Energy Intelligence
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EnergyCompass

Energy and Politics: The New Dynamics

Vol. XXI, No.1, January 8, 2010

Contents

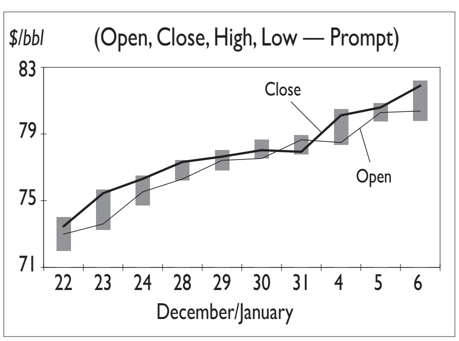
Pressure Points

Latest inventory reports from the US Department of Energy for the week ended Jan. 1 showed a 1.3 million bbl build in crude stocks, to 327.3 million bbl. Gasoline inventories were up by 3.7 million bbl at 219.7 million bbl, while distillate stocks — heating oil and diesel — declined by 300,000 million bbl to 159 million bbl.

Refinery margins eased in two of the three major centers. On Jan. 7, an incremental barrel of WTI made a $2.45 profit in a US Gulf cracker, up 70¢ from Dec. 23. In Rotterdam, Brent posted a 70¢ profit in a simple topper, down $1.05, and a 75¢ profit in a neighboring cracker, down $1.45. Dubai made a $4.05 profit in a Singapore cracker, down 15¢.

Opec's basket crude oil reference price on Jan. 6 was $79.64, up $8.32 from Dec. 22.

Brent Futures



HEADLINE NEWS

Power Play in Ukraine

- Viktor Yanukovich, a frontrunner in Ukraine's Jan. 17 presidential election, has said he would keep his country out of Nato, but that he would seek to improve Ukraine's eligibility for European Union membership by reforming the economy. Denied the presidency in 2004 by mass demonstrations against what was perceived as a rigged election, Yanukovich is regarded as strongly pro-Moscow. With the incumbent President Viktor Yushchenko expected to drop out of the race after the first round, Yanukovich is ahead in the polls and is tipped to beat Prime Minister Yulia Tymoshenko in a Feb. 7 run-off vote.

- Russian Prime Minister Vladimir Putin said Jan. 7 he hoped for improved relations with the US in 2010. In a New Year greeting, Putin praised US President Barack Obama's efforts to "reset ties" that had been put into diplomatic deep freeze under George W Bush. "I sincerely hope that this positive approach will allow us to find optimal solutions to even the most complex questions on the bilateral agenda," Putin said in the message. Putin, Russia's preeminent politician, on Jan. 5 criticized the US for not giving Moscow enough information on its reformulated missile shield plans, and linked the plans to agreement on a new nuclear arms pact (EC Dec.11,p10).

- A surge of ethnic violence in southern Sudan has resulted in the death of more than 2,500 people and forced 350,000 to flee their homes in 2009, according to a report issued by 10 aid groups. Seventeen people were killed on Jan. 7 when armed civilians ambushed southern Sudanese soldiers trying to disarm tribes following heavy fighting in the semi-autonomous region last year, an official said on Tuesday. On Jan. 2 armed Nuer tribesmen killed at least 139 members of a rival tribe and seized about 5,000 cattle in one of the most remote parts of the oil-producing south, according to officials. The report by aid organizations, including Oxfam, said a lethal cocktail of rising violence, chronic poverty and political tensions has left a fragile peace deal from 2005 on the brink of collapse.

- Yemen's foreign minister, Abubakr al-Qirbi, said he believes the country's own security forces must fight militants on its territory and rejected any direct US intervention. The foreign minister was being interviewed by US television network CNN after a Yemen-based wing of Al-Qaeda claimed responsibility for a Christmas Day attempt to bomb a US-bound aircraft. Asked whether Yemen would welcome direct US intervention, al-Qirbi said: "No, I don't think we will accept that. I think the US, as well, [has] learned from Afghanistan and Iraq and other places that direct intervention can be self-defeating. We think this is the priority and the responsibility of our security forces and the army" (see p3). As well as its Al-Qaeda problem, Yemen faces an ongoing conflict with rebels in the north and rising secessionist tensions in the south.

- February Nymex light, sweet crude futures settled Jan. 7 at $82.66, for a gain of $5.99 from Dec. 23. February ICE Brent settled at $81.51, up $6.06. ■

MIDDLE EAST

More Volatility

Just as 2008 came to an end with all-too literal bang in the Middle East, as Israel launched a war on Gaza, so too did 2009, with the attempted Christmas Day bombing of a US trans-Atlantic jet over Detroit, claimed by the Yemen-based Al-Qaeda in the Arabian Peninsula (AQAP). As before, the fallout promises to complicate an already murky outlook for the year ahead in the region.

While the US was already concerned about the threat posed by an increasingly volatile Yemen, it now faces the challenge of working out a middle-ground response that is strong enough to satisfy parties at home but not so heavy handed that it risks revitalizing Al-Qaeda affiliates that were on the wane in North Africa, Iraq and even Afghanistan (see p3). That Yemen and its rebellions — chiefly the Shiite Zaidi Al-Houthis in the north — are already serving, to some degree, as a proxy battleground for Iran and Saudi Arabia only underscores Yemen's explosive potential, and the need to proceed cautiously (EC Nov.20,p3).

Some of the biggest question marks in the region, however, surround the future of Iran itself, where a protest movement arising from the disputed re-election of Iranian President Mahmoud Ahmadinejad in June has failed to fade away (EC Dec.11,p1). "There's no going back," says Ali Ansari of the UK's St. Andrews University, "but where we are headed is another matter." The intrigue has only deepened as the focus of protests shifts from election fraud to attacks on the leadership of Ayatollah Ali Khamenei and the nature of the Islamic republic itself, as observers wonder whether it will lead to a fundamental change in the way Iran is governed. On top of this the Tehran regime faces an economic Achilles' heel that could play an equal, if less headline-grabbing, role in its deterioration.

Khamenei's "authority has been shattered," Ansari says. The leadership has boxed itself into a corner by demanding complete loyalty and signaling, through brutality, that it is not prepared to allow any degree of pluralism. But the regime has not yet executed its promised harsh crackdown — in part because it is not sure it can rely on the Revolutionary Guard to do it, Ansari says. The guard's voluntary arm, the Basij militia, has figured prominently so far.

An apparent growing divergence between the milder aims of election candidate Mir Hossein Mousavi — who, despite strong words against the conduct of the regime, is still focused on working within the current establishment — and those of the broader Green Movement, which seems bent on bigger changes, further complicates matters. But both agree that the regime has lost legitimacy.

Iraqi Vacuum

To the west, Iraq's oil outlook has brightened considerably after two bid rounds for service contracts, but politically the country faces a year of muddling through as parties gear up for parliamentary elections in early March. As in Iran, hazarding a guess at the outcome — barring that coalition-building will be key — is risky, although most expect the process of forming a government to take months, potentially pushing up against the US' August 2010 deadline for the withdrawal of most combat troops (EC Dec.4,p3). Should the electoral political vacuum overlap for long with the security vacuum left by the US drawdown, internal conflict could rise as militants take advantage (EC Aug.21,p3).

However, the Kurds are no longer positioned to be automatic kingmakers as in 2005, in part because a new electoral law means that a two-thirds majority is no longer required to form a government, only a simple majority, notes Norwegian academic Reidar Visser. The key question will be whether the Kurds play their trump card — their claim to the northern oil province of Kirkuk — during the process of forming a new government, says Joost Hiltermann of the Brussels-based International Crisis Group. This could trigger a prolonged political crisis, requiring some form of US security guarantee as a compromise. Against this, the Kurds remain the most united and disciplined of Iraq's factions.

Meanwhile, almost oddly, the turn of the year has been bursting with shuttle diplomacy involving parties with stakes in the stalled Israeli-Palestinian peace process. Most notably, Saudi Arabia has reasserted itself as a key influence, hosting recent visits by Palestinian Authority President Mahmoud Abbas and Hamas leader Khaled Meshaal. This could raise hackles in Egypt, the traditional mediator, which has been pushing a reconciliation pact between Abbas' Fatah party and Hamas, and promoting an agenda for peace talks between Israel and the Palestinians.

