Peak Oil Review

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1. Oil and the Global Economy

Oil futures in NY and London continued to climb last week in the wake of a breakdown in talks between the IAEA and Iran and at least temporary progress in the Eurozone financial crisis. Crude has now climbed some $30 a barrel since mid-October and NY gasoline futures are up 65 cents a gallon since mid-December. In terms of Euros, Brent crude is now at an all-time high of €93.60 surpassing the former July 2008 peak; however they are still $20 short of the 2008 dollar price of $147.

Despite increases in Saudi oil production in recent months, the global oil market is tight due to production outages, which total some 750,000 b/d, in South Sudan, Yemen, and Syria. Libya's output is still 600,000 b/d below normal. The incessant refrain from OPEC that the markets are "well supplied" ignores the shortages and rolling blackouts taking place across much of the underdeveloped world as $127 crude is simply unaffordable. Throw in the increased demand from Japan which now is down to only operating two nuclear reactors and is burning another 300,000 b/d to keep the lights on and you have a tight global market despite the fall in US demand to a level last seen nearly 15 years ago.

The week's US stocks report shows total commercial petroleum inventories increased by 3.3 million barrels last week with demand for petroleum products over the last four weeks down 6.7 percent from last year.

The new bailout for Greece announced last week will put off a default for a while, but most observers still see no long-term solution in the agreements reached so far. Outside of Germany, the EU's economy continues to stagnate, exacerbated by increasing doses of "austerity" and another round of downgrades by the rating agencies. The consequences of the EU's embargo on Iranian crude imports are yet to come.

As oil prices approach the highs seen four years ago financial observers are being forced to comment on where the oil price situation is leading. As much of the media is loath to predict bad or perhaps very bad times ahead, the commentary thus far has been circumspect. A few writers quote James Hamilton of the University of California that all but one of the recessions in the last 65 years were associated with an increase in oil prices. Some writers note that the 2008 oil-price spike was short-lived with prices tumbling precipitously in the 2nd half of the year thereby contributing to the economic rebound in 2009. This year, however, is likely to be different with intractable problems such as Iran, the EU, and the Arab uprisings unlikely to go away in immediate future, suggesting that the world's annual oil bill is on its way to a new record.

The *Wall Street Journal,* which by its very nature must remain optimistic, opines that high oil prices have done little to dampen optimism about the US economic outlook. The paper points to the rising equity markets and consumer confidence surveys as evidence consumers are in a better position to weather that $4 gasoline this time around.

2. The Iranian Confrontation

The confrontation over Tehran's alleged efforts to acquire nuclear weapons has grown into a multi-ringed circus being played out all over the world. With the fate of the global economy at stake should the situation deteriorate into efforts to block the Straits of Hormuz, most of the world has an interest in the outcome of this confrontation.

Last week the situation took a turn for the worse with Tehran's refusal to allow UN inspectors into sites where nuclear weapons development is suspected. This refusal was followed by an IAEA report saying that Iran had tripled its production of highly enriched uranium and is attempting to move much of its enrichment efforts underground where it would be less vulnerable to air attack.

In the meantime, efforts to modify Tehran's policies, by discouraging foreign countries from purchasing its oil and making it difficult to carry out trade with Iran, continue. While Iran's economy is already suffering from the sanctions now in place, for now the $30 a barrel jump in oil prices is helping the Iranians weather the storm. However, it is beginning to look as if the efforts to slow shipping to and from Iran and the difficulties the country has in collecting money from its exports is starting to take a toll. In addition to the Europeans, who will no longer be able to purchases Iranian oil after the 1st of July, several large Asian customers are scrambling to find other sources of crude.

Should fighting break out in the Gulf, Iranian exports are likely to be the first to go as the US and its NATO allies clearly have predominant military power in Gulf. This concern should limit how deeply China and other Asian countries want to become dependent on Iranian oil until this confrontation is settled.

Knowledgeable observers believe the elimination of electronic fund transfers (SWIFT) in and out of Iran, which are scheduled to begin soon, would be as devastating to the Iranian economy as the loss of much of their oil exports. Tehran has a lot of balls in the air at the minute. Not only are the Iranians taking on much of world, but they are also deeply involved in helping the Assad government suppress its domestic dissent, and are facing elections in the midst of growing economic dislocations.

This is clearly a dynamic situation. Syria is turning into a civil war; economic sanctions continue to tighten; Israel is threatening to strike Iranian nuclear facilities; the US and UK are strengthening their military forces in Gulf; US newspapers and TV commentators are beating war drums; and even candidates in the US primaries are making threats.

