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### 1. Oil and the Global Economy

New York oil prices fell last week during volatile trading, closing Friday at \$102.02 amidst concerns about the US government shutdown and the possibility of a US debt default later this week. London crude, however, which is more concerned with problems in exports from Libya and Iraq, has been trending higher for the past two weeks, closing Friday at \$111.28. The Brent premium over WTI is now \$9.26 – the widest spread since early June before the glut at Cushing, Okla. began to shrink. The IEA is not concerned about the effect on the oil market of a short US government shutdown as it is about a default of the US debt which would have widespread consequences. With several US refineries closed for maintenance, US crude inventories rose by 6.8 million barrels last week—more than was expected by analysts.

The Department of Energy announced on Friday that it would start suspending its weekly petroleum stocks report this week leaving traders with only the American Petroleum Institute's weekly telephone survey of the oil industry. This survey has been spotty in its reflection of reality as reported by the more thorough EIA survey based on detailed, mandatory reports to Washington.

In its monthly forecast, the IEA increased its estimate of global demand by 100,000 b/d to 1 million for 2013, and its estimate for 2014 slightly to 1.1 million b/d. The Agency also reported that OPEC production fell by 645,000 b/d to 29.1 million b/d in September due to problems in Libya and Iraq and despite a third month of 10 million b/d Saudi production.

US crude production increased to 7.83 million b/d for the week ending Sept 13<sup>th</sup>, a 24 year high. There is much discussion of the US becoming the world's largest oil producer next year. This seems unlikely as US crude production is still 2.2 million b/d behind Russia and Saudi Arabia. Without throwing in natural gas liquids and the so-called "processing gains" this seems a difficult goal as the rate of increase of "shale" oil production is starting to slip. Economic troubles in the US could also impact domestic oil and gas production in the coming year.

The EIA is optimistic that falling gasoline prices will encourage more people to drive and boost US gasoline consumption in coming months. The Administration is forecasting that Brent crude will be averaging \$105 a barrel by December and NY crude \$98.50. Increased US gasoline consumption seems unlikely until the country gets through the various sequesters, shutdowns, defaults and austerities that it is currently facing.

The IEA is forecasting that non-OPEC crude production will increase by 1.7 million b/d in 2014 with higher output coming from the US, Canada, and Kazakhstan while OPEC production lags due to various geo-political factors afflicting its members. The bottom line is that, unless there is a major crisis, there should be plenty of oil to satisfy demand in the coming year.

US natural gas futures rose by nearly 8 percent during the past week to close at \$3.77 per million BTUs on Friday – the largest jump in 11 months. Forecasters are projecting much colder weather across much of the country during the rest of October.

## **2. The Middle East & North Africa**

**Iran:** President Rouhani said last week that Tehran is determined to resolve the nuclear dispute in a short period of time in order to have the sanctions, which are hurting the Iranian people, lifted. While asserting the ritual right to enrich uranium under the Non-Proliferation Treaty, he said the country is ready to remove international concerns during talks with the P5+1 (Britain, China, France, Russia, the US, and Germany). Later in the week, Tehran made public its opening bid in the negotiations, suggesting that they might be willing to negotiate away parts of its enriched uranium stockpile and stop enriching to 20 percent, the level which allows for rapid further enrichment to weapons grade.

The Israelis continue to be upset about a possible rapprochement between Tehran and the West. Prime Minister Netanyahu is insisting that the West is being duped by the Iranians in its search for a compromise and that the only acceptable solution is to ban all uranium enrichment in Iran.

The end of the sanctions would add another million or so barrels per day to global exports and would relieve some of the pressures brought by problems in Iraq and Libya.

Iran is also concerned about the economic losses and environmental damage caused by the 1.4 billion cubic feet of natural gas it currently flares daily as part of its oil production. The problem is that Iranian oil fields are widely scattered and it would cost an estimated \$8 billion to build the pipelines and associated infrastructure to collect the gas and bring it to market.

**Iraq:** Bombs continue to go off almost daily with a growing number being attributed to the Iraqi branch of al-Qaeda which is increasingly targeting Shiite civilians in an effort to spark an all out civil war. Shiite militias which have been dormant for several years are regrouping. Prison breaks that released some 500 prisoners from Iraqi jails have increased al-Qaeda's ranks of experienced terrorists who are now estimated to stand at about 3000 including at least 100 suicide-bombers-in-waiting. Large numbers of weapons are making their way into Iraq from captured Syrian military stocks. With the government almost exclusively in Shiite hands, very little intelligence concerning terrorist activities flows from the Sunni community who simply do not trust the government. There is no end in sight for the violence which at some point begin to seriously affect oil exports.

