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In The Name of God

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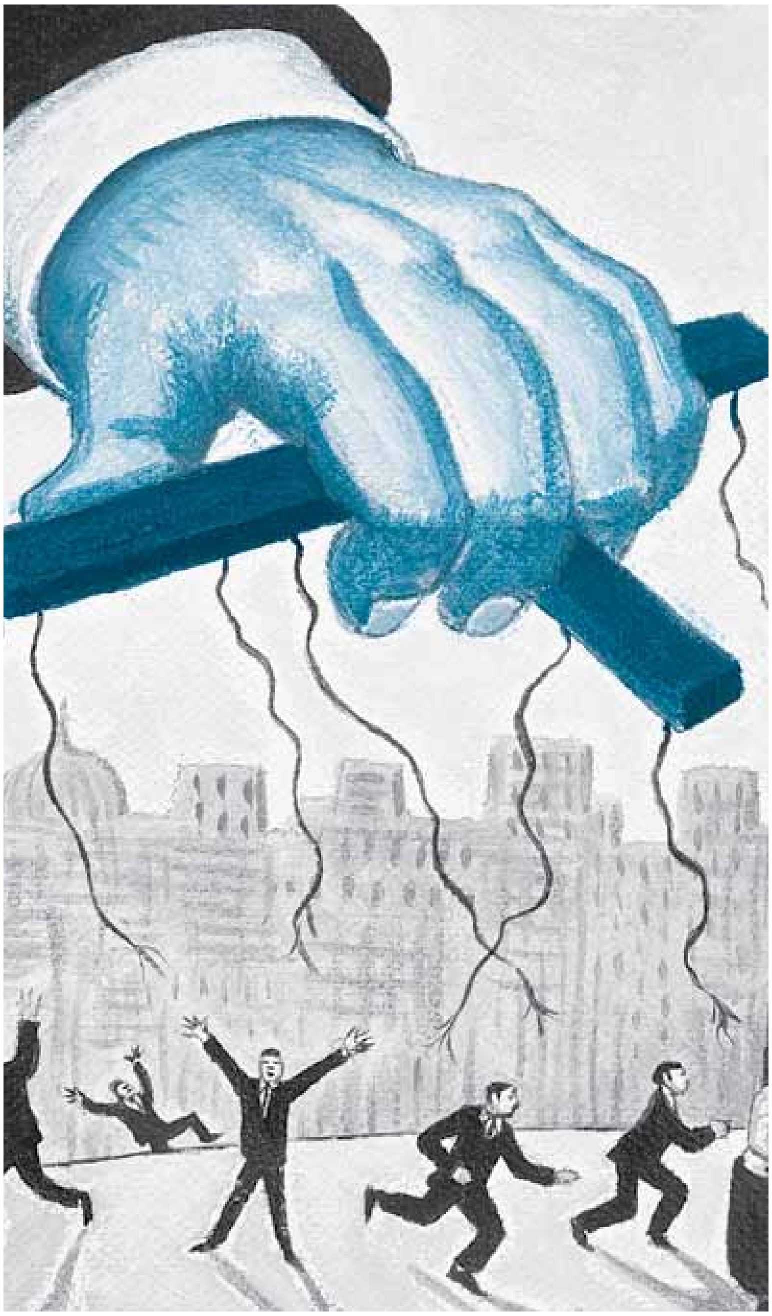
Impediments in the Way of Iran's Oil Exports to India

Are Saudis Taking Advantage of the Existing State of Affairs?



The India's inability to pay its debts to Iran for oil purchases has been the title of news in the global oil market in the past several months. Accumulation of India's oil debts to Iran has left the latter with a dilemma- whether or not oil supplies to India should be continued. Under such circumstances, the government of Saudi Arabia has given assurances to meet India's crude requirements should Iran decide to discontinue oil supplies to that nation.

The two questgions which are raised relevant to the story of India's oil purchases from Iran include; 1) why does the Indian government refuses to pay its oil debts and 2) what is the Saudi government pursuing amidst these developments?

Apparently, the Indian government has no serious intention to avoid paying for the oil it has purchased from Iran. After all, this is against reason for a nation to purchase goods and products from another nation and refuse to pay for that purchase. The restrictions and barriers set up in the way of international bank transfers to Iran should be claimed responsible for all this. The new round of sanctions which were imposed against

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Iran a few years ago and continue to be administered and pursued by the Americans, mainly target international transfer of money to and from Iran. Of the world's numerous national and international banks, only a few carry out and handle interbank transfer of huge amounts of money at international level. The era of barter business has become history and instead money is used for transaction. In the event banks refuse to transfer funds to or from any given country, the economy of that given nation will sustain a heavy blow and experience blockage. In such a case, the sanctioned country or government will no longer be able to use its export revenues nor will it be able to make payments for the goods and consignments that it purchases from outside world. Bank restrictions may not necessarily be aimed at completely blocking or paralyzing an economy. Such sanctions may just be intended to curb and control an economy. For instance, the international banking system may restrict certain payments of a nation and ease others.

