory of Gadhafi have seized part of Tripoli's water supply. The turmoil in Libya is just beginning.

**Egypt:** With the jailing of many Muslim Brotherhood leaders, the Army seems to have the situation in the streets under control for the time being. Demonstrations against the Army takeover have largely subsided and attention has shifted to the Sinai where the Army launched a major offensive against insurgents in the region. Some 22,000 troops are involved in the operation which is expected to last six months. The Egyptians have already located and destroyed the smuggling tunnels into Gaza and are establishing a buffer zone around the enclave to insure that they can not be rebuilt.

Part of the Army's objective in this operation is to keep militants as far away from the Suez Canal as possible. On August 31<sup>st</sup> a Chinese-owned container ship was attacked with rocket propelled grenades while transiting the canal. Some 2.2 million barrels of petroleum and products goes through the canal each day while an additional 1.7 million b/d is pumped through an adjoining pipeline. The canal and pipeline provide much of Egypt's foreign exchange earnings vital for a country which can no longer feed or fuel itself. Unless Egypt's domestic security situation deteriorates much further, security of the Canal is likely to be a top issue with the new government. Likewise blocking the canal will be top objective for groups opposed to the government.

**Iran:** President Rouhani says Tehran plans to restart nuclear talks in New York where he will attend the UN General Assembly meeting this month. Rouhani says that he expects the talks will lead to a "win-win" final outcome for the dispute. The remarks, however, came right after an announcement by the UN's IAEA that Tehran was not cooperating with nuclear inspectors who still have many questions related to Iran's development of nuclear weapons. Russia's President Putin has accepted an invitation to visit Tehran to discuss a role for Moscow in the nuclear standoff. President Obama warned Tehran that the use of force is not off the table with regards to Syria's chemical weapons or Iran's nuclear weapons program.

India's energy needs which are becoming increasingly desperate may cause New Delhi to form some partnership with Tehran to develop Iranian oil fields. The Indians realize that they would be treading a fine line to avoid involvement with US sanctions programs.

### **3. China**

Outside observers are having second thoughts about China's latest economic "recovery." Beijing announced last week that industrial production hit a 17-month high in August, with steel production up and electric power production increasing by 13 percent from August 2012. Analysts' doubts, however, come from the nature of the growth which consists of the traditional reliance on exports and debt-funded large infrastructure projects such as airports and railways. Many believe this model for growth cannot last over the longer term.

Last week Beijing revealed a new multi-pronged plan to battle air pollution. China will cut coal use, close polluters' facilities and promote cleaner energy production. New industrial projects in three regions along the East Coast will be banned from setting up their own coal-fired power plants and the country will make an effort to substitute natural gas and coal-bed methane wherever possible. Use of coal to generate electricity is to be cut from 70 percent of production to less than 65 percent by 2017.

The plan is in line with recent government statements that pollution must be curtailed and notes that China's air quality situation is "grim" and that high levels of fine particulate matter in the air have "harmed people's health and affected social harmony and stability." The new plan focuses on the more densely populated Eastern regions, however, and says little about the rapidly developing West. The plan does not say how the goals will be enforced or what the standards are.

China has had pollution control for many years, but it was rarely enforced as such controls interfered with production goals. It will be interesting to see if anything changes this time. Given current technology, it is difficult to see how serious pollution controls can be accomplished without cutting economic growth.

### **4. Quote of the Week**

- There is a "real and rising" risk the Libyan state could collapse. "Faltering state capacity and rising public ire mean that the government may not survive for that long if it is unable to effect at least a partial restoration of [oil] production currently still offline."