In the meantime, Shell announced that it opened Iraq's Majnoon oil field which is near the southern city of Basra and will soon be producing 175,000 b/d. This is the volume required for Shell to start recovering its development costs under the onerous contracts imposed by the Iraqi government.

Turkey is reported to be building a large natural gas pipeline that will link the Turkish city of Mardin to Kurdish gas fields. This move is likely to make Baghdad very unhappy as they will not share in the revenue and is one more step allowing the Kurds to gain greater economic independence.

**Libya:** The kidnapping and brief detention of Libya's prime minister by a militia group that functions as the country's "anti-crime" unit last week highlights the chaos that exists in the country. One story is that the militia was falsely told that the Attorney General had issued a warrant for the Prime Minister's arrest. This development is likely part of a struggle between pro- and anti-Muslim Brotherhood factions in the Parliament upset by events in Egypt. At any rate, the Prime Minister is back in his office calling the affair an attempted coup on the part of his political opponents. It is quite likely that there will be still more oil export outages in the future.

**Egypt:** In the three months since Egypt's Army overthrew the Morsi government and jailed his supporters in an effort to destroy the Brotherhood movement, the security situation has continuously deteriorated with

bombings and attacks on security forces on the rise. Last week Washington responded to the slide into military dictatorship by temporarily halting a portion of the aid that has gone to Egypt's armed forces for the last 30 years. The US is withholding delivery of planes and attack helicopters as well as spare parts for tanks in addition to cutting by \$260 million the US contribution to the general military budget. Egypt complained bitterly about the cutbacks and insisted they are on the "path to democracy."

The outlook is for continued confrontations and bombings for some time to come. Egypt does not have the hatreds imbedded in the Sunni/Shiite split which currently are tearing Syria, Iraq, and Lebanon apart, but it does have other ethnic tensions such as with the Christians. It is also more difficult for would-be insurgencies to have access to large stocks of arms and munitions than it is in Libya, Iraq, and Syria. The Army, however, realizes that its top priority is to maintain the security of the Suez Canal which is the main source of income to feed Egypt's 84 million people.

**Syria:** Scattered fighting continues across the country as UN inspectors prepare to start destroying Syria's stocks of chemical weapons. The chances of a meeting taking place in Geneva to negotiate a settlement seem dim despite Western and Russian backing. Iran refuses to participate unless it is agreed beforehand that the Assad government will remain in power and the rebels refuse to participate unless the meeting results in his departure.

From the perspective of regional oil exports, the longer this uprising goes on the greater the impact from increasing refugee populations, deteriorating economies, and the spread of the insurgency to other countries.

### **3. China**

Beijing's daily crude oil imports rose to a record of 6.25 million b/d in September which was 25 percent more than in August and 2 percent higher than the previous record of 6.13 million in July. When petroleum product imports are included, the total rises to 6.47 million b/d making it the world's top oil importer. The EIA is forecasting that China could increase its crude imports in October to 6.45 million b/d surpassing US crude imports of 6.23 million.

China is making an effort to increase its domestic oil production which has been growing at about 2.2 percent a year for the past decade while its demand has been increasing at about 4 percent. Last week China opened 25 offshore blocks for bids by foreign companies, the first time in a decade that foreigners have been invited to participate in developing China's oil.

Beijing will be announcing its 3<sup>rd</sup> quarter economic growth numbers this week which are expected to be on the order of 7.8 percent. The World Bank recently cut its projection for China's economic growth for this year to 7.5 percent saying that the recent expansion in credit has been less effective in generating growth. September trade figures showed exports unexpectedly dropping by 0.3 percent as compared to September 2012 and well below August's 7.2 percent increase. Some analysts say the drop may be due in part to efforts to improve the accuracy of the export data which has long been considered inflated by outside observers.

