

BI-WEEKLY OIL REPORT

Herodotus Antonopoulos &
Filimon Antonopoulos
Oil Market Analysts

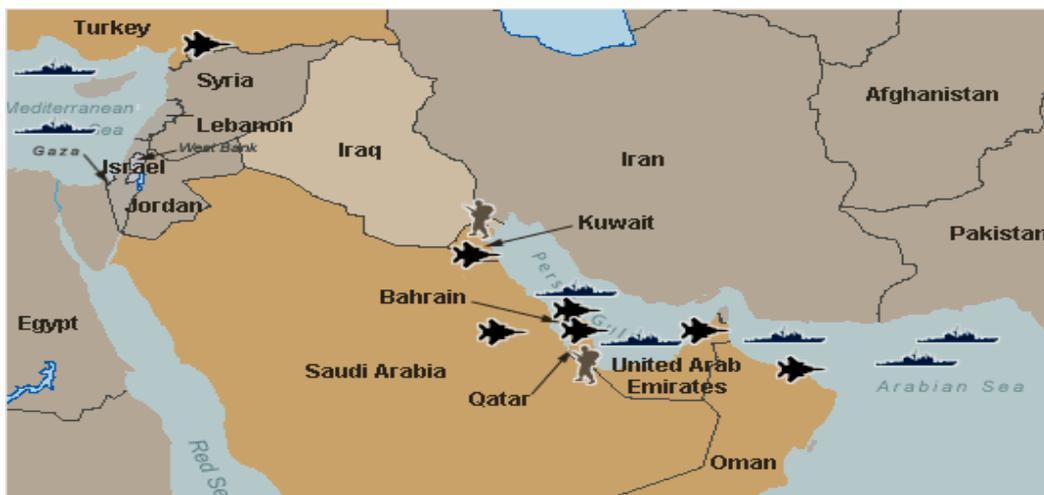
An attack from a US led coalition seems to be around the corner! The US army gave the green light for the commencement of the military operations at the discretion of their President G. W. Bush. The UN is still trying for a peaceful disarmament of Iraq. Meanwhile all oil market participants are trying to map the current situation and answer one of the most prevailing questions. How similar is the current situation with this of 1991? What are the threats and dangers that have built more than a \$5 premium in the oil price?

Clearly the success of the US led operation will not be judged so much on human casualties but rather on “oil casualties”! This view may sound cynical but the following numbers may help to better support such a statement.

In 1991 Iraqi forces were estimated to be around 450,000 troops well trained and experienced from the war against Iran. The military machine of Saddam was considered “intact” and his air-defense at excellent shape. In 1991, a coalition force of 540,000 troops against Iraq only counted 148 US soldiers dead and less than 500 wounded mainly due to accidents rather than actual combat casualties. The Iraqi army was quickly paralyzed and surrendered at first opportunity.

In 2003 the Iraqi air defense has been destroyed from more than 10 years of constant bombing from the US and UK fighters. The Iraqi military machine is aged with no opportunity -other than smuggling- to buy new weapons due to the UN imposed embargo. And the cohesion of the remaining 250,000 Iraqi troops is very fragile due to low moral and increased internal opposition against Hussein’s regime. Meanwhile the US military machine has improved rapidly the past ten years and the firepower of its new missiles and jet-fighters guarantee enemy destruction with minor casualties.

Map.1 Deployment of US led coalition forces.



It is no secret that the currently 250,000 strong coalition force is expecting minor casualties for such a large military operation. But what is the major concern of the US Operation Planners?

“Oil Casualties”

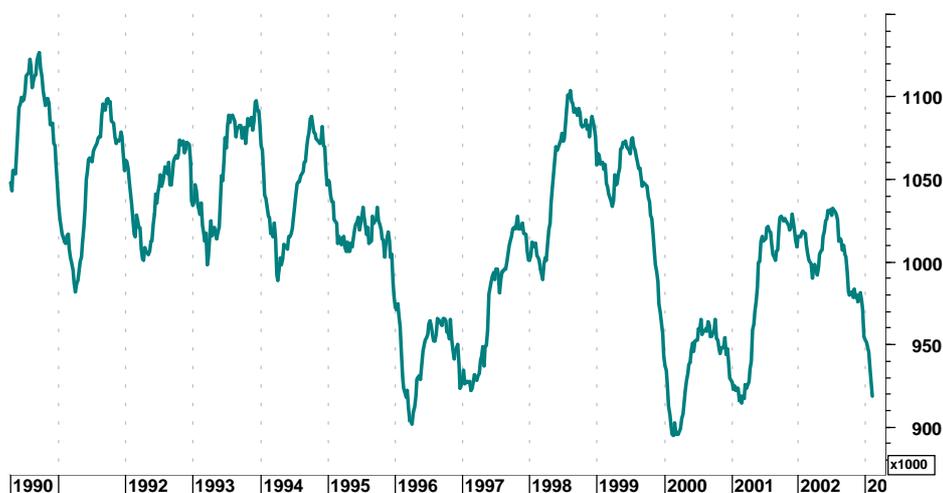
In January and February 1991 the Iraqi Army bombed more than 90% of the Kuwaiti oil wells, which leaked more than 60 million barrels of oil in the burning sand and spilled another 8 million barrels in the sea, destroying Kuwaiti’s production capacity for almost 1 year. Kuwait extinguished the last fire from the Iraqi sabotage in November 1991 and managed to return to a mere production of 400,000 bpd in January 1992!

