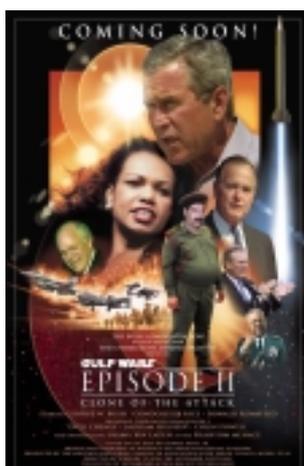


BI-WEEKLY OIL REPORT

Herodotus Antonopoulos &
Filimon Antonopoulos
Oil Market Analysts

After many months of talking and debating it seems that at last it is coming to a theater near you. As MAD magazine very cleverly put it, Gulf Wars-Episode II- is ready to be launched, despite the reactions of many critics, pointing at the poor performance of many of its main characters and a feeling that the sequel is inferior to the original. Such comments are, however, common among critics and one should not take them very seriously. If the producers are willing to go ahead, and the marketing campaign is effective, the movie could become a hit and could even be nominated for a number of academy awards !

On a more serious note, it seems that the long-expected war is nearing and one cannot avoid reflecting on the possible repercussions. The main event that took place yesterday was the report of UN weapons inspectors to the Security Council regarding the progress of the inspections. Chief Inspector Hans Blix, painted a confusing picture, stating that no smoking gun was found, but also noting that Iraq does not appear to have genuinely accepted to disarm and that is not sufficiently cooperating in certain aspects of the investigation. By making such statements, he gave fuel to the arguments of both sides. US and UK are arguing, that partial cooperation is not acceptable and clearly places Iraq in breach of the UN resolution. Those



reacting to the notion of war, including Germany, France, Canada, Arab league countries, Russia and China consider the fact that no smoking-gun was found as positive and are pushing for the continuation of inspections, at least for a few more months.

Figure 1. MAD magazine cover.

The first serious sign regarding US stance will become clear tonight, when US President Bush will give his “State of the Union” speech. It is expected that he will try once again to show that Iraq poses a threat to the world and is still dangerous. He will also try to show that the “Saddam regime” did not cooperate sufficiently with the UN inspectors and is therefore in breach of the resolution 1441. The key element in his speech will be whether or not he will show signs of willingness to give inspectors more time. If an

extension is implied in his speech today, oil prices could swiftly reverse course from recent high levels. Such an event however is not very likely to happen for a number of reasons. One main concern for the US is that by doing so, they lose face in diplomatic battle against France and Germany, setting a bad precedent and showing increased vulnerability to diplomatic pressures.

More important however is the fact that the US administration wants to be able to use the failure of full cooperation as reason for the trigger of a military operation. By giving more time to inspectors, US is effectively linking its case with the discovery of “a smoking gun” and it could get trapped in having to undertake the burden of proving that such “...guns” exist. The Bush administration has been very clear on that matter, stating that it is Iraq that has to prove it has disarmed and not vice versa. Proving that Iraq possesses weapons is a much harder task than showing that it failed to comply with resolution 1441.

We would therefore expect President Bush to reject the idea of prolonged inspections and at the same time use very strong language regarding Iraqi failure to address all UNSCOM demands. As a good-will gesture, he may decide to wait until February 14th, when the next inspection report is due, but unless something dramatic happens in the meantime, he will proceed with his military plans.

By standing firm on its intention to attack, US will pose great pressure on many of its critics. No country, especially those with direct interests in the region would want to be left out from a possible new arrangement in Iraq. Russia and France would by no means like to lose their existing contracts and leave US and UK, alone, to chose the “post Saddam” government. It is therefore very likely that they could start becoming more accommodating to US demands once they realize that a war is inevitable.

Figure 2. NYMEX crude oil futures price (\$/barrel)



Such a war scenario, however, could have less dramatic effects to world oil balances than portrayed by the media. Iraq's military machine has nothing to do with that of 1991. The destruction of a very large part of it during the war and the subsequent bombings, the lack of spare parts and the inability to purchase new weapons, at least in large quantities, diminishes the threat that it could pose to the US military machine. There is only the fear of acts of desperation (blowing up oil-fields) and the use of biological weapons that creates anxiety, but they are unlikely to occur, and in the case they do their effects will be limited and the US response will be fierce.

The most likely scenario is one in which the US prevails easily and is able to control the major cities and oil infrastructure relatively fast. Whether Saddam will be detained or not, is not easy to tell, but is of small significance to the oil markets. Such a situation will not substantially affect the world oil supply-demand balance and will lead to lower prices, even if some infrastructure damage occurs in Iraq.

Recent reports from both the US Energy Information Administration (EIA) and the Paris-based International Energy Agency (IEA) suggest that such a scenario is what most of the analysts expect.

Figure 3. EIA, IEA Supply/Demand Estimates for 2003
(million barrels/day)

EIA	Q1	Q2	Q3	Q4
Demand	78.1	75.7	77.1	78.9
Supply	76.3	77.3	78.3	79.0
Surplus/Def.	-1.8	1.5	1.2	0.1

IEA	Q1	Q2	Q3	Q4
Demand	77.8	76.3	77.8	79.6
Supply	77.8	78.8	80	80.6
Surplus/Def.	0	2.5	2.2	1

As one can see from the tables above EIA sees a possible draw-down in world inventories during the first quarter of 2003, but it expects the replenishment of stocks during the coming quarters. Overall it expects a year of a positive supply/demand balance.

IEA is even more optimistic, calling for no change in Q1 inventories and for significant builds during the remainder of the year. IEA's scenario clearly points towards much lower prices, as soon as the Iraqi situation is resolved.

As we have mentioned in the past, the only wildcard in this analysis is Venezuela. It will be very hard for oil producing countries to cover the supply gaps caused by both Venezuela and Iraq. They account for a combined 5 million barrels per day of production and their simultaneous withdrawal from the markets could cause many supply bottlenecks. It seems however that Venezuelan production is being steadily restored, and despite the fact that none of the outstanding issues has been resolved, the strike seems to be disintegrating.

The decision of the Supreme Court to cancel the February 2nd referendum dealt a big blow to the opposition. Events in the South American country will be watched with close attention as the situation could escalate rapidly. Nevertheless as long as oil operations are being restored market participants will be more optimistic.

To summarize our review of "Gulf Wars Episode II - Clone of the Attack", we must encourage everyone to watch it; not because it is a masterpiece of modern cinematography, but because it has the potential to affect our everyday lives in many different ways. What remains to be seen is under which category it will be classified. Comedy could cover many of its aspects, but one could also find many dramatic elements to it, especially if she/he considers the fate of the common Iraqi people. Regarding the rest of us, it is very likely that once again, to some, this war may look like a video-game.

Disclaimer

Information contained herein is based on data obtained from recognized statistical services, issue reports or communications, or other sources, believed to be reliable. However, such information has not been verified by **www.iraj.gr**, and **www.iraj.gr** does not make any representation as to its accuracy and completeness. Opinions, estimates and statements nonfactual in nature expressed in this research report represent the author's judgment as of the date of the report, are subject to change without notice and are provided in good faith and without legal responsibility. In addition, there may be instances when fundamental, technical and quantitative opinions, estimates and statements may not be in concert. Neither the information nor any opinion expressed shall constitute an offer to sell or a solicitation of an offer to buy any securities, shares, warrants, convertible securities, futures or options by no means.