China's passenger car sales in September rose by 21 percent over last year to 1.6 million vehicles. For the year sales are expected to be up by 10-20 percent over 2012. An early smog settled on Beijing last week closing highways and slowing air traffic. Beijing is making a major effort to reduce coal fired electricity production by closing four large generating stations, which together burn some 40 percent of the city's coal consumption, and replace them with four natural gas fueled generating stations at a cost of \$7.8 billion. The plants are to open by the end of 2014 – an astonishing pace. Some observers note that heroic and expensive efforts to improve air quality such as those currently taking place in Beijing are likely to be confined to a few major cities while the rest of the country suffers with ever increasing pollution.

## 4. Quote of the Week

- “We have been acting with mineral resources as if we were pirates looting a captured galleon: grabbing everything we can, as fast as we can. There is this nagging question: how long can we go on mining? It is a question that started being asked in the 19th century and the answer is both easy and difficult. It is easy to say “not forever,” but it is difficult to say for how long, exactly. So, what form will depletion take? How is it going to be felt on the economy?”

-- Ugo Bardi, *Club of Rome*

## 5. The Briefs

- In **Nigeria**, Royal Dutch Shell announced on Friday it had declared force majeure on exports of Bonny Light crude. The company said it has closed down the entire 150,000 b/d pipeline system at least five times since early July because of multiple leaks caused by oil thieves. (10/12 #19)
- **The Caspian Pipeline Consortium** will reduce November shipments to the lowest in eight months, even with additional exports from the Kashagan field. CPC's shipments will decline a combined 663,170 b/d (10.4%). Production at Kashagan was halted again after traces of dangerous gas were detected during a routine inspection of a pipeline. The field was also shut on Sept. 24 for two weeks because of a leak. (10/12 #17)
- In **Mexico** President Peña Nieto is heading toward a crossroads with his plan to allow private companies back into the oil business: whether to insist on a rare contract model that denies companies any of the oil and gas they produce, or join the majority by using a model that shares production. If Mexico goes down the path of least political resistance, it may end up with another watered-down reform like one in 2008 that fails to turn around a declining domestic energy industry. (10/12 #21)
- **Iraq** has signed an agreement with Switzerland-based Satarem to build southern Iraq's first new, large-scale (150,000 b/d) refinery in 30 years. The unit will be contracted under a 50-year, Build-Own-Operate model, cost nearly \$6 billion, and open by 2018. (10/12 #12)
- During the last few weeks the energy world has applauded the startup of three large **new energy projects**: Kazakhstan's much delayed, hugely expensive Kasahagan oil field; the Caspian Shah Deniz natural gas field; and Iraq's giant Majnoon oil field. (10/8 #8)
- **Saudi Arabia** is pushing to boost its oil production capacity by 1.75 million b/d by 2017 and is fast-tracking shale gas exploration. Riyadh is battling increased domestic oil consumption (currently 3 million b/d, growing 7 percent per year, and doubling in a decade), which means reducing the oil exports that provide most of the kingdom's revenue. To meet the projected domestic and global demands by 2020, Saudi Arabia will have to pump between 12.5 million and 15 million b/d. (10/12 #14)
- **North Africa** may be "the next big opportunity" after North America for oil and gas production from shale, if drilling costs can be reduced, said Repsol. (10/8 #11)
- The **Ugandan** government invited companies to tender for the construction of a \$2.5 billion oil refinery in the oil-rich Lake Albertine Rift basin. (10/8 #13)
- **Hydraulic fracturing in Europe**: The early signs are that densely populated Europe, with citizens generally more sensitive to environmental concerns and more willing to tolerate high energy costs, is unlikely to embrace the technique as the Americans have. France and Bulgaria have already banned it, and in Britain the government's attempts to promote it have led to heated demonstrations in the countryside. (10/10 #16)

