

# Peak Oil Review

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[Tom Whipple](#), Editor  
[Steve Andrews](#), Publisher

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## 1. Production and Prices

Oil prices spent the week bouncing around the \$115-a-barrel level. A strong US dollar, concerns about a slowing world economy, and the closing out of large speculative positions by hedge funds and others were enough to overshadow rather serious supply disruptions that normally would have been enough to send prices much higher. At one point oil touched \$111.34 or 24 percent below the July 11<sup>th</sup> record high of \$147 before closing out the week at \$113.77.

The sudden fall in prices already has the OPEC price hawks, Iran and Venezuela, suggesting that world oil production is a million b/d too high so that a cut at the September 9<sup>th</sup> OPEC meeting might be in order. Many observers are saying that oil will have to drop below \$100 before OPEC takes action.

OPEC production increased by 236,000 b/d in June; however, non-OPEC production has been slowing and July has seen major disruptions in the supply of Caspian oil and in Nigeria. The supply/demand situation, world stockpiles, and prices could look considerably different by the time OPEC meets three weeks from now.

## 2. Oil from the Caspian

It has been an eventful two weeks for exports of Azerbaijani oil. On August 5<sup>th</sup> a bomb, probably set by Kurdish separatists, closed the 800,000 b/d Baku-Tbilisi-Ceyhan (BTC) pipeline in Turkey. Last week the fire, which blazed for nearly a week, was put out allowing the Turks to determine that it was indeed started by a bomb.

A few days later fighting broke out between Georgia and Russia over a pair of Georgian provinces that are seeking independence. During the fighting the Russians bombed remote areas of Georgia along the BTC pipeline, suggesting that they were either trying to damage the pipeline or sending a message that Moscow is not happy about its existence. When bombing of Georgian military facilities continued, BP shut a second oil export pipeline that runs from Baku to Supsa on the Black Sea.

The situation got worse this Saturday when a key bridge on the main Georgian rail line was blown up, likely by the Russians, halting the shipment of Caspian oil by rail to Black Sea ports. The only remaining outlet for Azerbaijan's oil is a 100,000 b/d pipeline that runs to Russia's Black Sea port of Novorossiisk.

Nearly 1 million b/d of Caspian oil that had been exported via Georgia and Turkey to Europe and the US has now been shut in by the bombings. As yet there is no indication of how long the interruptions will last. The Turks speak optimistically that damage to the BTC pipe will be repaired in a week or so but others are saying it will take more than a month. The damage to the rail bridge will likely take weeks to repair.



Reopening the Baku-Supsa pipeline will depend on the course of relations between Russia and Georgia. Despite a ceasefire, Russian troops are digging in deep in Georgian territory so it may be a while before all this is sorted out.

There are at least two political disputes going on here. The Kurdish separatists who have been fighting for independence since the end of World War I may have a powerful new

weapon in the vulnerable BTC pipeline. If they were indeed responsible for the explosion, which appears likely to do much harm to West by delaying oil exports, there is little reason why they will not continue the attacks for an 1100-mile pipeline is nearly impossible to defend.

A Western export corridor for Caspian oil through Georgia makes Moscow very unhappy and is likely the root cause of the current military incursion. Unless the 1 million b/d interruptions can be remedied shortly, they are likely to lead to price increases within weeks. Over the longer term, either some agreement between Russia and the West over access to Caspian oil will be worked out or the troubles will continue indefinitely

### **3. Chinese Demand**

In another month, the 2008 Summer Olympics will be a memory, and Beijing will be back to concentrating on economic growth as its highest priority. Traffic will return to normal and industrial enterprises that were closed to ameliorate air pollution will return to production.

In recent years Chinese imports of crude and oil products have become highly volatile. Large increases in imports during the buildup to the Olympics in the spring contributed significantly to the run up in prices just as a sharp drop in imports during July and August has contributed to recent price declines.

There are many cross currents that will be influencing Chinese imports of petroleum and products during the rest of the year. There is little doubt that China's exports will shrink as a world-wide recession sets in. China's GDP, however, has recently been growing at 10-11 percent a year; Beijing resolutely maintains that its economy is largely world-recession proof.

Two months ago Beijing increased retail prices for oil products by nearly 18 percent so that, while still subsidized, they are not that far behind world prices. Some believe that high oil prices are starting to reduce demand, even in China.