During the final days of Iraq's Saddam Hosein, an economic sanction entitled "oil for food and medicine" was in force against the Iraqi government by the UN. Based on that plan, a quota had been specified that restricted Iraq's oil exports and the nation's oil revenues were transferred to the UN accounts to be spent on food and drug purchases. The sanction was intended not to allow the government of Iraq to pursue its plans and policies.

The regime of Saddam Hosein had learnt how to outmaneuver those sanctions in order to finance its plans and policies. One way to do so was underground sale of crude oil beyond quotas specified by the UN. Re-export and sale of foodstuff and medicine already imported into the country was another way. A relatively similar scheme appears to be in force against Iran, this time not through the UN but through the international banking system. Oil is supplied to world market, however, international banks refuse to transfer Iran's oil revenues. They may show more flexibility insofar as import of consumer goods is concerned but in the case of import of capital and intermediary goods, they act tougher and more restrictive. The government appears to face no impediments to import cooking oil, rice, meat and fruits but import of equipment required for the construction of various phases of South Pars field project encounters a host of road-spikes. In such a case, sanctions and bank restrictions will put a development oriented government which cares about infrastructural investments that guarantee the future of the society, into a deep trouble. However, a government that does not heed development work and just strives to meet the routine requirements of its people is unlikely to have any problem with the sanctions or banking restrictions. International banking restrictions are silent in nature and for that matter the national government considers them to be ineffective and for that matter the local public opinion is barely mobilized against sanctions and the governments which impose sanctions on them. Studies conducted inside the US on the impacts of sanctions against Iran reveal that the Americans care about the opinion of the public as an effective parameter when making decisions relevant to sanctions. Perhaps at the time when the oil for food plan was put into force against the former regime of Iraq, international bank transfer systems were not under the US control like they are today and therefore failed to monitor the Iraqi regime's bank transactions and transfers, however, modern banking technologies and procedures associated with international laws and regulations in place against money laundry as well as availability of systems and software packages that allow monitoring of international transfers facilitate precise monitoring of any such transactions by outside sources.

The Indians, South Koreans and others have made it clear that they are prepared to pay for the oil they purchase from Iran, however, currently there are no avenues available to

transfer such amounts through the inter-bank system or even if in the unlikely event such a transfer takes place the money may be blocked or frozen somewhere else. Therefore, the only available avenue is to engage in barter transactions with these states that means purchase of goods from their local markets in return for the sale of crude. Insofar as barter transaction is concerned, a market as diversified and large as China (and low-quality goods of course) may be easy to deal with and meet some of the nation's requirements, however, that is not true in the case of a restricted market like that of India. How can one justify Saudi government's approach and posturing? There already resides skepticism about validity of Saudis' claimed consistent surplus crude production ability. Despite all such claims, Saudi Arabia failed to compensate for the market crude shortage due to Libya's suspended crude production (as a result of social developments and turmoil in that country) and now the Saudis are giving assurances to India to fill their crude supply gap.

Under circumstances when Libya's crude supplies to the market have been suspended due to political developments there, and the oil market is experiencing the kind of shortage which has kept prices high quite to the dissatisfaction of consumers particularly the industrialized nations of the world, imposition of oil embargo on Iran and pushing Iran out of the international oil market is practically impossible and may jack up prices to unprecedented levels hence intensifying economic crises that are already in place in the industrialized nations. In these conditions, the best option for the states which have imposed sanctions against Iran would be to allow continued export of Iran's crude and at the same time deprive the Iranian government of having easy access to oil revenues. In case Iran's oil exports to India discontinue, the latter will have to fill the gap from a different source and that will trigger shortage of crude in the market. Therefore, the industrialized nations' best choice could be continued export of Iranian oil to India. As was mentioned earlier, under conditions when Iran's decision making system is about to review continued sales of oil to India due to the latter's huge debts, the Iranian decision makers are recommended to continue supplying oil to India because otherwise they will lose an age old traditional oil market taking into account the very fact that India recently managed to settle part of its debts to Iran. It was exactly at this hope inspiring point when the Saudi government expressed its preparedness to compensate for the gap in oil supplies to Indian market aimed at making it more difficult for the Iranian officials to come up with a decisive decision. And there was no better way the Saudi officials could serve the interests of India and the rest of oil consuming states.

Sanctions of this type may be the most effective solution for the dominant states for as long as Libya has not resumed oil supplies to the market, however, with the overthrow of another dictator in Libya, the latter's oil will gradually be supplied to the market in which case Iran will have to expect new scenarios to emerge.