With the Palestinians still split, Egypt and Saudi Arabia jockeying for influence, Israel intent on settlement-building and Syria seemingly out of the picture, progress will be difficult. But the US, despite overwhelming foreign policy pressures elsewhere, is nonetheless trying to keep the wheels oiled, visiting and sponsoring key parties.

Syria's absence from the equation will need a fix after the cooling of an early initiative by Washington for improved ties with Damascus last year. A growing confluence of views between Syria and Saudi Arabia — including shared concerns over Iranian influence in Iraq and Yemen — as well Syria's warmer ties with Turkey suggests that the time is ripe for a new US push here, as well as on the Israel-Syria front.

Key issues for the region in 2010 include:

• *Security:* Yemen's AQAP has revived global concerns about Al-Qaeda. In Iran, the regime may be forced to test its strength versus the people by bringing out the Revolutionary Guard to quell protests. Iraq faces a potential midyear security vacuum.

• *Economy:* Archaic economies in Syria and Iran face further stresses but are potential political game-changers: Syria, for example, is keen to serve as a gas export route for Iraq. Dubai's financial implosion will add to the pressure on some regional governments, while handing Abu Dhabi greater influence in the UAE.

• *Politics:* Future scenarios in Iraq and Iran are too uncertain to call, while advancing the Israeli-Palestinian peace process remains fraught with difficulties. Turkey's role as a key regional player with, in some instances, greater staying power and credibility than the US, should grow. ■

Jill Junnola, London

Yemen: Al-Qaeda's New Front

As Yemen enters the new year, the impoverished Mideast country, bordering the world's oil-producing sweet spot, faces a critical year for taming its three spiraling conflicts. Their origins date back decades and Yemen has proven adept at finding compromises without addressing the root grievances. But with pressure mounting for real solutions, the country is stepping up its use of force, running the risk of greater chaos in the short term. Real progress will only be found in non-military solutions, which will take far longer to implement, analysts say.

The top priorities for Yemen in 2009 were suppressing the Houthi rebellion in the northern Saada province and taming rising secessionist protests in the south, but as the year drew to a close, the country was forced to focus more on disrupting the local Al-Qaeda branch (EC Nov.20,p3).

Yemen has been dealing with Al-Qaeda for years, but the group's recent escalation in sophistication and potency — especially across international borders — has raised the stakes, say Yemen-based experts. Al-Qaeda in the Arabian Peninsula (AQAP), which moved its headquarters to Yemen in 2009 by forming a "supercell" of militants from Saudi Arabia and Yemen, claimed responsibility for training Nigerian national Abdul Farouk Umar Abdulmutallab, who allegedly tried to detonate a bomb on a Detroit-bound US flight on Dec. 25. The group also claimed a failed suicide attack in August targeting Saudi Arabia's Prince Mohammed bin Nayef, the kingdom's top counter-terrorism official (EC Sep.4,p6).

Success in either attack would have deeply scarred those countries and exposed Yemen to unilateral action by Washington or Riyadh, say experts. Instead, the botched attacks have forced Yemen's President Ali Abdullah Saleh to prioritize neutralizing Al-Qaeda, choosing to cooperate with the West as he did following the Sep. 11, 2001 attacks on the US.

Stronger action against Al-Qaeda has yielded early results. Scores of members were killed or captured in a series of December raids in the capital Sanaa and in Shabwa and Abyan provinces. The US has quietly kept a close eye on militant cells in Yemen since the *USS Cole* bombing in Aden in 2000, which was claimed by Osama bin Laden's Al-Qaeda network. After Abdulmutallab's attempt, US President Barack Obama vowed to increase his country's involvement in Yemen.

Despite the gains, taking on Al-Qaeda will not be easy, warns one Yemen-based analyst. The group has deep roots in Yemen, dating to the 1980s when large numbers of Yemeni Mujahidin returned after fighting the Soviet Union in Afghanistan. Those fighters laid the groundwork for a second wave of Yemenis to volunteer their services in other conflict zones in Chechnya, Bosnia, and Iraq (EC Apr.18'08,p3).

The government and Al-Qaeda coexisted for years under a delicate truce — if members did not attack Yemeni targets, the government would use a softer hand. The local membership was not highly organized and current or former militants used Yemen as a safe haven rather than an operating base. But since 2006, various Yemen-based Al-Qaeda groups have stepped up their campaign in Yemen, carrying out crude mortar attacks in Sanaa, shooting foreigners and launching attacks on oil facilities. A coordinated September 2008 twin car bombing at the US embassy — which failed to penetrate the outer gate — foreshadowed an evolution of tactics and organization. Analysts say AQAP represents a highly trained third phase of Al-Qaeda in Yemen, similar in ideology to Osama bin Laden's network.

In the fight for hearts and minds — especially in poor regions — the government's focus must be on economic reforms, analysts say. "The hard power is not enough. The government needs to mobilize the people against Al-Qaeda by going to the schools and the mosques," says Ahmed Saif, director of the Sanaa-based Sheba Center for Strategic Studies. To this end, Saleh has called for a national dialogue "to address all crucial issues."

Yemen's tougher stance on Al-Qaeda is increasing foreign involvement in the country. US troops are already on Yemeni soil training counter-terrorism units, and the UK plans a major conference later this month in London to address Yemen's woes. But the US is deeply unpopular among many Yemenis, who resent America's invasion of Yemen's ally Iraq and its stance on the Israeli-Palestinian conflict — and the danger is that the stronger foreign role could provoke a backlash. Yemen's deputy premier for defense and security, Rashad al-Alimi, warned Thursday that direct US intervention could serve to strengthen Al-Qaeda. The Al-Qaeda-linked Al-Shabab in nearby Somalia has already pledged to send support for Yemen's militants.

Taking a harder line also risks upending Saleh's balancing act with powerful tribal elements, which have provided safe havens to militants but are essential for Saleh's support base. Dwindling oil revenues mean increased military action will strain the budget, and escalating conflicts only scare away needed foreign investment in oil exploration, tourism and industry. The government's inability to crush the Houthi rebellion in Saada shows the limitations of force. Yemen has also failed to make headway with its other domestic priority: a surge in protests and violence in the southern provinces, which until 1990 formed communist South Yemen and where inhabitants complain of marginalization. ■

Alex Schindelar, Dubai

Compass Points

- SIGNIFICANCE: Yemen begins 2010 in a precarious position. After international terrorist plots were planned inside its borders, the government has had to shuffle its priorities to disrupt local Al-Qaeda cells, while also continuing campaigns in the north and south, before foreign governments interfere.

- CONTEXT: Yemen's oil revenues — the main driver of government income — slid 64% in the first 10 months of 2009, with output dropping 46,000 barrels per day year-on-year to 280,000 b/d. The new Yemen LNG will pitch in new revenues, but has started at a time of weak gas prices.

- NEXT: Despite predictions that Yemen is teetering on the brink of failure, President Saleh has proven an adept operator even in the face of multiple hostile fronts. But the stakes have now risen and the West will demand results, not backroom deals supporting the status quo.

OPEC FILE

Handling Venezuela's Data

The controversy over Venezuela's production, and the Opec Secretariat's secondary source supply data in general, continues to nag, as Opec watchers remain divided about how to handle published Venezuelan statistics.

Arguing that it was producing much more oil than independently estimated — and so deserved a higher quota — Venezuela in May 2009 started releasing export data certified by monitoring firm Inspectorate. In a bid to assure observers that the port-by-port statistics were authentic, Caracas in November started including a list of vessel names, loading dates and cargo sizes.