China is suffering a severe electricity shortage due to inadequate supplies of coal. Some foresee increased demand for diesel to make up for power shortages as we are already seeing across the subcontinent. Others say that oil is now too expensive to be used for generating electricity, and that it will not be used on any significant scale.

China has built the facilities for a large strategic petroleum reserve, but has been waiting for lower prices to begin filling it. With oil down more than 20 percent, now would be a good time to make substantial purchases. New refineries with a capacity in excess of 500,000 b/d are scheduled to be completed later this year which could substantially increase the demand for crude.

After assessing all aspects of the situation, the International Energy Agency warned last week that while oil consumption in the US is expected to fall by 3.1 percent this year and 2 percent

next year, Chinese oil consumption, while only a third that of the US, is expected to grow by about 5.6-5.7 percent in the next two years, thereby offsetting much of the drop in US consumption. The IEA says that consumption in China should spring back after the Olympics, while other analysts remain skeptical.

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

- **OPEC forecasts** in its monthly report that world oil demand will fall by 30,000 barrels a day. While forecasting demand growing by 1 million barrels a day this year, and another 900,000 barrels in 2009, the report noted that world demand growth next year will also be "the lowest since 2002," with growth from the major industrialized countries actually declining. (8/16, #1)
- A shortage of **steel pipes** could disrupt the boom in US natural gas drilling for the energy companies that rely on the tubes to drill and line their wells. Seamless steel pipes, known as tubular goods in the oil patch, are in short supply after an unexpected resurgence in the North American onshore drilling market. (8/11, #17)
- US House **Speaker Pelosi** outlined a new energy bill that includes new offshore exploration. The policy shift follows a similar move in recent days by Democratic leaders in the Senate and by presidential candidate Barack Obama in the face of a public angered by high energy prices. (8/17, #10)
- Countries with **fuel subsidies** accounted for virtually the entire increase in worldwide oil consumption last year, according to one estimate. (8/17, #14)
- **Liquefied natural gas prices** in Asia may climb about 80 percent this year as new projects get delayed, as Japan seeks more gas to offset a shut-in nuclear power plant, and as countries from Indonesia to Egypt curb exports. Cargoes of LNG may rise to as much as \$25 per million Btus during the Northern Hemisphere winter. (8/15, #9)
- **The European Union** has been keen on the recent plan to run a natural gas pipeline from the Caspian area through Georgia as a way to gain bargaining power against Russia and reduce the risk of supply cutoffs. But the Russia-Georgia war may have reduced the prospects for such a gas pipeline getting financing and European backing. (8/17, #16)
- **Demand in the OECD countries** is set to average 48.6 million barrels per day this year, a decline of 1.3 per cent or 620,000 barrels from 49.2 million in 2007, the IEA says. The US Transportation Department said this week that Americans drove 4.7 per cent, or 12.2 billion, fewer miles in June compared with a year earlier--the eighth straight monthly fall. (8/16, #4)
- **Nigeria's** oil minister last week admitted security concerns in the southern oil producing region had seen production drop to 1.8 million bpd. Shell reports that it is struggling to repair recent damage to a major pipeline (8/16, #8-9)
- **US consumers** spent more on gasoline than vehicles and parts for the first time in 26 years in May and June, as gas prices headed for a record. During the period from 1978 to 1983, prices rose high enough to cause global demand for oil and petroleum products to drop 8.4 percent. (8/16, #14)
- In a move that could alter the economics of the global solar industry, California utility **PG&E** announced it will buy 800 megawatts of electricity produced from two massive photovoltaic power plants to be built on the state's central coast. This purchase dwarfs by orders of magnitude the five-to-15 megawatt photovoltaic power stations currently in operation around the world. (8/16, #21)
- **Nineteen of 30 oil analysts** surveyed by Bloomberg News said prices will increase through Aug. 22. It was the most bullish response since December 2006. (8/15, #2)