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Trembling Foundations of Oil Market in 2012

The latest forecast by the secretariat of the Organization of Petroleum Exporting Countries (OPEC) reveals that in 2012, the average demand for OPEC oil shall not exceed 30.04 million barrels a day. And that suggests in case OPEC produces 30.04 million barrels of crude per day in 2012, the market will experience balance, however, in the event OPEC fails to produce this volume of crude, then oil stocks are expected to compensate for such a shortfall. Contrary to this scenario, should OPEC manage to produce crude in excess of the above figure, the surplus crude shall be pumped into stocks.

Estimates suggest that OPEC's overall production in August of 2011 (the last month in which figures are available) has reached 29.92 million barrels a day. OPEC's estimates, however, suggest that in the event the current rate of production is maintained in 2012, oil market is expected to experience a daily shortage of 120 thousand barrels of oil and the market worries will keep prices at the current strong rates. OPEC's average basket price in 2011 (prior to September 2011) stood at US$107.40 per barrel. Should the oil market come across shortage of production, depending on the volume of such a shortage, oil prices are expected to maneuver round the current rates.

Any assumption in favor of continued high production rate by OPEC in 2012 appears to be far from reality. OPEC is currently encountering agitating conditions. Due to political instabilities, Libya's crude production rate dwindled to three thousand barrels a day in August 2011 compared with 1.6 million barrels in January of the same year. Now that the opponents of the government of Libya's colonel Qadhafi have won victory in that country, Libya is expected to restore its share of oil market. In a recent analysis of Libyan oil industry, OPEC expresses optimism that resumption of crude production in the remote oil fields of Libya in the east and west of the country in the coming days is very likely and that these fields are expected to produce one million barrels of oil per day within the next six months. Central Libyan oil fields are also expected to go back into operation. The report further adds that little or no harm has been done to oil production and export installations of Libya including oil transfer pipelines and terminals and that it will not take long before the slightly damaged installations are restored. Therefore, it will be no surprise if Libya manages to produce 1.6 million barrels of crude per

day within a period of 18 months. The same report reiterates the point that there reside competent and highly skilled oil experts in Libya and in the event the new government manages to bring Libyan oil experts back together within a single organization, the nation will be able to restore its production rate of 1.6 million barrels a day way earlier than expected. Shokri Ghanem, former head of the National Libyan Oil Company announced on 23rd of August 2011 that it would take the nation 18 months before it can revive its pre-clashes period production rate of 1.6 million barrels of crude per day.

Although establishment of security in Libya will serve to be a key factor for the restoration of crude production rates, however, it was on the 25th of August 2011 when dissidents called on oil workers to return to work at oil terminals. Meantime, news agencies reported of the resumption of production of oil in Libya on 12th September 2011 and that Libya had 2 million barrels of oil available for exports. Libyan officials meantime announced that soon, more oil consignments were expected to be available for exports by early October 2011.

Amidst all these controversies, the International Energy Agency has adopted a more pessimistic approach and announced that it will take Libya two to three years before it is able to resume production of 1.6 million barrels of oil per day. The Agency has meantime stated that Libya's crude production will reach to 350 to 400 thousand barrels per

day by the end of 2011 and 1.1 million barrels by the end of 2012.

Although the Libyan national transitional council has reiterated that the nation's production of oil in September will register a record 500 thousand barrels per day and probably 1.6 million barrels within a period of one year, the International Energy Agency views this statement as ambitious. At any rate lifting of bans by the EU could release Libya's US$ 15 billion in assets and such a huge amount of financing can meet the immediate requirements of the Libyan oil industry for increasing its output.

Evidently, political tendencies as well could contribute to such remarks. OPEC secretary general, Mr. Al Badri is originally from Libya and it is likely that he is striving to portray a triumphant picture of the new government and for that matter maneuvers on the strong points and merits of the Libyan oil industry. At the same time, the International Energy Agency aims to convince OPEC not to react to Libya's joining the oil market and shows doubt about immediate production of oil by Libya and that lays the cornerstone for the Agency's pessimistic approach.

A fairy reasonable assumption is that pursuant to the establishment of security and political stability in Libya, the nation is likely to be able to have its share of the oil market by producing at least 1 million barrels of oil per day in 2012.

In addition to Libya, Iraq will as well be in a position to change equations in OPEC's output by the end of 2012.

Deputy Iraqi oil minister announced on 7th of September 2011 that his country had plans underway to increase crude production to 3.5 to 4 million barrels per day by the end of 2012. This is under circumstances when according to the latest estimates of the secondary sources, Iraq produced a daily 2.631 million barrels of oil in August 2011. Should security and political conditions be restored in Iraq, the nation plans to increase output by one to two million barrels per day in 2012.

In view of the above, one can expect that in 2012 alone two million barrels of additional oil will be supplied to the market from the side of OPEC in which case total crude output of OPEC in 2012 will exceed 31.9 million barrels a day whilst market demand for OPEC's crude during the same period of time is expected not to exceed 30.4 million barrels per day i.e. a surplus of 1.62 million barrels a day.