Opec Crude Production and Targets

('000 b/d)	2009 Dec.	Nov.	Oct.	Jan. '09 Targets	Dec. vs. Target	Capacity Current	Spare
Saudi Arabia*	8,223	8,220	8,200	8,051	171	11,740	3,518
Iran	3,650	3,675	3,625	3,336	314	4,000	350
Venezuela	2,580	2,611	2,673	1,985	595	2,700	120
Kuwait*	2,363	2,355	2,335	2,223	139	3,000	638
UAE	2,250	2,200	2,250	2,223	27	2,800	550
Nigeria	1,995	1,917	1,748	1,673	322	2,700	705
Angola	1,818	1,874	1,888	1,517	301	2,150	332
Libya	1,550	1,550	1,550	1,469	81	1,775	225
Algeria	1,350	1,365	1,325	1,202	148	1,425	75
Qatar	800	780	760	731	69	875	75
Ecuador	450	445	455	434	16	510	60
Opec 11	**27,028**	**26,992**	**26,809**	**24,845**	**2,183**	**33,675**	**6,647**
Iraq	2,475	2,550	2,502	—	—	2,475	0
Opec 12	**29,503**	**29,542**	**29,311**	**—**	**—**	**36,150**	**6,647**
Compliance	*48.0%*	*48.9%*	*53.3%*				

*Including Neutral Zone shares.
Source: Opec, Energy Intelligence

Of the six secondary sources used by the Opec Secretariat to monitor members' production, initially only *Petroleum Intelligence Weekly* — and other Energy Intelligence publications including *Energy Compass* — began using the trade data as one of several sources for monthly assessments (EC May14,p2). This resulted in an upward revision in Venezuela's production estimate to 2.5 million-2.7 million barrels per day — above its 1.985 million b/d Opec allocation, but still short of the 3 million b/d often claimed by Venezuelan officials. Since then, only one other source, consultancy IHS Cera, has followed suit in using the data.

Three other sources — the International Energy Agency, the US Energy Information Administration and London's Centre for Global Energy Studies — have yet to make use of Venezuelan trade data in their estimates of the country's crude output, remaining closer to 2 million b/d. The sixth source involves a survey by Platts that is believed to include information from some, if not all, of the other five sources.

The addition of more detailed shipping information is supposed to allow a more explicit tracking of Venezuelan oil exports to counter criticisms that not enough of the volumes are showing up in regularly tracked OECD locations to give credibility to the Inspectorate-certified data. Venezuela argues that significant exports are destined for non-OECD countries, particularly in the Western Hemisphere. The recurrence of specific vessels loading during the month supports this assertion of local trade, but the limited amount of non-OECD Caribbean and Central American refining capacity casts doubts on the size of such volumes.

Even if the export data issues are resolved, the veil over Venezuela's internal crude movements continues to hamper calculations of actual production. Critics of the higher estimates point to well-documented problems at the aging fields of Western Venezuela going back to the oil strike of December 2002 and more recent struggles with Orinoco synthetic fuels production.

Venezuela is certainly not the only Opec member whose production statistics are murky; indeed, none of the other members offers the same amount of data as Caracas. Loading schedules for a few countries can be compiled with varying degrees of effort, from the relatively easy to collect and corroborate Iraqi shipments to the much-murkier Angolan and Nigerian exports.

But, as with Venezuela, exports tell only part of the story and have to be supplemented with estimates of domestic crude use by local refineries — and, in the case of Iraq, direct burning — to come up with a figure for total production. Adjustments must also be made where there are significant amounts of non-crude inputs into refineries — such as condensates and natural gas liquids, as in Venezuela. Mideast Gulf loadings are tracked by a few specialized firms but are not widely available, while data for North African members Libya and Algeria and Opec's smallest producer, Ecuador, is generally opaque.

The bottom line is that current Opec production is running well above the agreed-upon production targets. By Energy Intelligence calculations, compliance fell to 48% in December, with all members exceeding their individual allocations (see table). Venezuela retained its position as the No. 1 violator, but rejects the September 2008 base figures used to set the targets. Nigeria, Iran and Angola — which cannot make such claims — each came in at more than 300,000 b/d over target. ■

David Knapp, New York

Compass Points

- SIGNIFICANCE: Venezuela has put itself in the forefront of Opec's broader issues of data transparency and credibility with its continued assertions of high production levels. While some revision is justified, the official claim seems implausible given internal conditions.
- CONTEXT: Ongoing efforts to improve Opec reporting of oil data have been disappointingly slow. The Joint Oil Data Initiative (Jodi), in which Opec plays a leading role, has yet to establish itself as a reliable database, particularly with regard to Opec production.
- NEXT: Secondary sources will review Venezuela's new data. Regardless of their response, all are expected to press for more disclosure, especially on internal production by region.

LATIN AMERICA

New Balance of Power

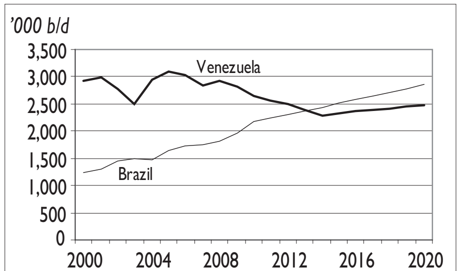
For decades, Venezuela has been the energy powerhouse of South America. The largest crude oil producer and exporter on the continent, Venezuela used its oil revenues to distribute aid and gain political clout in the region and beyond. But 2010 ushers in a decade when a new oil power should take over — Brazil.

As production rises in Brazil and tapers off in Venezuela, the former will continue to close a gap in output that has been narrowing for the past five years.

In Venezuela, oil production has been dropping steadily since 2005. Declines at aging fields in the Maracaibo region have not been replaced by new discoveries. Production was also held back in 2009 by lower synthetic crude output from the country's four Orinoco tar sands upgrading projects, although much of the heavy oil was still blended with lighter crudes and exported. Energy Intelligence forecasts a drop in Venezuelan crude and condensate production from 2.83 million b/d in 2009 to 2.64 million b/d in 2010, after sliding from 3.09 million b/d in 2005.

Meanwhile, in Brazil, large-scale oil production from the recently discovered offshore subsalt region is due to start up this year at the giant Tupi field, where output should reach 100,000 b/d in the fourth quarter. Existing fields in the traditional Campos Basin, which generates 80% of Brazil's oil output, will also contribute to rising production. Oil output is set to increase to 2.17 million b/d this year from 1.96 million b/d in 2009, after growing from 1.64 million b/d in 2005, according to Energy Intelligence estimates.

Latin America's Oil Giants



Venezuela data includes condensates. Figures for 2010-20 are projected.
Source: Oil Market Intelligence, Energy Intelligence Research

Brazil's subsalt production will not hit 1 million b/d until the second half of the decade. But with Venezuela's oil industry in continued decline, Energy Intelligence projects that Brazil will overtake Venezuela by 2014, when the former would produce around 2.44 million b/d and the latter 2.29 million b/d (see graph).

Venezuela's total proven reserves will still dwarf those of Brazil. State-controlled Petrobras says that, once certified, its new subsalt discoveries will add another 10 billion-16 billion barrels of proved reserves to Brazil's current total of 12.6 billion bbl. Venezuela, by comparison, had a massive 172 billion bbl of proved reserves at the end of 2008, according to government statistics, with more being certified in the Orinoco Basin.

Still, the discovery of Brazil's subsalt oil reservoir — estimated to hold 50 billion-100 billion barrels of oil equivalent — has drawn attention from international oil companies interested in investing in South America, where Venezuela has until now been the only big game in town. Now, both Venezuela and Brazil can offer access to huge reserves in projects that, despite large up-front investments, have low exploration risk.

But both also pose aboveground risks that generate questions about how much investment will really flow in — and which country holds greater appeal. Venezuela plans to auction three large heavy oil upgrading projects in early 2010, but it is unclear how many companies will agree to the government's demanding fiscal terms while taking on the political risk of investing in a country whose government has nationalized entire industries with little warning. Caracas has already been forced to sweeten the terms for its Carabobo bid round (EC Oct.9,p5).

Brazil, too, will hold a bid round to auction off exploration licenses in the subsalt zone, but not before the government reforms the oil licensing framework to boost state control (EC Sep.4,p3). The legislation would give partially privatized Petrobras a minimum 30% stake and operatorship of all subsalt blocks. In addition, a new fully state-owned company, Petrosal, will be represented on the boards of all subsalt joint ventures and enjoy veto power over investment decisions. Many international oil companies could be wary of becoming "passive investors," financing the project with little say over operations, says Jeremy Martin, director of the energy program at the Institute of the Americas in California.

Besides fresh investment and higher oil production, Brazil may also gain less tangible benefits from its oil boom, including international clout. Until recently, Brazil lacked the economic wherewithal to back up its aspiration for a global political role, says Eric Farnsworth of Washington's Council of the Americas. "Part of the reason they now have it is their energy profile," he says. Brazil's increasing political influence was evident in its role as a key negotiator in the climate change summit in Copenhagen and at the Doha round of the World Trade Organization. Likewise, analysts argue, Venezuela's oil wealth has historically granted it an important role in global affairs, with current President Hugo Chavez continuing a trend stretching back to the establishment of Opec 50 years ago (EC Feb.29'08,p5).

