22 June 2004

MONTHLY OIL REPORT

Herodotus Antonopoulos & Filimon Antonopoulos
Oil Market Analysts
Equalia Asset Management Ltd

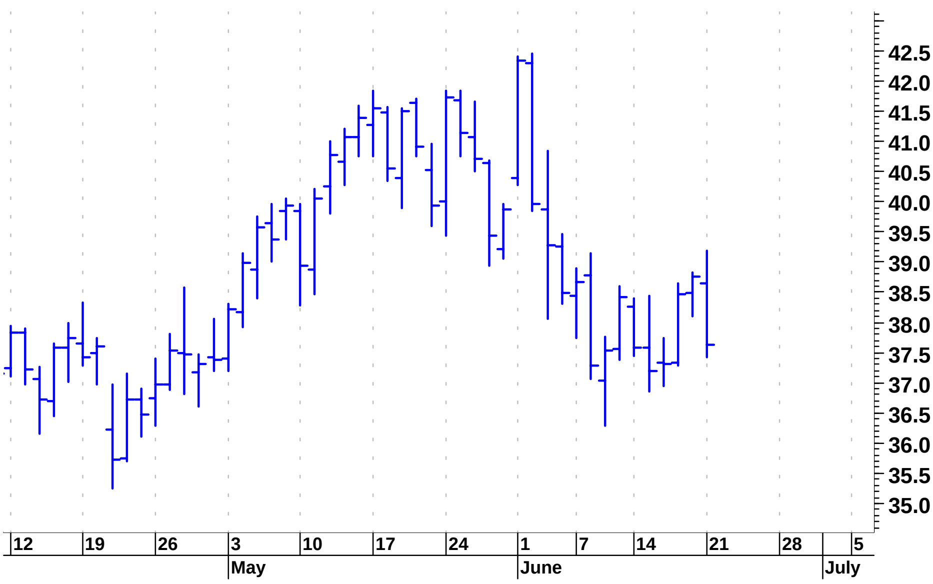
lnx@otenet.gr ; info@iraj.gr

China's appetite for oil.

In a world where tensions are escalating and the security of energy supplies is becoming the center of attention, a country that has gradually started to make its presence felt in many sectors of world trade is now considered the main determinant of future petroleum supply/demand balances. China wants its share of global resources and the western world should better pay attention!

During the past month prices showed significant strength reaching an all time high for NYMEX futures of $42.45 on June 2nd raising again serious questions regarding oil supplies to the western world. The sabotage of major Iraqi pipelines that halted almost all exports from the country for several days, oil worker strikes in Nigeria and Norway, refinery snags in the US and rising violence in the Middle East did not allow for prices to drop significantly since then.

Chart 1. WTI crude oil futures price (Daily in $/barrel)