*-- PFC Energy, a consultant group based in Washington*

## 5. The Briefs

- **North American** oil production helped offset declines from non-OPEC and OPEC members alike, the IEA said Thursday. Crude oil supplies from OPEC members declined 260,000 barrels per day, with an increase in production from Saudi Arabia only partially offsetting Libya's major declines. Non-OPEC production is expected to rise by 520,000 barrels per day quarter-on-quarter as a seasonal decline in the North Sea is more than made up for by North American growth and steady production elsewhere. (9/13 #4)
- According to the IEA, **worldwide demand growth for oil** is forecast to rise 1.1 million b/d to 92 million b/d in 2014, as the underlying macroeconomic backdrop solidifies. (9/12 #7)
- **OPEC's monthly market report** said non-OPEC supply should increase by 1.1 million b/d this year. By next year, non-OPEC supply should grow by 1.2 million b/d. (9/11 #10)
- **The worldwide rig count** last month was 3,416, up from the 3,362 counted in July, though down from the 3,471 counted in August of last year, according to Baker Hughes. The international rig count for August was 1,267 (37% of the world total), down from July's 1,305 but up from 1,261 counted in August 2012. Meanwhile, the average U.S. rig count for August was 1,781 (52% of world total), up from July's 1,766 but down from the 1,894 counted in August 2012. (9/9 #4)
- In **Nigeria**, Shell officials on Monday will begin talks in the southern city of Port Harcourt with representatives for the Bodo community on compensation and cleanup five years after one of the worst oil spills in Nigeria's history. Some experts say the two spills that started in 2008 caused the largest loss of a mangrove habitat ever caused by an oil spill, affecting about 30,000 inhabitants in the Niger Delta area. (9/9 #8)
- **Currency depreciation** in some emerging-market countries may slow global oil demand and push them into rolling back subsidies used to shield their industry and private consumers from already high global oil prices, the IEA said Thursday. Slower oil demand growth from major oil importers like India could help tamp down prices. (9/14 #4)
- **In Libya**, there was a near total blockade of oil exports after the National Oil Corp. declared force majeure on national export terminals, according to reports from Platts. (9/14 #10)
- A failed attack on a container ship transiting **the Suez Canal** has raised concerns that as Egypt descends into widening violence the strategic waterway could become a target for Islamist militants. Roughly 2.2 million barrels of crude oil and petroleum products transit the canal every day, and another 1.7 mb/d is pumped through a parallel pipeline. (9/12 #19)
- **In Iraq**, lack of a skilled labor force may be an inhibiting factor in long-term oil development plans. This will make it harder to meet IEA projections for Iraqi oil production of 6.1 million b/d by 2020 and 8.3 million b/d by 2035. (9/13 #10)
- The North Caspian Operating Co. said Wednesday oil was being produced from the giant **Kashagan field** in Kazakh waters of the Caspian Sea for the first time, 13 years after the field was first discovered. In the initial phase [*cost: \$41.2 billion*] output will grow up to 180,000 barrels per day. Afterwards, the production will increase progressively up to 370,000 barrels of oil equivalent per day. (9/12 #20)
- Anglo-Turkish oil exploration company Genel Energy permanently stopped oil exploration and withdrew its expatriates from **Somalia's** separatist region of Somaliland (northwestern Somalia) following security threats and political pressure. (9/11 #18)