It is not clear exactly how Brazil would use its oil wealth to wield geopolitical power, and most analysts agree that it would not "buy" political friends with oil, nor use its influence to build an "anti-US" coalition of Latin American countries as Venezuela has sought to do. Brazil's oil-backed foreign policy may start to become clearer in 2010.

The key events for 2010 will be:

• *Venezuela:* The Orinoco Belt's Carabobo bid round is due to go ahead this month after several delays. Will it proceed as planned? Under what terms? And who will dominate: state-owned and politically friendly companies or Western majors?

• *Brazil:* Congress should approve a new oil licensing framework by May. This — plus the outcome of October's presidential election — will set the stage for a new era in Brazil's oil industry. With all this going on, the subsalt bid round will probably be postponed until 2011. ■

Lisa Viscidi, New York

ASIA

Sustaining the Rebound

Asia led the world's economic recovery in 2009 and looks set to return to strong growth this year. But the key question for governments across the region is how the rebound can be sustained by relying more on domestic consumption and investment and less on the traditional model of export-led growth.

Most countries entered the economic crisis in 2008 with stable, resilient balance sheets and manageable unemployment rates, says Joseph Tan, chief Asia economist at investment bank Credit Suisse. "And the recovery was swift," he adds. "There was a huge amount of liquidity and central banks reduced interest rates to nearly zero."

China has indicated it will continue its expansive monetary policies — centering on high government spending and easy private-sector access to credit — to ensure the economy is back on track (EC Jul.31,p5). Still-wary Chinese officials are targeting modest 8% growth for the year, although most economists anticipate levels of 10%. However, with loose lending and excess liquidity, analysts are keeping a close eye on inflation, manufacturing and industrial overcapacity and nonperforming loans.

Assuming the global recovery looks more certain going into the second half, Beijing could tighten its macro policy to prevent the economy overheating. Going forward, the government has recognized the need to shift away from its traditional export markets in the US and Europe and to gear growth more toward domestic drivers — including urbanization of the rural population, infrastructure construction and retooling capacity toward the local consumer.

The bulk of the government's 4 trillion yuan ($586 billion) stimulus package unveiled in late 2008 has so far been devoted to infrastructure spending, with only a fraction earmarked for social welfare programs — limiting the impact on Chinese consumers' disposable income. "There is a permanent shift of the growth pattern of consumption in the US, which means a permanent redundancy of capacity in China," warns Mark Ferchen, an academic at China's Qinghua University.

Similar questions are being raised across Asia, particularly in export-dependent countries such as Japan, South Korea, Singapore, Malaysia and Taiwan. Some believe Southeast Asian economies could partially replace their lost US and European sales with new exports to China (EC Oct.9,p7). But others, like Hong Kong property tycoon Ronnie Chan, disagree. "We can increase intra-Asian trade, but much of this will consist of intermediary goods to China, which eventually will be exported to end-user markets in the West," he said at a Singapore conference last month. "Much of the rest of Asia produces for China to produce for Western markets."

Bank of America Merrill Lynch expects the region to take a step this year toward a new model focused on domestic consumption, but says decoupling from Western markets is unlikely. In a recent research report, the bank predicted that Asia's emerging economies should grow by 8.2% this year — versus 5.9% in 2009 — with a "solid upturn in consumption and fixed investment" once the global uncertainty fades and exports recover. But it will be "many more years before domestic demand is seen as a reliable driver of growth," the bank said.

India, Japan, South Korea and Malaysia have all benefited from fiscal stimulus measures that helped prop up domestic demand. India is expected to grow by 8% in the current fiscal year through March 2010, compared with 6.8% in fiscal 2009, and could potentially touch 9% next year, analysts say. Standard Chartered says the positive wealth effect from improving asset markets and credit access should boost household spending while investments by the corporate sector should also pick up. A major challenge for the government will be to balance growth with inflation, buoyed largely by agricultural and food-supply constraints.

Following a recession, Japan could see marginal growth this year, particularly if exports to the US rebound in the second half. However the newly elected Democratic Party of Japan will continue to grapple with structural deflation and traditionally weak domestic demand. South Korea's growth should also improve to about 5% this year after flat-lining in 2009. Low household spending and high private-sector debt will challenge the government, but it has pledged to maintain stimulus spending, especially on green projects after pledging to slash the country's greenhouse gas emissions over the next 20 years.

Malaysia — where close to 90% of the economy is dependent on exports — could see a rebound in growth to 4.2% this year, following a 2.2% contraction in 2009. Indonesia is an exception: It escaped relatively unscathed from the financial crisis because of its low dependence on exports and growth in domestic consumption. The government is targeting GDP growth of 6.6% annually over the next five years, compared with 4.4% in 2009.

Thirst for Oil

Oil demand in Asia has rebounded from the lows of January 2009, when it contracted by 8% year-on-year, says Credit Suisse. The bank predicts that the region will account for close to 600,000 barrels per day of incremental demand this year, nearly half the world's total. China's apparent oil demand grew by an estimated 6.3% last year, largely due to crude oil stockpiling, with demand for key products gasoline, gas oil, jet kerosene and fuel oil likely rising by only 0.5%. Credit Suisse sees Chinese growth moderating to 4.1% this year, with a likely pick-up in middle distillate demand as industrial activity recovers.

Energy Intelligence's *Oil Market Intelligence* projects similar numbers, with Asia growing by slightly more than 600,000 b/d, or more than 60% of the world's total, and China expanding more strongly by 6%.

Asia's political outlook should remain relatively stable, with only the Philippines scheduled to hold major elections. Outgoing President Gloria Arroyo's ratings have languished because of recent election-related violence but the economy is likely to post a respectable growth of 2%-plus this year.To combat inflation, Malaysia and Indonesia are expected to push through further fuel price hikes, especially if crude markets edge back up toward $100 per barrel. Standard Chartered economist Fauzi Ichsan sees Jakarta hiking domestic fuel prices and electricity tariffs by 20%-30% in the first quarter, a move facilitated by President Susilo Bambang Yudhoyono's comfortable election win last year (EC Feb.6,p5). ■

Song Yen Ling, Singapore

UNITED STATES

Obama's Second Year

If "engagement" was the central foreign policy goal of US President Barack Obama's first year in office, then "escalation" may be the end product of his second. Having broken a first-year presidential travel record, Obama may have to match the 21 countries he visited in 10 overseas trips last year as he tries to deliver on his goals.

After notable journeys to the Middle East, Asia and Europe, one of his last in December was to Norway to accept the Nobel Peace Prize — an honor he himself admitted may have been awarded prematurely. In Oslo, Obama talked at length about the nature of "just war" and his hope that nations would strive toward a "gradual evolution in human institutions."

Obama will be hard-pressed for a second-year encore. Domestic issues will rise to compete as budget deficits balloon and midterm elections approach, while with the possible exception of Iraq, all the remaining areas of contention — Afghanistan, Pakistan, Russia, China, Israel-Palestine and Iran — remain seemingly intractable, and others such as Yemen continue to flare up.

The relentless nature of these challenges has led some to wonder what exactly Obama, who has less-settled views on war and peace than perhaps any US president in the last 50 years, had in mind during his Nobel speech and what elements of an "Obama Doctrine" he may have tried to sow in the minds of his listeners.

The speech left supporters saying he staked new ground, promising to end US unilateralism and focus on regional stability in return for more overt diplomatic and material support and, implicitly, less anti-American criticism from traditional allies. His critics saw it differently, complaining that the dissonance caused by his acceptance of the peace prize within days of ordering 30,000 more combat troops to Afghanistan showed a leader confused by the intellectual tensions of his high office.

By the end of 2010, friends and competitors alike will want to know what Obama aims to accomplish before the gravity well of the 2012 re-election cycle starts to pull strongly. The list of flash points confronting the 44th president includes:

• *Iran:* The Islamic republic in December dismissed a year-end deadline to accept a UN-drafted deal to swap enriched uranium for nuclear fuel. The US warned Iran to take the deadline seriously and has promised tougher sanctions if there is no response. But the Obama administration must tread carefully to avoid destroying any possibility of compromise or undermining Iran's protest movement.