- **Iran and Turkey** signed several cooperation agreements Thursday but failed to complete a deal for building a new natural gas pipeline — a project the United States has opposed. (8/15, #6)
- **Nigeria's** government threatened to impose stiff penalties against foreign oil companies that fail to provide a certain amount of natural gas to the domestic market by the end of the year. (8/15, #7)
- **China's power generation** growth eased in July to 8.1 percent, its slowest in over six years, underlining the deepening supply woes that have forced nearly half the nation to ration power. (8/15, #11)
- New information on commodities **speculators** show that they are a larger piece of the oil market than previously known, a development enlivening an already tense election-year debate about traders' influence. (8/15, #13)
- **A South Korean-Russian consortium** has lost its license to explore and develop a huge offshore oilfield in Russia's west Kamchatka. Unless things change, an estimated \$259 million already spent on exploration and drilling by the Korean National Oil Company will go to waste. (8/15, #16)
- **The global economy** -- which had long remained resilient despite US weakness -- is now slowing significantly. On Thursday, the European Union's statistics agency said gross domestic product in the euro zone contracted 0.2% in the second quarter, the equivalent of a 0.8% annual rate of decline. Nonetheless, China, India and other large developing countries continue a strong growth trend.(8/15, #17)
- **The Iraqi Oil Ministry** said it was reviving an oil contract worth 1.2 billion dollars that had been concluded with China but was cancelled after the US invasion in the spring of 2003. (8/14, #5)
- The growth in **China's CPI** has dropped over the past three months to 6.3% in July, and the government is likely to reduce energy subsidies once more. (8/14, #14)
- **US automakers** are offering discounts of \$10,000 or more on some **SUVs** just to get rid of them, so dealers have space to stock more of the fuel-efficient cars. On average, new sport utility vehicles sold for 20 percent below sticker price in July. That, in turn, has decimated prices for used SUV's. (8/14, #15)
- Shell, BP and Exxon Mobil ran into difficulties in talks with **Iraq** to open up the country's oil fields, and it's not clear if negotiations are continuing. (8/13, #7)
- In **Angola**, Exxon Mobil started production up the Saxi and Batuque oil fields, adding to output at its largest offshore project. When combined with the Mondo field, which started up in January, production from the Kizomba C project is expected to reach 200,000 barrels a day of oil later this year. (8/13, #9)
- **South Korea**, Asia's third-largest crude oil buyer, will expand the use of nuclear power and alternative energy sources to counter high oil prices and reduce greenhouse-gas emissions. (8/13, #15)
- **Iran** has discovered four new oil and gas fields holding about 3.7 billion barrels of oil and 1.5 million cubic meters of gas, according to the oil ministry's Web. (8/12, #10)
- In India, the power shortage sweeping across the country is chipping away at the competitiveness, if not the survival, of **India Inc.** (8/12, #13)
- **Vietnam**, the largest supplier of energy coal to China, may cut exports of the fuel by a third after a cyclone damaged a port. (8/11, #15)

## Quotes of the Week

- “Energy experts were heartened that an overdue discussion about the nation's energy future has begun in earnest. But they worried that much of what voters hear is long on gimmickry but short on frank talk and long-term solutions.”  
*Bill Lambrecht, Post-Dispatch*
- “Back when it began falling, I said oil was headed to \$200 via \$80 and I stand by that.”  
*Phil Roth, chief technical strategist at Miller Tabak.*

## **Commentary: A Failure to Prepare for the What Should Have Been Expected**

By Roger Blanchard

*(Note: Commentaries do not necessarily represent ASPO-USA's positions; they are personal statements and observations by informed commentators.)*

I occasionally read the Detroit newspapers and based upon some of their articles and commentaries it appears the present oil crisis came as a surprise to the U.S. auto industry. My impression is that many U.S. industries that are heavily dependent on cheap oil were taken by surprise, as well as most Americans.

In the last few decades, the U.S. auto industry has relied heavily on SUVs and light trucks to make their profits. They assumed that cheap oil would last forever. Unfortunately cheap oil is now history and the U.S. auto industry is scrambling to catch up to foreign auto companies, particularly Japanese, in the manufacture of fuel efficient vehicles.

Toyota, a leader in fuel efficient vehicles, has steadily increased its U.S. and global market share in the last decade and in the first 6 months of 2008, it sold more vehicles globally than General Motors. Making fuel efficient vehicles isn't the only factor in Toyota's increased market share, but it's a significant factor.

The U.S. auto industry has a long history of fighting safety, environmental and fuel efficiency measures. In recent years, they have consistently fought measures to improve vehicle fuel efficiency. They did not have the foresight to prepare for the time when oil would no longer be cheap. To their credit, Toyota and Honda came out with hybrids years ago and have worked hard on fuel efficiency technologies beyond conventional hybrids.

