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Of China, Strategic Petroleum Reserves, and "them again"

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Dear Me! There has been a considerable stir in the TOD house, since CERA have just come out with a report restating their position that there is no Peak Oil Problem. For a mere $1,000 you may discover (perhaps) what is new since the last time they said this. Now we have commented about problems with the CERA position on a number of occasions (try one, two, three , four and five for a start). But since it is better to do a little checking first, it may take a little time to go through and see exactly what is different this time around, if anything.

In the meantime, the election is over, and a small, cynical, part of my mind wonders how long it will be before we start adding more oil to the Strategic Petroleum Reserve. Last year's Energy Policy Act authorized increasing the size of the reserve to 1 billion barrels. The current reserve is made up of 273.5 million bbls of sweet and 415 million bbls of sour, for a total of 688.5 million, as of November 3rd. However, over the past few months there has been very little activity. The reserve had been filled to its initial target of 700 million barrels by August 2005, but then, following Katrina there was a period where it proved its intended value:

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> On August 27, 2005, Hurricane Katrina entered the Gulf of Mexico and began a path of destruction that caused massive damage to production platforms, terminals, pipelines, and refineries in states along the U.S. Gulf Coast. Because of the severe disruption to petroleum supplies, Secretary Bodman immediately approved six requests for emergency loans of crude oil from the SPR and President Bush directed that a drawdown and sale of crude oil be conducted. Ultimately, 9.8 million barrels were loaned and 11 million barrels were sold. Because the loaned oil is repaid with similar quality oil, plus a negotiated volume of premium barrels, 10.3 million barrels were scheduled to be repaid. By late Spring 2006, repayment of 8.6 million barrels had been completed. However, delivery of the remaining 1.7 million barrels was deferred at the President's direction as part of his Four Part Plan to Confront High Gasoline Prices. The final 1.7 million barrels will be delivered during Spring 2007.

One can thus anticipate, that purchase coming in the spring. However, in the President's message in April, the deferral of purchases was meant only to be temporary.

> The President has directed the Department of Energy to defer filling the Reserve this summer. Our Strategic Reserve is sufficiently large to guard against any major supply disruption over the next few months. Deferring deposits until the fall will leave a little more oil on the market - and when supplies are tight, every little bit counts.

The example of Katrina provides a justification for the SPR's, and this has, perhaps, not been lost on the Chinese, who have suffered a more-than-normally-vicious typhoon season this past year, including Saomai and Prapiroon. They had initially planned to start filling their SPR about this time last year, but hesitated because of concerns that the price was high and that buying for the reserve would drive prices up further.

They have obviously now changed their minds, and have been buying for over a month, but the size of the reserve anticipated may now be considered too small. The current size is sufficient for about 7 days, though this is projected to increase to 10 days.

> China's first batch of the four strategic petroleum reserve bases are designed to be in Zhenhai (Ningbo of Zhejiang Province), Huangdao (Qingdao of Shandong Province), Daishan (Zhoushou of Zhejiang Province) and Dalian (Dalian of Liaoning Province). The other three reserve bases are expected to be completed by 2008. By then, they will form a total petroleum strategic reserve capacity for consumption of more than ten days.

A second set of sites is now in process of being identified.

Now that the current sites are being filled, there remains the issue of price,

> The Ministry of Commerce issued the statistics on increase of major import commodities of China in the first half. Of them, import volume of crude oil increased 15.6% year on year, and the value surged 53.9%; while import volume of oil products went up 16.1%, and the value up 71.8%. According to the latest statistics from the General Administration of Customs, the average price of import of crude oil was 452.9 US dollars/ton in the first half, up 33% year on year, and the average price of imported oil products was 423.3 US dollars/ton, up 48%.
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> As the second biggest oil consumer in the country, China's dependence on import of oil products is 40%. Prices of oil, as a basic energy, have influenced the prices of the whole industrial sector, and will finally affect the GDP growth.

But the fact that China is now pressing ahead suggests that they might be recognizing that, as the supply volumes shorten, there might not be a time when the price is cheaper than now. Their current source is apparently Russian oil, with some 3 million bbl already stored, about 10% of that available. It is expected that they will have another 4.4 million bbl in storage by mid-December. There will be additional space available in the beginning of the year.

> A second batch of tanks at China's second reserve site in Zhejiang province should be ready by the end of the year, a newspaper reported on Monday.
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> More tanks are also planned for Qingdao in Shandong province and Dalian in Liaoning province as part of a first phase of a reserve plan, due for completion in 2008, that will have a total capacity of 16.2 million cubic metres (102 million barrels) -- or about a month of imports at current rates.
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> Oil traders fear China will have to increase imports by as much as 100,000 barrels per

> day (bpd) in order to fill the reserves. That would be a relatively small volume in global terms but represent a 3.4 percent rise from current imports.

The actual rates at which the SPR is filled is giving rise to some concern. There is also some worry that the Chinese will use their reserve in a more commercial manner. But this is where my opening question regains a bit of relevance, since if the US starts to fill it's SPR at 100,000 bd, and the Chinese start filling theirs at 100,000 bd, and this is added to current incremental growth in demand, and the change in purchasing practices of those nations now in depletion, then the drivers to higher gas prices may already be falling into place.

It is also worth noting that the Chinese are getting their additional oil from Russia, and that they are paying for it from their dollar reserves. This leads on into questions about Russian exports, but that would get us into another lengthy story, that is better left to another day.

In similar fashion the CERA inability to distinguish between what they call reserves, which includes

> Those who believe a peak is imminent tend to consider only proven remaining reserves of conventional oil, which they currently estimate at about 1.2 trillion barrels. In the view of many petroleum geologists, this is a pessimistic estimate because it excludes the enormous contribution likely from probable and possible resources, those yet to be found, and plays down the importance of unconventional reserves in the Canadian oil sands, the Orinoco tar belt, oil shale and GTL projects. CERA believes the global inventory is some 4.8 trillion barrels, of which about 1.08 trillion barrels have been produced, leaving 3.72 trillion conventional and unconventional barrels, an order of magnitude that will allow productive capacity to continue to expand well into this century

and their reliance on un-named new technologies, also requires a much lengthier rebuttal - although it will largely be a repeat, as their press release and report appears to be, of ground that has been plowed before. Well, I am sure that we will return to this again, before long.