• *Afghanistan/Pakistan:* The additional 30,000 US troops will not fully arrive in Afghanistan until well into 2010, leaving the potential of a spring offensive by the Taliban that could boost US troop losses (EC Dec.18,p7). Relations with Pakistan — uneasy at being lumped together with Afghanistan and at the US' military role inside Pakistan — are likely to remain prickly. Noticeably absent is any sustained US focus on an India-Pakistan peace that would allow Islamabad to focus on its western border.

• *Russia:* The killing of the Bush-era missile defense program has cut tension out of the US-Russia relationship, but additional help on Iran and nuclear proliferation may demand more acquiescence from the administration, perhaps on unresolved trade issues that have lingered since the Soviet era (EC Oct.2,p5).

• *Israel-Palestine:* Efforts to unblock the peace process remained bogged down last year over the issue of an Israeli settlement freeze. The Obama administration continues to try to find a way for the two sides to start talking again, with Egypt playing an important role and Saudi Arabia also reasserting itself. The proposed reconciliation of Palestinian factions Fatah and Hamas would help, but uncertainty will remain over Palestinian elections and the future of Palestinian Authority President Mahmoud Abbas.

• *China:* Beijing's warnings in 2009 about the amount of debt being amassed by the Obama administration sent chills through American policymakers. China's position as America's largest creditor gives it significant, if subtle, influence over US foreign policy — especially on energy and financial issues.

• *Iraq:* Obama's plan to withdraw more than 50,000 troops from Iraq by the second half of this year could continue apace if Iraqi elections come off as planned in March and political violence stays at current, relatively low levels. A surge in oil infrastructure investment after two successful bid rounds might make Iraq one of the few positive political stories of the year. This is not a foregone conclusion, however.

• *Terrorism:* As the Christmas Day failed airline bombing over Detroit showed, the US remains a target of militant Islamists, regardless of the occupant of the White House. The perceived missteps over the failed attack, even if largely unwarranted, showed Obama's vulnerability to criticism on national security in the event of a successful attack.

In terms of Obama's larger strategic vision, pay attention to the goings-on during May in New York, when a month-long review session for the UN Nuclear Non-Proliferation Treaty will take place.

Obama, unlike any US president since perhaps Ronald Reagan, has made the elimination of nuclear weapons a calling, and will likely push the US Senate to sign the Comprehensive Nuclear Test-Ban Treaty that it rejected in 1999. This may allow him to argue he has broken new ground in order to re-energize the NPT, which lacks only the signatures of Israel, Pakistan, India and North Korea. A new, stronger non-proliferation agreement would match Obama's idealistic, largely pacific vision of US foreign policy (EC Dec.11,p12). That said, an aggressive effort to create a new non-proliferation paradigm could leave him open to criticism of focusing too much on foreign policy during a time of extended economic woe.

The last two presidents to devote large amounts of political capital on foreign policy during their first terms, George HW Bush and Jimmy Carter, were basically fired by the American electorate for not paying enough attention to domestic joblessness. Obama will hope that his breaking of the former's first-year foreign travel record is not a portent of things to come. ■

Bill Murray, Washington

RUSSIA

Getting Back on Its Feet

Russia heads into the new year full of optimism and in much better shape than a year ago. Having coped with its major 2009 challenge of maintaining social control during an economic crisis — the most difficult period for the last 12 years, according to President Dmitry Medvedev — Moscow has a more pragmatic plan to help the country recover from recession. The priority for the first half of 2010 is to try to broaden the economic resurgence to small- and medium-sized enterprises and sectors such as services and retail through affordable credit and lower inflation. Strategically, the focus is on diversification from natural resources, the development of innovative technologies and expansion of infrastructure.

The government is confident that the economy will grow this year, although it prefers to avoid firm numbers. In an interview with Russian television, Medvedev cited analysts' forecasts that gross domestic product would grow in the range of 2.5%-5.5% in 2010, compared with a decline of 8.5% in 2009. Prime Minister Vladimir Putin is targeting a maximum of 7.5% for inflation this year; it averaged 8.8% in 2009, lower than the expected 11%.

Emboldened by the recent resilience of oil prices and revival in the global economy, both the government and oil companies have been revising their hitherto gloomy forecasts for 2010 and beyond. The Ministry of Economic Development is now forecasting average crude oil and condensate production of 9.9 million barrels per day this year, on par with 2009. Earlier scenarios envisaged output of 9.74 million b/d for 2010. Production is seen staying flat through 2012 under the ministry's "moderately optimistic" base case scenario, while prices for Russian Urals crude would edge up from $61 per barrel last year to $65/bbl in 2010 and $71/bbl in 2012. The ministry's base case also foresees a strong 12% recovery in gas output in 2010 to 643 billion cubic meters, rising to 669 Bcm by 2012, a figure regarded as optimistic by analysts.

Indeed, plummeting gas demand on international markets remains the gravest problem for Russia's energy sector and is likely to be the main driver for state policy this year. This will include advancing major pipeline projects such as Nord Stream and South Stream, as well the Pre-Caspian pipeline to carry Turkmen gas to Russia and an expected gas supply agreement with China. A possible renegotiation of long-term supply contracts with European customers will be influenced largely by demand; Gazprom has already agreed not to penalize some buyers for taking less than their contracted volumes.

Despite its desire to diversify, Russia's economy will remain heavily dependent on oil, analysts say. The country earns approximately $550 million per day from oil exports, with about 80% of this going to the federal budget, investment bank Uralsib calculates. Medvedev's plan to build a "smart economy" should see greater emphasis on areas higher up the value chain in the next three years, including refineries, petrochemicals, LNG and others, analysts say. Medvedev also has a more ambitious goal of nurturing an innovative economy, centering on the development of Russia's own technologies instead of Western versions. At a recent meeting devoted to the matter, organized in Gazprom's offices, Medvedev demanded a significant increase in spending for scientific research by all state-controlled corporations.

Russia's shift to a domestic investment bias, and from planning to doing, should be helped not only by signs of a global economic recovery, but also by improved relations with the European Union and the US, according to Uralsib. "The missile dispute has been resolved (for now) and relations have improved with the UK and with other EU countries," wrote Uralsib's chief strategist, Chris Weafer. He added that there is "almost no risk" of a gas transit dispute with Ukraine in January, which a year ago severely damaged the reputation of both countries.

Despite earlier signs that Moscow could ease its stance on foreign investors in Russia, the rules of the game are not expected to change, at least in the foreseeable future, experts say. The 2008 law on investments in strategic sectors, including oil and gas, limits foreigners to a minority stake and requires special permission from the government (EC Jul.31,p5).

Political Rivals

In domestic politics, competition between President Medvedev and Prime Minister Putin could grow as they position for the presidential election in 2012. Both have expressed their intention of running in the race, with Putin recently declaring that "you will never see me leaving" politics. The main difference between the two lies in their view of the state's role; while both adhere to the goals of diversification and reform, Putin seems to favor state control at every step. Although the two continue to vie for public support, the real conflicts so far have been between their respective teams. Tensions broke into the public arena last year as the two camps disagreed over certain pieces of legislation, with each side holding the upper hand on different occasions. ■

Nelli Sharushkina, Moscow

Compass Points

- SIGNIFICANCE: After withstanding the economic crisis of 2009, Russia will switch its focus to investment in basic infrastructure and supporting the growth of core industries. In energy, gas will remain at the forefront as Moscow strives to manage weak demand in Europe and competition from the Caspian.

- CONTEXT: This time last year, the government was still in crisis mode and was engaged mainly in firefighting, with social unrest the major threat (EC Jan.2'09,p4). Now, it is starting to pursue a broad stimulus program, many months after other world economies.

- NEXT: Russia's economic plans could be threatened if the oil price falls below $60 or if there is a breakdown in political consensus. Watch the development of pre-election rivalry between Medvedev and Putin. The outcome of Ukraine's presidential election on Jan. 17 could influence Russia's future relations with Europe.

MARKET FORCES

All About Demand

Oil markets in 2010 will be all about demand, and demand will be all about the economy — for the most part, at least. Other factors promise to be major drivers, too, but the outlook for prices rests largely on whether there is a return to robust growth in physical demand.