An unbiased analysis of oil production data over the years should have made it obvious that there was a coming problem. Unfortunately most people believe their beliefs rather than believing data. I've been warning about a coming oil crisis for 15 years or longer. To make people aware of the problem, I wrote a book which was published in 2005. Below is an excerpt from the final chapter.

There are no dramatic revelations in what I wrote below, but it's worth pointing out that it should have been clear that an oil crisis was coming that would create major problems for the American and world economy. If major industries that rely heavily on cheap oil didn't see a coming problem, it suggests a desire not to see the obvious.

As oil resources become tighter, prices will rise. We are now experiencing early signs of oil resource problems as the average oil price in 2003 was \$27.54/barrel and in the first 8 months of 2004 it was \$40.56/barrel. Even with elevated oil prices, supplies are still tight. As the price of oil increases, it's reasonable to expect that the impact will be felt most heavily by people in poor and developing countries, people who can't easily afford paying higher prices. Gradually people in those countries will be squeezed out of the market, to the detriment of their increasing expectations.

In wealthy countries, people can absorb higher prices up to a point. In the U.S., there have been complaints in the last few years over higher gasoline and heating fuel prices,

but most people can handle the increased costs. In time, price increases will seriously impact the majority of Americans. During the oil crises of the 1970s, shootings occurred in gas lines as tempers flared. Any cutoff of oil supplies or dramatic increase in prices could result in a repeat of such behavior.

Assuming that the price of oil increases significantly in coming years, there will be a concerted effort to produce the world's remaining conventional oil as rapidly as possible. In the early 1980s, the price of oil increased to ~\$35/barrel from ~\$3/barrel in the early 1970s. Due to the price increase, the number of drilling rigs in the U.S. increased dramatically, but oil production in the lower 48 states barely increased. The same situation is likely to occur globally in coming years and the economic impacts could be severe. Back in the late 1970s and early 1980s, there were undeveloped conventional sources of oil globally that could be brought on-line, ultimately leading to higher production and a decline in the price of oil. There will be few undeveloped sources of conventional oil globally after ~2010.

Economists argue that declining conventional oil production will stimulate the production of unconventional oil resources, and that is true. There is further latitude to increase oil production from the Orinoco Oil Belt and Athabasca Oil Sands, but production from those sources can only be increased slowly relative to conventional oil. Most of the world's oil shale may never prove to be economically or practically viable. As well as the slow production rate increases from unconventional oil resources, the maximum possible production levels and low energy profit ratios are problems.

Alternatives to conventional oil beyond oil sands and oil shale will be tried, but probably with limited success. The advantages of oil for transportation and heavy equipment use are substantial. There are no alternatives on the horizon that come close to the advantages of oil.

Increasing efforts at conservation and energy efficiency will occur as oil supplies tighten. In the U.S., urban sprawl has made much of the population dependent on motor vehicles. Americans will buy more fuel efficient vehicles in the future when oil prices get high enough, but it would not be easy to restructure urban areas so that people wouldn't need to rely on motor vehicles. U.S. motor vehicle manufacturers are dependent upon large fuel inefficient vehicles such as SUV's and light trucks to make profits. Those manufacturers could develop serious financial problems if higher oil prices lead a large part of the population now buying SUV's and light trucks to buy higher efficiency motor vehicles. Manufacturer's problems would be more serious if a significant portion of the population couldn't afford motor vehicles due to high oil prices.

Although the U.S. population is quite wealthy relative to much of the world, it is ill prepared for large oil price increases. The U.S. economy is heavily dependent on cheap oil and many industries depend upon it: construction, agriculture, logging, air transportation, trucking, motor vehicle manufacturing, etc. Those industries could experience serious financial problems if the price of oil rises dramatically. The home building boom in the U.S. is predicated on the belief that cheap oil will last forever. Modern industrial agriculture has been termed a process of converting oil into food. Dramatically higher oil prices would greatly increase food prices over what they are today.

If terrorist attacks target oil pipelines and refineries in the Middle East causing a sudden cut-off of oil supply from that region, it could have a devastating impact upon the world economy. The impact would be even more serious in the future as the world relies more heavily on the Middle East for its oil supply.

*Roger Blanchard is Assistant Professor of Chemistry at Lake Superior State University, Sault Ste. Marie, Michigan. Roger is the author of "The Future of Global Oil Production: Facts, Figures, Trends and Projections by Region" published by McFarland & Company (2005).*