- **Norway** may see a series of Arctic oil finds after a well produced crude from a previously unproductive layer of rock. The Gohta discovery in the Barents Sea, holding as much as 145 million barrels of oil, opens as many as 10 possible drilling targets in the surrounding area. (10/9 #15)
- In the **US**, rigs targeting oil and natural gas declined by 13 last week to 1,743, according to Baker Hughes. Oil rigs fell by five to 1,367. The gas count dropped nine to 369. (10/12 #38)
- Due to **improved drilling** efficiencies, the average US onshore drilling rig is now producing 2 percent more wells compared to only three months ago. (10/12 #39)
- **North Dakota oil spill:** Tesoro Logistics said workers had contained oil from a 20,000-barrel spill caused by a late September pipeline rupture in a rural western North Dakota field. Of the 7-acre spill, Tesoro said no water was contaminated and the surrounding environment should be shielded from any major damage. (10/12 #40)
- Newly exploited **tight oil formations** account for more than 100% of the increase in US production of crude oil since 2005. But that doesn't mean it's easy to make money getting oil out of the ground this way, said economics Professor James Hamilton. (10/7 #16)
- The volume of petroleum products delivered on **US rail** systems for the week ending Oct. 5 was 7.5 percent higher year-on-year, a trade group said. (10/12 #34)
- Reducing by 16 percent scheduled increases in **ethanol** blending requirements is on the table at the EPA amid complaints from refiners that increases would exceed their ability to blend it into fuels without putting engines at risk. In a leaked proposal, the EPA admits the blend wall - the 10 percent threshold of ethanol-mixed gasoline that is at the crux of the lobbying war - is an "important reality". (10/12 #30)
- **US refiners** are selling more refined fuels abroad than ever before, effectively exporting the American energy boom. Refiners along the Gulf Coast are increasingly using local oil, which is less expensive than the North Sea crude that European refiners use. That often means diesel and other fuels made in the US are a bargain abroad even after adding the shipping costs. (10/9 #13)
- **Peak oil** theory--a contention that conventional sources of crude oil, as of the early 21st century, either have already reached or are about to reach their maximum production capacity worldwide and will diminish significantly in volume by the middle of the century--is now described in the Encyclopedia Britannica. (10/9 #16)
- **Chesapeake Energy** laid-off 800 employees as part of their new CEO's restructuring efforts to improve the company's sustainability and competitiveness. (10/10 #14)
- ExxonMobil, BP, ConocoPhillips, and TransCanada have selected a location on the Kenai Peninsula as the site for the companies' proposed South Central **Alaska LNG** plant and terminal. The companies continue to refine the \$45-\$65 billion concept that includes a gas-treatment plant on the North Slope, an 800-mile, 42-in. pipeline with up to eight compressor stations, at least five off-take points for in-state gas delivery, and a liquefaction plant and terminal for exports. (10/8 #19)
- Consol Energy, one of the world's oldest **coal** companies, is exploring ways to significantly reduce its coal holdings and focus on natural gas. (10/12 #32)
- **Coal** is poised to become the most-used fuel for power generators through the rest of this decade, undermining targets for cutting greenhouse gases even as prices rebound from a four-year low. About 434 gigawatts of coal-power capacity will be added globally by 2020, compared with 241 gigawatts for gas and 92 gigawatts of nuclear generation. Coal is really emerging as a fuel of choice because of its

abundance and affordability. European coal prices for 2014 delivery dropped to an all-time low of \$81.75 a ton on Friday. (10/12 #10)

- After a record of 7.5 percent growth in 2010, growth in Brazil has been on the slide, though still strong when compared with the performance of neighbors. Argentina was hit by dockers' strikes, Chile faced street riots and other countries had similar woes. (10/12 #20)
- **Chevron** will face a judge but not a jury when it heads to federal court in New York this week to try to undermine a \$19 billion environmental verdict in Ecuador. (10/8 #14)
- Lawyers for **BP** and the federal government sparred last Monday over the methods competing teams of scientists used to estimate the size of the company's 2010 oil spill in the Gulf. The government told the court that some 4.9 million barrels spilled, however BP estimates that just 3.26 million barrels escaped into the sea. Both sides acknowledged that 810,000 barrels of oil collected in cleanup will be excluded from the final tally. (10/8 #18)
- Protests broke out in **Khartoum** and other Sudanese cities in late September when the government - reeling from the loss of oil revenues after the independence of South Sudan - lifted gasoline subsidies. This nearly doubled the price of fuel overnight and caused an increase in the price of other goods. The government reacted forcefully; nearly 70 people died in the violence and 700 people were arrested. (10/12 #18)
- Prime Minister Abe said **Japan** is open to receiving overseas help to contain the widening disaster at the crippled nuclear plant in Fukushima, where radioactive water leaks and other mishaps are now reported almost daily. (10/7 #13)
- The price of solar **photovoltaic cells** has dropped 99% in the past quarter century. So in an increasing number of markets around the country, solar is at or very close to grid parity. (10/10 #19)