Geopolitical issues are almost assured to return to the fore as the Middle East grapples with Iran's nuclear program and internal unrest, tensions in Yemen and uncertainty in Iraq, but should be tempered by spare capacity (see p2). The appetite for paper barrels will also continue among investors, a trend that should lift prices but also leave the market vulnerable to volatility — including a major price correction if demand does not pan out. The supply side is important, but not as much as in the past, given ample excess capacity, upstream and downstream.

Global oil demand fell by more than 1 million barrels per day in 2009 — the largest decline in a generation. Two main consumers, the US and Japan, led the way down, while the sharp rebound in China put some brakes on the decline. The outlook improved throughout the year — preliminary data show global demand growing again in the fourth quarter, with further expansion projected for 2010. The weak baseline in 2009 and strong economic growth in non-OECD countries are serving as the main props.

While most analysts agree that demand will grow this year, they differ on the scale. The International Energy Agency sees demand rising by 1.5 million b/d, for example, while Opec predicts a modest 820,000 b/d increase. A sharp rise would eat into bloated inventories and prompt investors to jump in on the long side of the market. On the flip side, a smaller increase would keep the market in a perpetual surplus and push investors to look for other markets. Energy Intelligence forecasts a rise of just under 1 million b/d for 2010.

Wild Card

The discrepancy in forecasts stems largely from uncertainty over the outlook for economic growth. For the most part, developing countries, led by China, India and the Mideast Gulf, are likely to see robust growth, while OECD economies, with a few exceptions, should experience flat to slightly lower demand, compared with 2009. That leaves the US, which consumes almost a quarter of the world's oil, as the biggest wild card. US demand contracted sharply in the early part of last year, falling by as much as 7.8% in May and 5.8% in the first half as a whole. But by December, the decline rate had slowed to just 0.6% year-on-year. Put simply, the US could swing the pendulum either way for global demand

Current trends suggest that demand will grow this year in the US, but there is no guarantee that the economic recovery will be strong. One danger is that the country falls into a double-dip recession if real estate and equity markets turn back around, unemployment keeps rising and banks do not boost lending. Even if a worst-case scenario is avoided, a stalled recovery could take shape in the face of higher interest rates and stagnant unemployment. And while a strong recovery is not out of the question, it may not translate into higher oil demand given advances in fuel efficiency, conservation and alternative fuels.

Investors, as usual, will have a significant impact on prices this year, possibly underpinning the market even if the supply surplus persists. "The investment demand for oil is now recognized by even the most hardened skeptics as an important factor in oil pricing," says David Hufton of PVM brokerage. Despite the economic meltdown in late 2008, an estimated $60 billion moved into oil futures in 2009. "These inflows have played a large part in supporting oil prices in the face of an excess of supply over demand," Hufton notes.

But money can move both ways. While a large influx of funds can lift prices, a liquidation can puncture the market when investors depart en masse. Investor money can only raise prices as far as fundamentals allow. Moreover, the US dollar is seen by many as the key driver in oil markets (EC Oct.30,p7). When the dollar falls, investors flee and buy oil, and vice versa. Against this backdrop, the actions of central bankers will be a major consideration this year, as they were in 2009 — particularly when the US Federal Reserve decided in the spring to print money to stimulate the economy, weakening the dollar and ultimately changing the dynamics of the oil market for the rest of the year. If the Federal Reserve keeps interest rates near zero, the dollar could keep declining, but any rate hikes — a strong possibility — would strengthen the dollar and perhaps hurt oil prices.

Comfortable Cushion

Geopolitical threats have had a more limited impact on oil prices in the past couple of years, as macroeconomic developments overshadowed political risks and excess spare capacity reached a point where any outages could be matched by higher production elsewhere.

Tension will continue to hang over oil markets, with Iran and the West still on a collision course over Tehran's nuclear ambitions. But Opec has some 6.6 million b/d of spare capacity these days, while government strategic reserves are supplemented by huge volumes of commercial storage on land and at sea. Even with a more cautious estimate of Opec capacity that excludes conflict zones like Nigeria, there is still plenty of slack — the US Energy Information Administration sees global spare capacity of around 4 million-5 million b/d this year, compared with 3.9 million b/d last year and just 1.5 million b/d in 2008.

Downstream, there is even less pressure, with some 2.7 million b/d of refining capacity expected to come online this year and next, a sharp turnaround from the tight balance of the last decade. ■

Matt Piotrowski, Washington

MARKETPLACE

Riotous Party

Market bulls are enjoying a prolonged and positively riotous New Year's party. It is 10 days since crude oil futures last posted a loss. During that time, the front-month February Nymex crude futures contract has traded from a Dec. 21 intraday low of $73.17 to a Jan. 6 and 14-month high of $83.52 — an increase of $10.35, or 14.2%. February ICE Brent futures climbed from a Dec. 22 intraday low of $71.97 to a Jan. 6 intraday high of $82.21 for a similar gain. Crude futures are heading into the new decade in some style and in defiance of physical fundamentals.

The current rally has been fueled by cold weather across most of the Northern Hemisphere, a simmering, oily dispute between Belarus and Russia that could threaten Russian pipeline supplies to Europe, and rising political temperatures in the Middle East, notably in Iran and Yemen (see p2). Add growing optimism about a global economic recovery fed by encouraging manufacturing data from the UK, US, India, China and South Korea, season with early indications that the flow of investment funds into oil and other commodities is increasing, and the result is a very potent brew.

Technical signals are encouraging, and even a dip in prices following a bearish US inventory report on Jan. 6 was regarded as a buying opportunity that led to new highs. A minor setback on Jan. 7 was widely dismissed as an entirely predictable bout of profit-taking following the long rally.

However, a hangover may be in the making. A growing number of financial soothsayers are warning that the US dollar could be embarking on a rally of its own that could take the ICE US Dollar Index from its current 78-plus to 80 fairly quickly — within weeks — and possibly onward and upward through 82 to 84. To help it on its way, the euro may be heading for trouble.

After Dubai's restructuring of its debt, the focus of concern about sovereign debt is shifting to a number of eurozone countries: Greece is first, but a number of other countries, including Ireland, Italy and Portugal, have all incurred massive budget deficits that ignore European Union regulations stipulating that shortfalls cannot exceed 3% of GDP. Greece and Ireland have budget deficits in excess of 12%, Spain's is almost 10%, and Portugal's 6.7%, with Italy's a marginally more manageable 5%. These countries' ratios of debt to GDP are even more nightmarish.

This can only lead to increasing economic strain within the monetary union and rising political tensions between member nations. Already Germany is on record as saying it won't bail out poorer countries and a prominent board member of the European Central Bank is backing Berlin.

That said, market sources add a health warning. During the latest oil price rally, the inverse correlation between the dollar and oil has been less than perfect. Dollar strength based primarily on euro weakness will not be enough to send oil prices skidding. However, if the dollar strengthens because of wider macroeconomic considerations, that might well lead to a sell-off.

Meanwhile, the party might just last awhile longer, as even physical fundamentals are beginning to perk up a little. ■

Axel Busch, London

Compass Points

- In technical terms, the front-month February Nymex crude futures contract is trading massively above this week's pivot of $76.35, as well as the $78.25 pivot projected for next week. The contract broke through both its weekly projected high of $80.50 and strong range resistance at $82. These levels now provide support, ahead of the pivots, $75 and $73.75. To the upside, $84 and $86.35 — the monthly and quarterly projected highs, respectively — provide strong resistance.

- The February ICE Brent contract similarly is trading way above both this week's $75.50 pivot and next week's projected $77 pivot. It easily jumped hurdles at $79.50 and $80.25, which now provide support ahead of the pivots. Resistance looms at the monthly projected high of $82.50 and the quarterly projected high of $84.60. A break to the upside would target $87.50.