There is growing discussion over the consequences of a deliberate strike on Iranian nuclear facilities or some unintended start to hostilities between the West and Iran. Thanks to the Iranian bombast, much of which is intended for domestic consumption, many believe Tehran would attempt to block the Straits, attack its neighbors, or sink an American warship, in the event of an Israeli strike.

Predictions of the outcome of all this are all over the map. Some say that in event of hostilities oil prices would go to $220 a barrel, but nobody really knows what would happen – there are simply too many variables. A rational Iranian government, that must import half its food supply, should realize that its export revenues, its armed forces, its nuclear facilities, and indeed much of its economy could quickly be destroyed if the situation gets out of hand.

Unless there is a change in the political dynamics in Tehran fairly soon, much higher oil prices in the near future seem unavoidable.

3. Gasoline prices

With US gasoline prices up 13 cents to a national average of just below $3.70 a gallon in the past week, three major questions arise. How high will prices go before they reduce demand? What will the high prices do the US economy? And what impact will all this have on the federal elections this fall?

While the "how high" question is entwined with the issue of disruptions and embargos in the Middle East, the new factor is the shutdown of refineries supplying the US East Coast. Prices in some sections of the East and West Coast are already in the vicinity of $4 gallon which for the East Coast is well above the normal relationship to the national average. Gasoline within a given state can vary 30 cents a gallon or more depending on grade, whether it has been reformulated to reduce ozone and the local situation. The conventional wisdom at the minute seems to say we have another 30-50 cents to go before the summer peak, which would put the peak national average price somewhere around $4.25 later this summer and the coastal prices in the vicinity of $4.50. Many are saying $5 and as there are new factors involved, it is impossible to say how it will play out.

The damage to the US economy seems fairly straightforward. Here the issue is one of wishful thinking with economists working for financial institutions trying to spin the notion that as a nation we have become inured to high prices. History shows we are more likely to be in for economic troubles as in the other recent gas price spikes. With US consumption already down by some 2 million b/d in the last four or five years, the easy cuts or a lot of the fat in energy consumption has been worked out. From here on, a lot of the increase in oil prices is going to come at the expense of other expenditures suggesting that there will be troubles even without further disruptions in supply.

The impact of high gasoline prices on the November elections is an open question. The underlying principle is that there is very little government policies can do to deal with increasing demand for oil from Asia, or depleting oil reserves, or centuries of conflicts in the Middle East. Attacking the administration is easy, coming up with real solutions for the short run is impossible. It is interesting that "solutions" such as lifting environmental restrictions on drilling, cutting taxes, or building the keystone pipeline are starting to get short shrift from commentators who appreciate that these "solutions" would take years or decades to have any impact, while the economic damage they are designed to mitigate is only weeks or months away.

The real issue may be that gasoline prices rise so high this year that voters grasp at any solution no matter how improbable.

Quote of the week

- "Efforts are underway to convince the general populace that our energy concerns are a thing of the past and that the new energy discoveries in the Bakken and other shale formations have proven Peak Oil to be a mistaken idea. Some efforts go even further and flatly state that energy independence is right around the corner. Nothing could be further from the truth."

-- Chris Martenson

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

- **India** is poised to surpass China as the world's biggest thermal coal importer as Prime Minister Singh seeks supplies for power companies that have halted plans for $36 billion of new plants because of a fuel shortage. (2/21, #11)
- Brazilian oil and gas producer **Petrobras** reported its third oil spill in Brazilian offshore waters in less than a month. (2/25, #14)
- It's probably not the biggest risk Brazil faces, but it is worth noting that the one true magnet that's attracting all of that foreign capital flowing into **Brazil** is due to just one company: oil and gas rich Petrobras. (2/23, #14)
- **Libya** plans to export close to 1.2 million barrels of oil per day (bpd) in February, up from around 970,000 bpd in January. (2/24, #14)