- Exxon Mobil, Shell and other energy companies operating in **South Africa** said planned changes to mineral and energy laws lack clarity and will deter investment by the oil industry in the continent's largest economy. (9/12 #21)
- **Iran** projects an increase in oil production this year to 4 million b/d and is seeking to boost exports, new President Rohani said. The country pumped 2.57 million barrels a day in August, according to data compiled by Bloomberg. (9/12 #15)
- The **US** is set to pass Russia and become the leading non-OPEC in the production of liquid fuels such as crude and ethanol this quarter, the International Energy Agency said. (9/12 #9)
- In **North Dakota**, oil production hit a new record high in July as oil companies brought more wells online once summer rains stopped, the state regulator said. Output in July jumped by 55,000 barrels per day from the month before, to just below 875,000 bpd. Some 67% of that oil reached final markets via rail tankers instead of through pipelines. (9/14 #17)
- **Regulatory permits** for U.S. onshore drilling are rising. Permits reached their highest level this year in August, up 14 percent from July to 5,231 issued in 30 states. Barclays researchers say an increase in permits tends to precede an increase in well drilling by two months. (9/14 #20)
- Weekly **rail traffic** of US petroleum and petroleum products so far this year averaged 13,488 carloads, a 39.3 percent increase over 2012. In June, the average daily rail delivery of 700,000 b/d represents about 10 percent of the total US crude oil production. (9/14 #18)
- **California's** refiners received a record amount of crude by rail in the second quarter—748,802 barrels-- which more than tripled the volume from a year earlier, as shipments from Colorado, North Dakota and other states grew. (9/10 #13)
- The **US Securities and Exchange Commission** is pressing energy companies to disclose how much of their reserves—a key gauge of future profit—consists of oil rather than less valuable liquids like propane. Companies including BHP Billiton Ltd. and ConocoPhillips have recently joined Exxon Mobil and Anadarko Petroleum Corp. in agreeing to break out how much of their liquid is crude (\$95/b last year) rather than liquids derived from natural gas (\$45/b). (9/14 #15)
- Secretary of State for Energy Ed Davey set out Monday the case for shale gas exploration in the **UK**, trying to put the industry back on track after a summer of protests against fracking. Davey, speaking to the Royal Society in London, stressed in particular that shale gas could be explored in line with the UK's climate change targets. (9/9 #13)
- **Chesapeake Energy Corp** has agreed to release more than 13,000 acres of land leased for oil and gas drilling in New York State as a ban on fracking extends into its sixth year. (9/10 #12)
- **In Lebanon**, lack of a functioning government for the last five months—the result of religious-based political rivalries fueled by outside powers—is holding up exploration for natural gas in its sector of the eastern Mediterranean while Israel and even bankrupt Cyprus are already well advanced in exploiting their reserves. No political decisions are being made as sectarian violence spills over from the civil war in neighboring Syria and the economy tanks. (9/14 #11)
- A senior official of Tokyo Electric Power, operator of the crippled **Fukushima** nuclear plant, said Friday that the situation in the stricken plant was "out of control," less than a week after Prime Minister Shinzo Abe assured the world that the situation in the damaged nuclear plant is "under control." (9/14 #14)
- Citibank has released an interesting report on "**peak coal**" in **China** - referring to peak demand rather than any supply driven peak of production. The limit to coal use appears to be how much pollution the

Chinese population is willing to tolerate - a reminder that there is more than one "limit to growth". Changes in Chinese coal demand have serious ripple effects on three categories: (1) globally traded coal and commodities, (2) countries and companies reliant on coal production and (3) carbon emissions. (9/13 #20)

- The Obama administration plans to block the construction of new **coal-fired power plants** unless they are built with novel and expensive technology to capture greenhouse-gas emissions, according to people familiar with a draft proposal. (9/2 #30)
- **India's** biggest underlying financial problem is its heavy and growing dependence on imported energy. More than half of India's \$191 billion trade deficit in the financial year to March - \$109 billion - was made up of oil, with India importing 82 percent of its oil needs. India is already the fourth biggest energy consumer on the planet, after China, the US and Russia. Indian energy use is growing inexorably and rose 5.1 per cent last year (9/13 #21)
- The European Parliament voted Wednesday to limit the use of **biofuels in the European Union**, one of a series of potential changes to the bloc's climate-change policies that investors say are creating uncertainty and bottling up energy investments. The Parliament approved a proposal to limit the share of food-based biofuels in cars and trucks to 6 percent of total consumption by 2020. (9/13 #24)
- Valero Energy, the world's largest independent refining company, called on the Obama administration to waive the country's **biofuel** target immediately, saying the cost to reach it has skyrocketed. (9/11 #22)
- From 2006 to 2011—the five years preceding **Syria's** civil war—some 60 percent of Syria's land experienced the worst long-term drought and most severe set of crop failures since agricultural civilizations began in the Fertile Crescent many millennia ago. That, on top of natural resource mismanagement by the Assad regime — subsidizing water-intensive wheat and cotton farming and unsustainable irrigation techniques — led to a large amount of devastation and helped trigger the civil war. (9/11 #25)
- **Canada's** Natural Resources Minister Joe Oliver said his nation wants to work with the U.S. to cut greenhouse-gas emissions, including from Alberta's oil sands, the source of crude to be carried by the Keystone XL pipeline. (9/10 #15)
- **Population growth in the US** is adding energy demand faster than any nation on Earth. China and India are also important (and in absolute terms they are certainly more important energy growers, due to a rapidly changing standard of living). But as to whose population growth is having the largest effect on global energy demand?—it's the U.S. (9/11 #26)