Crude Oil Markets

	Jan. 6	Dec. 22	Chg.
Futures			
Brent 1st	81.89	73.46	+8.43
Brent 2nd	82.49	74.16	+8.33
WTI 1st	83.18	74.40	+8.78
WTI 2nd	83.75	75.06	+8.69
Oman 1st	81.62	73.12	+8.50
Oman 2nd	82.07	73.87	+8.20
WTI-Brent	+1.29	+0.94	+0.35
Brent-Oman	+0.27	+0.34	-0.07
Benchmarks			
Dated Brent	80.27	71.65	+8.62
B-Wave	80.87	72.82	+8.05
Mars	81.24	70.87	+10.37
Dubai	79.90	72.00	+7.90
Oman (spot)	79.60	72.11	+7.49
Tapis	83.55	77.25	+6.30
Minas	82.50	74.85	+7.65
Differentials			
Dated Brent:			
Urals NWE	-0.65	-0.55	-0.10
Urals Med	-0.55	-0.65	+0.10
Bonny Light	+1.50	+1.20	+0.30
Cabinda	-0.50	-0.50	0.00
WTI:			
LLS	+2.15	+1.20	+0.95
Mars	-1.95	-2.50	+0.55
Bonny Light	-1.42	-0.52	-0.90

$/bbl.
Source: Icis, exchanges

Refining Margins

	Jan. 6	Dec. 22	Chg.
Rotterdam (Brent)	+0.23	+0.50	-0.27
US Gulf (Mars)	-0.18	+0.57	-0.75
Singapore (Oman)	+0.04	-1.07	+1.11

Incremental Margins, $/bbl.
Source: EIG

Product Markets

	Jan. 6	Dec. 22	Chg.
Rotterdam			
Reg. Gasoline (10ppm)*	712.50	637.50	+75.00
Diesel (0.001%)*	680.50	630.50	+50.00
Fuel Oil (1%)*	484.00	426.00	+58.00
Fuel Oil (3.5%)*	467.50	410.50	+57.00
US Gulf Coast			
RBOB†	209.48	193.95	+15.53
Distillate Fuel (0.2%)†	216.05	188.15	+27.90
Fuel Oil (0.7%)‡	74.13	70.38	+3.75
Fuel Oil (3%)‡	74.53	67.13	+7.40
Singapore			
Naphtha‡	82.19	78.21	+3.98
Premium Gasoline‡	88.37	80.50	+7.87
Gas Oil (0.5%)‡	87.50	78.50	+9.00
Fuel Oil (3.5%)*	504.25	456.75	+47.50

* $/ton. † ¢/gallon. ‡ $/bbl.
Source: Thomson Reuters

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AUSTRALIA

Woodside Petroleum lost one of its two foundation customers at the Browse LNG project after PetroChina pulled out. Woodside said its key terms agreement with PetroChina for 2 million-3 million tons/yr of LNG starting in 2013-15 had expired. Market watchers concur that the Chinese firm views the Browse deal, signed in 2007, as excessively pricey and is seeking cheaper prices currently available (EC Feb.22'08,p11).

GUINEA

US minnow Hyperdynamics submitted a plan to relinquish 64% of its huge offshore oil and gas contract area to the government, in line with a revised agreement (EC Dec.11,p4). The company also submitted a 2010-11 work plan for the remaining 11,160 square miles, in partnership with Repsol YPF and Dana Petroleum. This envisages 3-D seismic this year and a first well in late 2011. The government has the right to auction off the 64% to other companies, but Hyperdynamics has rights of first refusal.

INDIA

Brazil's Petrobras is pulling out of the KG-DWN-98/2 Block in the Krishna-Godavari Basin to focus attention on subsalt discoveries at home, and will sell its 15% interest to operator ONGC. The block sits next to Reliance's prolific KG-D6 fields and is home to 10 gas discoveries, including the ultradeep UD-1 find, estimated at 2.08 Tcf. The Brazilian firm had an option to raise its stake to 30%. Majors Royal Dutch Shell and BP are said to be keen to plug the gap, with ONGC seemingly favoring Shell's technology for a floating LNG facility.

KAZAKHSTAN

Tough talks lie ahead for joint operators BG and Eni after Kazakhstan confirmed its intention to take a stake in the giant Karachaganak gas and condensate field. The Karachaganak consortium, which also includes Chevron and Lukoil, is already locked in a dispute with the government in a bid to claw back tax payments amounting to $1 billion, said to be roughly the sum the Kazakhs are looking to pay for a 10% stake (EC Oct.2,p7). The issue has echoes of the row that paralyzed the country's giant Kashagan field.

NIGERIA

Legal challenges are mounting over the protracted absence of President Umaru Yar'Adua, who has been seriously ill in a hospital in Saudi Arabia since late last year. With no indication as to when Yar'Adua might return, the federal high court in Abuja will hold hearings on Jan. 14 relating to three separate lawsuits that claim his failure to cede power to Vice President Goodluck Jonathan violates the constitution. While Jonathan has been presiding over cabinet meetings, executive powers have not officially been transferred, prompting questions about the legality of decisions (EC Dec.18,p11).

PERU

Licensing agency Perupetro will solicit bids for around 20 oil and gas blocks this year, according to the energy ministry — but has delayed the initial launch from January to April to allow consolidation into a single offering and give time for consultation with local communities. Most lie in the northern and central jungle region, with some on the northwest coast. The energy ministry also foresees up to $178 million in new investments though 2011 by Repsol YPF and Petrobras in Blocks 57 and 58, next to the Camisea gas project.

RUSSIA

Moscow and Ukraine pulled back from the brink of a new energy row that could have cut Russian oil flows to Europe. The two adversaries were heading for a falling-out over Kiev's decision to increase pipeline tariffs. Moscow activated the early warning mechanism agreed with the European Union and informed Brussels about possible disruptions in supplies (EC Oct.9,p6). With the affair under global scrutiny, a solution was quickly found. A separate dispute has threatened to flare up between Russia and Belarus, another transit country for energy supplies to Europe.

SUDAN

A US pension fund managing more than $402 billion of assets has followed through on a pledge to divest from companies active in Sudan that refuse to attempt to address human rights abuses in Darfur. New York-based TIAA-CREF sold stakes worth about $58 million in PetroChina, CNPC Hong Kong, Sinopec and India's ONGC after failing to make progress in its dialogue with the companies over the issue (EC Dec.18,p6). TIAA-CREF kept its holding in units of Malaysia's Petronas, which it said "has acknowledged our concerns and engaged in dialogue about how it might address them."

TURKMENISTAN

Turkmenistan awarded contracts totaling $10 billion to service companies from the UAE, China and South Korea to develop its super-giant South Yolotan gas field. Royal Dutch Shell, Total and Chevron had submitted proposals, but Turkmenistan appears to be stick-

Iraq Deals Advance, But Some Held Up

The seven oil deals awarded in Iraq's second postwar licensing round last month have made quick progress through the bureaucracy, with Iraq's cabinet giving the thumbs up this week to four multibillion-dollar contracts, including one for supergiant Majnoon, and the remaining three set to follow. Baghdad is due next week to start signing final contracts with the consortia (EC Dec.18,p2).

But progress on two first-round deals — initialed by companies in early November — has been slowed by Baghdad's insistence on amending the 20-year service contracts for West Qurna-Phase 1 and Zubair. The round-one changes, requested by the legal adviser to Prime Minister Nouri al-Maliki and said to be minor, were written into the second-round contracts.

Acceptance of those terms, along with three final contract changes, paved the way for cabinet clearance of second-round projects led by Royal Dutch Shell at Majnoon, Angolan state Sonangol at Qaiyarah and Najmah, and Malaysia's Petronas at Garraf. Lukoil at West Qurna-Phase 2, Gazprom at Badra and China's CNPC at Halfaya are expected within days to agree the slight amendments, which concern insurance, exemption of duties on equipment imports and arbitration.

For the pending round-one deals, both Eni, which leads the group for Zubair, and Exxon Mobil, partnered with Shell at West Qurna-1, are expected to meet with Iraqi officials in Baghdad this month for further discussion of Iraq's 21 adjustments.

The contract alterations will not apply to the first deal signed — with BP and CNPC for the Rumaila field — which took effect on Dec. 17. The contract's baseline production rate has been revised up to 1.066 million b/d from an original 956,000 b/d. The BP-CNPC duo must raise output by 10% above this rate to start receiving their $2/bbl remuneration fee. Ultimately, they have promised to hoist Rumaila's flows to 2.85 million b/d. A first joint management committee meeting between operators BP and state South Oil Co. will be held on Jan. 20 in Basrah. ■

ing to its guns and reserving onshore fields like South Yolotan for its state companies to develop with the help of outside contractors, while keeping its offshore Caspian blocks for foreign oil companies (EC Nov.27,p4). Petrofac, China's CNPC and a joint venture of LG and Hyundai picked up orders for gas treatment plants and drilling services.