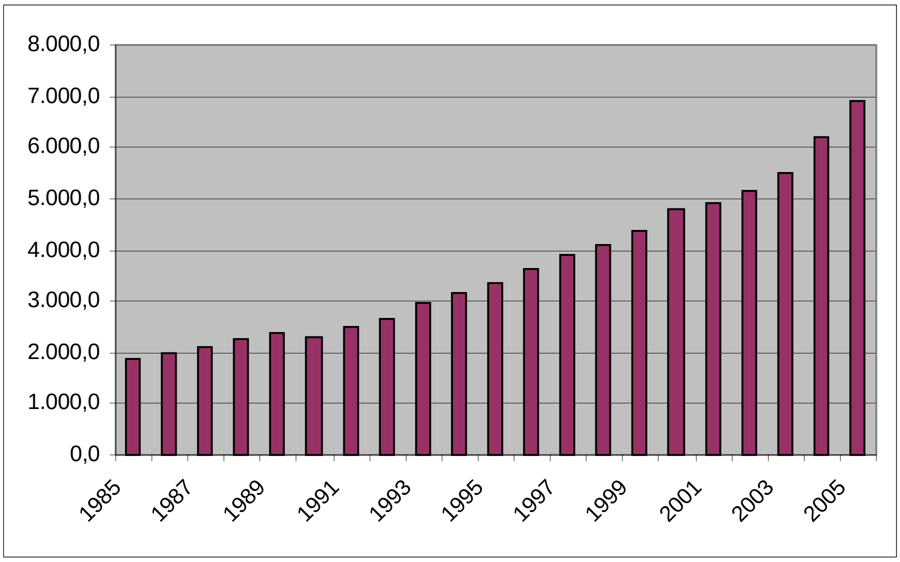
Source: NYMEX

Such steadily increasing geopolitical turmoil did not allow most analysts to focus on a rapidly rising bullish fundamental factor, the surging Chinese petroleum demand. Recent strong economic performance in the world's most populous country made it more than clear to the world that future energy balances will be mainly determined by China.

EIA expects a 1.2 million bpd growth in worldwide demand during 2004, 700,000 bpd (or 58%) of which come from China. The pace of growth is not expected to slow down significantly during the coming years, as the country's growth potential is extremely large and is hard to compare it with that of any other country.

The government's goal is to double the country's GDP, during the first decade of the 21st century, and it seems to be on target. GDP growth was 8% in 2002, 9.1% in 2003 and reached 9.8% during the first quarter of 2004. Estimates for this year call for growth to surpass the government goal of 7%.

Chart 2. Chinese petroleum demand ('000 bpd)



Source: EIA

Petroleum demand growth was even more spectacular as it is expected to reach 12.73% in 2004 and 11.3% during 2005. Its significance in the coming supply/demand balances is obvious, as it has become the largest consumer of oil in Asia and the second largest consumer in the world behind the US.

The observed growth in petroleum demand may seem impressive, but the numbers may become stunning if Chinese industry and transportation start coming closer to the standards of developed countries.

China has 4.3 million registered automobiles compared to 128.7 in the US, whereas it has 10.2 million trucks and buses compared with the 88 million in the US. US has a population of almost 300 million, whereas China has a population of 1.3 billion. Should the Chinese acquire the economic means to purchase equivalent amounts of cars with the Americans, they will need an additional 550 million private vehicles and 370 million trucks and buses.

It is unlikely that world's metal supplies can meet such demand and it is impossible for petroleum supplies to cover the fuel needs of such a gigantic vehicle fleet. While it may take a long time for the Chinese to reach the wealth status of the citizens of the US, it is clear that their energy needs will accelerate during the coming years and as Mr Klaus Toepfer, head of the UN environmental program, bluntly put it "…world can't afford rich China!" (Reuters 17/7/2003)

Even if both economic and energy demand growth slows down during the coming years, it is clear that China will become a direct competitor to the US, Japan and Europe for the world's energy resources. In a clear indication of its intentions the giant state own shipping company COSCO announced only last week that it will double its fleet's crude oil carrying capacity during the next three years from 2 million deadweight tons to 4 million. Russia who until recently had focused its efforts to provide supplies to Europe, is now seriously considering or has already started implementing various projects in order ship petroleum to Northeast Asia. The Sakhalin export terminal and pipelines with a capacity of 250-300,000 bpd, which is expected to be completed in 2005 and the proposed construction of the Angarsk (Siberia) – Daqing (China) pipeline are two of them.

There are analysts who claim that it is this huge appetite for energy and raw materials that will eventually bring the giant country down to its knees. Barging into the commodity markets in such manner will send basic material prices skyrocketing raising its production costs and harming world economic growth. This will in turn harm its export led economy as it will cause low capacity utilization of infrastructure that has been build on large credit by semi-state owned banks, leading to a major economic collapse, similar in many ways with that of its neighbor Japan.

While it is not unlikely that such a scenario could prove correct, it is very hard to make any prediction on if and -even more importantly- when it would occur. The more prominent position China takes in world political and economic life the more complicated and serious the effects of its rise or downfall will be. Whichever the case, however, one thing is for certain: the world can no longer ignore China's big appetite for commodities!