This time there is the fear of Saddam igniting his own oil fields of 3 million barrels per day capacity of which 2.5 million barrels per day are exported. Analysts believe that if such a destruction occurs it will take more than two years for Iraq to be brought up to current output levels. 500 oil wells in the north and another 1,000 wells in the south are in danger of being blown up.

Why is the US so concerned of securing Iraqi oil fields? Is the US in 2003 more oil dependent than 1991?

As we pointed out in our previous report the inventory situation before the Gulf War in 1991 was much better than today.

Figure 2. Total US commercial inventories (million barrels)



Source: Energy Information Administration

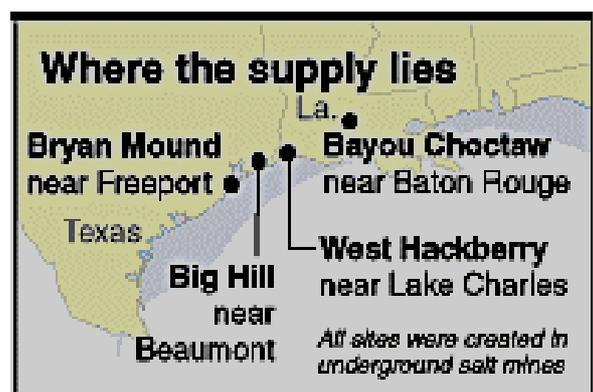
There is a differential of almost 240 million barrels between 1991 and 2003 and the US demand was averaging 16.714 mbpd in 1991 and 20.2 mbpd today! As a result in 1991 there were enough inventories for 70 days when today inventories last for only 46 days!

USA's Wild Card!

Once again USA's wild card for taming oil prices at the unfortunate event of a significant loss of oil flows is the Strategic Petroleum Reserve (SPR).

SPR was officially established in 1975 by President Ford. In April 1977 the US government acquired several "salt caverns" along the Gulf of Mexico coastline and created the SPR storage facilities with a total capacity of 700,000 million barrels. The main storage facilities are in Bryan Mound and Big Hill Texas and Bayou Choctaw and St James Terminal LA. The first crude oil was delivered into SPR on July 21 1977 at the West Hackberry storage near Lake Charles LA.

Map 3. Strategic Petroleum Reserve Location



SPR oil can enter the US market in 15 days at a maximum rate of 4.1-4.2 million barrels per day for 90 days.

It is the world's largest emergency stockpile of crude oil currently standing at 600 million barrels.

It can be used at the President's discretion to counter an oil supply interruption.

There is no preset "trigger" for withdrawing oil from the SPR. Instead, the President determines that draw-down is required by "a severe energy supply interruption or by obligations of the United States" under the International Energy Agency. The Energy Policy and Conservation Act (EPCA) – 1975- defines a "severe energy supply interruption" as one which: 1) "is, or is likely to be, of significant scope and duration, and of an emergency nature;" 2) "may cause major adverse impact on national safety or the national economy" (including an oil price spike); and 3) "results, or is likely to result, from an interruption in the supply of imported petroleum products, or from sabotage or an act of God."

An SPR release has been ordered twice so far by the former US Presidents. The first 33.75 million barrels SPR release was ordered by President G. Bush in January 16th 1991 at the launch of the US attack against Iraq. Oil prices dropped by \$9-10 per barrel in one day.

In September 22nd 2000 President Clinton ordered a 33 million barrel SPR release to bolster oil supplies in the US markets. Oil prices drop almost \$10 per barrel, the following two months.

It is therefore clear that this time "Oil Casualties" have posed a greater challenge to the heads of US Intelligence than "Human Casualties". US is about to confront Iraq at a "real military fight", the UN at a "diplomatic fight", a severe -stubborn- cold winter at an "unexpected fight" and a fragile economy that is being undermined from high oil prices, having only one "wild-card" against a severe oil supply disruption, the Strategic Petroleum Reserve.

Hopefully, the world will get out of this explosive situation gracefully without the need of emergency measures triggered from "a sabotage" or "an act of God"!... It is only 5 minutes to Midnight!

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