UNITED STATES

The Strategic Petroleum Reserve (SPR) reached its current capacity, holding nearly 727 million bbl of crude oil, according to recent data. A 2005 law calls for expansion to 1 billion bbl, but the Obama "administration has not stated a position" on this, according to the Department of Energy. The department's Energy Information Administration sees US net oil imports falling through 2035, allowing existing reserves to comfortably cover the IEA's requirement that total inventories cover 90 days of supplies.

VENEZUELA

State PDV said it would form a joint venture with Italy's Eni to produce and refine up to 240,000 b/d of extra-heavy oil from the Junin 5 Block of the Orinoco Belt. Pending approval by the companies' boards, a final accord will be signed on Jan. 26. PDV will have a 60% stake and Eni 40%. It would be the first venture to build and operate a refinery in the Orinoco Belt, rather than a synthetic crude upgrader.

VIETNAM

The government is nearing a decision on revising its crude pricing formula. State Petrovietnam, trading arm PV Oil and equity producers have been weighing options for the past few months with the goal of dropping Asian Petroleum Price Index (APPI) assessments from the formula (EC Aug.7,p6). Vietnam will either use a formula of half dated Brent and half Indonesia's Minas crude, or peg prices solely to dated Brent. Most Vietnamese crudes are currently priced off Minas assessed by APPI and Platts. The new formula will likely be implemented from Jul. 1.

YEMEN

The US city of Boston is considering blocking LNG imports from Yemen into GDF Suez's Everett terminal due to security concerns following the claimed involvement of the local Al-Qaeda arm in the alleged attempt to blow up a US airliner on Christmas Day (see p3). Boston Mayor Thomas Menino has been concerned since 2001 about the proximity of the port to residential areas. Cargoes from the 3.35 million ton/yr Yemen LNG first train, which started operating in November, have been sent to Asia, but the US market may be needed to absorb volumes when a second train starts up later this year.

BORDERS

Iran and Iraq will meet next week to discuss a border agreement, including the status of a disputed oil field that raised tensions last month (EC Dec.25,p1). Iranian soldiers took control of Well No. 4 in Iraq's Fakka field Dec. 18 before later withdrawing. Border disputes, which led to the 1980-88 Iran-Iraq War, have resurfaced as Baghdad has auctioned its oil fields to international companies. Fakka was offered in Iraq's first post-war bid round in June, but was not awarded.

CORPORATE

Mature and well-established oil and gas companies raised a record amount of money on the London Stock Exchange in 2009, with 13 equity issues totaling £1.15 billion ($1.85 billion) up to Dec. 18. In 2008, such issues amounted to £417 million, up from £44 million in 2007 and £78 million the year before, according to LSE data. Active companies included Tullow Oil (£400 million in January), Cairn Energy (£175 million in March and November) and Premier Oil (£171 million in April). Dana Petroleum, Hardy Oil & Gas, Heritage Oil and Melrose Resources also raised funds. The majors' strong balance sheets meant they had no need to go to the markets.

10 YEARS AGO

In three months, when he is almost certain to be crowned as Russia's new czar, acting President Vladimir Putin will face a dizzying array of challenges, from redefining Russia's place in the world, to transforming the country's virtual economy into something more productive. Little is really known about Putin, though in a flurry of activity over the last five days he has begun to flesh out his public persona. He has stressed the need to boost exports of oil and gas, which presumably bodes well for a host of pipeline projects that have remained glued to the drawing board for the past few years. He also calls for greater state involvement in Russia's economy. But the shape of Putin's Russia will only become clearer once he reshuffles his cabinet, although he appears keen to combine the job of prime minister with that of acting president until after the elections (EC Jan.7'00,p4). ■

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Low High

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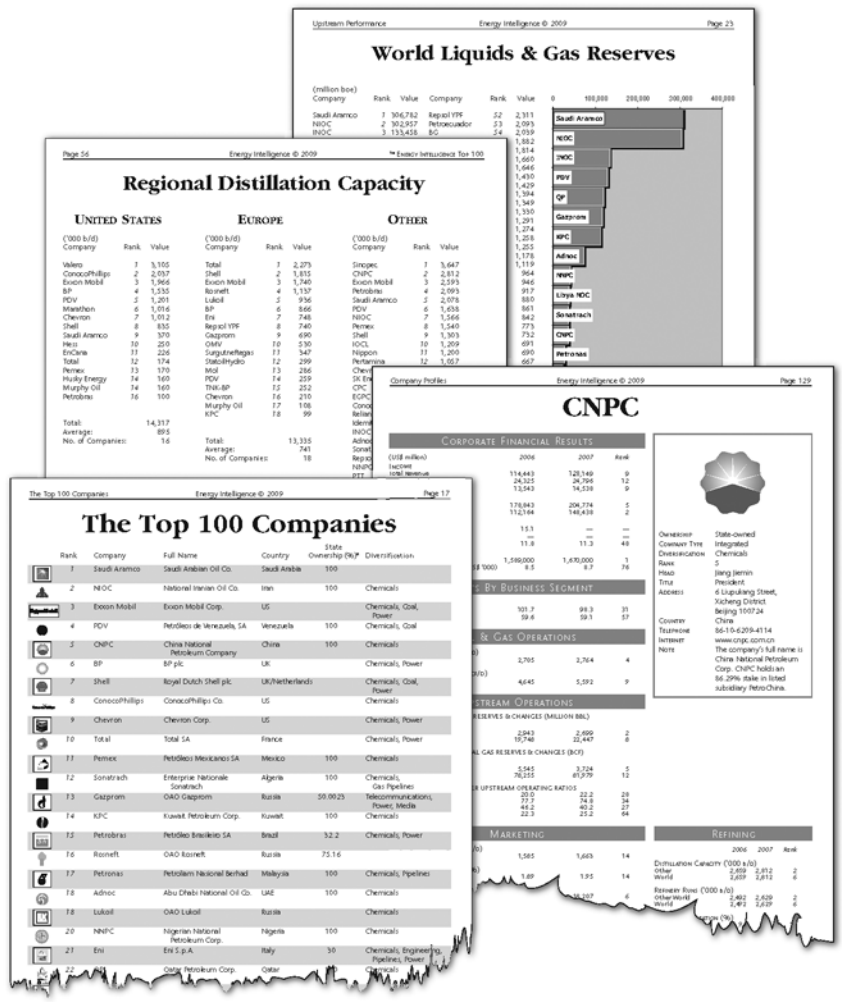

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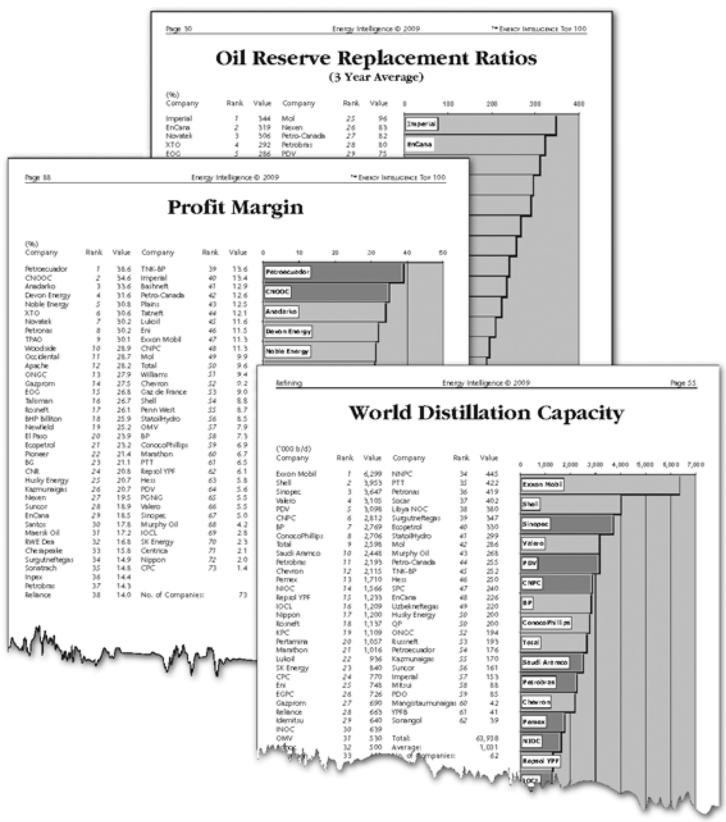

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