Libya, oil production, OPEC responses, Saudi Arabian capabilities and the SPR

Posted by Heading Out on February 28, 2011 - 11:16am

The impacts of the disruptions in the Middle East are now starting to become evident as supplies no longer flow into the delivery pipelines that carry fuel from countries such as Libya to their European customers. It is now considered likely that the 1.6 mbd that Libya delivers to the world market will not be available for some time. Ireland, for example, which has had other problems with the banks in the recent past, is now faced with the loss of perhaps 23% of its fuel supply, which while only 14 kbd is, for that country, likely to be very significant. For while the Libyan shortage at present may be just due to Gadhafi ordering the ports closed, if he is also ordering the destruction of facilities, as is rumored, then the consequences may be more long term. ENI has reported that the Libyan shortfall is currently 1.2 mbd.

It is in this context that the world turns to OPEC, which has stated that it has enough oil in reserve to stabilize deliveries, and looks to see a compensating production increase from those nations with that potential. And here is the rub, for some OPEC countries are themselves in a little political difficulty which might negatively impact their own production, while those that can, in the short term, increase flow volumes to match the shortfall are likely all called Saudi Arabia.

So the next questions become – first can Saudi Aramco now bring that oil to market, and then second, will they? It is actually not that simple because the oil that will be marketed is likely to be the heavier crudes that Saudi has more difficulty in selling in normal times – since the higher quality Arabian Light has an established market. As I mentioned in a post earlier all oils are not created equal, and not all refineries are set up to easily switch from light to heavy. KSA has said that they can immediately increase the output from Khurais from 1 mbd to 1.4 mbd but that, in itself, will not be enough. Bear in mind that the oil has to be not only produced, but also shipped, and so there will be an additional delay as tankers are chartered and a new delivery line is established. It might also be remembered that there is often confusion about which volumes that KSA are talking about when they mention increasing flow. If we assume total liquids, then KSA has been producing at around 10.2 mbd. They have stated that they can produce up to 12 mbd, if they are still counting oranges – this gives a cushion of around 1.8 mbd (and if some of that is really counting Manifa it is not really there). We will have to see what they have in mind.

This is the time of year when demand is normally low, as heating needs become less critical, yet it is too early for the summer driving increase. But that fall has not been as evident this year. OPEC produced at a two-year high of 29.85 mbd in January. Because of the increase in demand from China and India overall demand has been increasing, and prior to the current situation, had been anticipated to rise an additional 1.5 mbd this year.

Which brings up another concern, since much of the current debate seems to assume that the current events will have a transitory impact, but I cannot see the justification for that assumption. Were the countries involved in the position where there was a clear opposition with a history of government, then a transition might have limited impact. The problem is that in most of the countries that are now in turmoil the outgoing administrations in general were able to keep power for the decades that they did by ensuring that there was no effective opposition, or alternate ruler that could replace whoever the "Leader" was. The example of places such as Iraq shows the difficulty in establishing a functional new government and getting oil and natural gas supplies flowing at historic levels (they are almost but not yet there).

Changes in philosophy, and the need to switch to providing more to the general populace is likely to reduce funds available for continued development of oil and natural gas. This will affect much more than just the immediate oil flow from Libya. OPEC themselves currently purport not to see a problem since, by their numbers, there is more supply available (by about 700 kbd) than demand. However as the Libyan change has shown, supply to greater levels than this can go off-line relatively quickly, and probably take a lot longer to get back into production after the turmoil is over. Which is a finite period in its own right.

For the very short term the governments of Europe have pointed to their stored volumes to explain why they don't need to worry, and certainly the US has the ability to release some of the Strategic Petroleum Reserve which is currently as full as it has ever been. At what point that might become an issue is yet too early to tell, but with a growing concern that ever rising oil prices might drive the world back into a similar recession to that which followed the last visit to $147 a barrel oil, that option is likely to be increasingly considered.