- **Venezuelan** President Chavez defended an oil sale to Syria by saying his is a free country that can trade with whichever country it wishes. A Venezuelan ship carrying oil arrived in Syria last week, one day before the U.N. General Assembly passed a resolution censuring Damascus for its crackdown on dissidents. (2/24, #15)
- A tanker carrying 600,000 barrels of disputed **Sudanese crude oil** arrived in a Japanese port after a delay of more than a week because of uncertainty over the ownership of the cargo. (2/24, #16)
- When a civil case against **BP** opens on Monday, federal prosecutors plan to accuse the oil giant of making a series of decisions that caused it to be grossly negligent in the deadly explosion on the Deepwater Horizon drilling rig. (2/23, #27) (2/24, #27)
- **Exxon Mobil** announced that additions to its proved reserves in 2011 totaled 1.8 billion oil-equivalent barrels, replacing 107 percent of production. Excluding the impact of asset sales, reserves additions replaced 116 percent of production. Much of this is natural gas, not oil(2/24, #29)
- **European Union** experts failed to reach a majority view on a proposal by the European Commission that would discriminate against the use of crude from oil sands, pushing the issue up to ministerial level. (2/24, #30)
- Shell Oil says **Nigeria** loses an estimated 150,000 barrels of crude oil each day because of theft in the Niger Delta region. (2/23, #11)
- **Chevron's Kazakhstan venture** will spend between $6 and $8 billion to sustain output in the country's Tengiz oil field. (2/23, #9)
- The **National Oil Company of Liberia** welcomed the announcement by African Petroleum that their Narina-1 exploratory well drilled off the coast of Liberia indicated a potentially large oil deposit, while emphasizing that development of any discovery will take several years. (2/23, #12)
- **South Sudan's** President Mayardit has formed a committee which will decide how to limit spending, as the government seeks to cut the annual budget by a half following the shutdown of its entire oil production. (2/23, #13)
- Pumping has been halted at **Colombia's** second-longest pipeline, the Cano Limon, after several bombings by leftist guerrillas in recent days, according to an official at national oil company Ecopetrol. (2/23, #18)
- **CoolPlanet BioFuels**, a start-up developing technology to convert low-grade biomass into high-grade fuels and carbon that can be sequestered, claims it has achieved a conversion yield of 4,000 gallons gasoline/acre biomass in pilot testing using giant miscanthus, an advanced bioenergy crop. (2/23, #31)
- **South Korea** gave assurances to **Gazprom** that it was interested in building a natural gas pipeline to Korea for natural gas. (2/22, #16)
- A consortium of **Japanese** natural gas companies agreed to examine investments needed for an LNG plant with **Gazprom**. (2/21, #12)
- **South Korea's** plans to boost nuclear power face increasing resistance from civic and environmental groups, post Fukushima. South Korea relies on nuclear energy for about 30 percent of its electricity needs, supplied by 21 active nuclear reactors. (2/21, #14)
- **Japan** posted a record high trade deficit in January after its nuclear crisis shut down nearly all the nation's reactors for tougher checks, sending fuel imports surging. (2/20, #21)

- The **Japanese government** will partner with the private sector to promote exports of megafloats to stockpile oil products, starting with a possible deal with Vietnam in 2013. (2/20, #22)
- **Saudi Arabia**, OPEC's largest crude producer, reduced oil output and exports in December from November when it produced the most in more than 30 years. The country reduced output by 237,000 barrels a day or 2.4 percent to 9.81 million barrels a day of crude compared with 10.047 million in November. (2/20, #12, #13)

Commentary: Become a Member-Supporter of ASPO-USA

By Jan Mueller, ASPO-USA Executive Director

Are you a Peak Oil Review subscriber or reader? Is timely, cutting-edge information on oil and energy issues important to you? Are you concerned about Peak Oil and its consequences for your business, your life, and your world? Do you want to be part of an organization that is focused on solutions and strategies to adapt to an oil-constrained world?

If you answered yes to any of these questions, **we urge you to become a member or supporter of the Association for the Study of Peak Oil & Gas USA** (ASPO-USA). ASPO-USA publishes and circulates *Peak Oil News* and *Peak Oil Review* to its subscribers for free, but, of course, they are not "free." Each edition appears in your inbox as the result of an investment of considerable resources and many hours of work (the Herculean efforts of chief editor Tom Whipple, in particular).

ASPO-USA needs your support, to keep publishing *Peak Oil Review* and *Peak Oil News,* and to make them even more useful and chock-full of valuable information. For example, we are developing a database that will make it easier for users to catalog and search past articles.

ASPO-USA is also developing new ways to bring you up-to-date information and analysis on rapidly changing issues concerning oil and energy. We are working diligently to harness the power of our network of experts, advisors, and contributors to create new information and education products, including: a journal-style publication that will provide more in-depth analysis and data synthesis; an integrated Peak Oil training curriculum; and special educational events featuring leading Peak Oil experts. And, we are working to strengthen the ASPO-USA annual conference as the preeminent forum for learning about Peak Oil and its far-reaching consequences.

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There are also new membership categories to make ASPO-USA membership affordable to all.

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