That is under circumstances when the economic growth of the European and American states is exposed to a fresh wave of downturn and emerging economies such as India and China have opted for contractive economic policies. This is worth mentioning that the rate of global economic growth which was assumed to stand at 3.9% at the beginning of 2011 is currently not expected to exceed 3.6%. Accordingly, during the January-September 2011 period, OPEC reduced its estimated rate of global demand growth for oil from 1.23 million barrels per day to 1.06 million barrels and at the same time reduced its already estimated demand for OPEC oil from 350 thousand barrels per day to only 170 thousand barrels.

Financial situation in the Euro zone is so critical that the ministers of finance of these states have revealed in a classified report that the Euro zone banks are exposed to a tragic debt crisis. Such a financial crisis can end up in an increase in loan costs thus restricting investment. Even the head of the World Bank has admitted that global economy has now entered a dangerous state and that the United States, Europe and Japan should make critical decisions to avoid intensification of global economic downturn which can well impact demand for oil in 2012. The likelihood exists that concurrent with the drop in demand and higher production rates by OPEC and non-OPEC states, oil prices drop further unless OPEC makes a striking decision to manage prices.

And in this manner, if no unexpected event takes place to curb flow and of course supply of oil, crude prices are expected to drop in 2012 or at least will become exposed to such a threat in which case OPEC will be left with no option other than adjusting production rates, however, OPEC's production rate in 2012 may face fundamental challenges. There is no doubt that Iraq and Libya are not enlisted as countries which should cut production. And Saudis have proved to have violated production quotas more than any other member state in the past. The question is whether Saudi Arabia will adhere to any decision by OPEC as regards production cut or not.

The response to this question will come concurrent with the emergence of the first signs of serious cuts in oil prices, for by tradition, as long as prices remain at above US$100 a barrel, OPEC members show reluctance to cut production rate.

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Kharg NGL plan picks up pace

Since the arrival of the new local partner in 'Khrag associated gas gathering and NGL project' in the Persian Gulf, its implementation has gathered speed.

According to the sources close to the project, once the new comer got involved in this project, proper amount of fund was injected into the project over the last two months which accelerated the related operational works. However, due to the fact that only a short time has passed since the new contract came into effect; it has not made any considerable progress. Its progress will be probably assessed within the next 6 months only if the current situation persists.

Presently, the new team is in talks with domestic and foreign sub-contractors of the project to reach an agreement over the terms and conditions to continue with the project implementation plan.

In October 2006, a JV of Iran International Engineering Co. (IRITEC) and IRASCO won the tender for this project on condition that its foreign financial resources to be secured by the contractor and its internal fund by the client- Iranian Offshore Oil Co. (IOOC). The project had been supposed to be completed 44 months after it started; however, it has only made over 23% progress over a year after the specified date.

Iran oil minister asks Chinese to speed up SP phase 11

Iran oil minister Rostam Qasemi demands implementation of South Pars phase 11 development project to pick up the pace so as to compensate for the delays.

According to the Naftnews website, in a meeting with a delegation from China National Petroleum Corporation (CNPC) - the buyback contractor of phase 11 - Qasemi reminded the CNPC's managers that they are behind schedule. The project, according to Qasemi, has made only 9.5% headway, while it was supposed to be 17%.

Moreover, by giving ultimatum to the Chinese, Qasemi emphasized: "Any acceleration of the project succeeds a reward. By the same token, any delay will bring up a penalty which subsequently follows new decisions."

Although two years have passed since the relevant contract was signed with CNPC to develop SP phase 11, the operation works have not started yet and CNPC has not started even site preparation for the construction of the refinery or equipped any workshops for that purpose. This company was also supposed to set up a services office in Assalouyeh, for which no action has been yet taken either.

This project consists of the construction and installation of 2 separate platforms, drilling of 24 wells, construction of two 32" pipelines and two 4.5" pipelines, and construction of a gas refinery to separate gas from gas condensate and stabilize the produced condensate.

IOOC to develop Mahshahr oilfield on Korean's delay

Following the delay of North Korea in the talks over developing Iran's Mahshahr oilfield in the north coast of the Persian Gulf, Iranian Offshore Oil Co. (IOOC) is eyeing to develop this field and bring it to its early production stage (EPS).

According to the PR office of IOOC, this company is presently busy preparing a master development plan (MDP) for EPS of this field, the production capacity of which has been estimated to be approximately 10,000 bpd of crude oil.

In early 2010, there had been some talks between Iran and N. Korea over developing Mahshahr oilfield in order to pay off their debts to Iran; however, due to N. Koreans' delay, the talks have not been yet fruitful.

3D seismic data acquisition of this field has been carried out by Oil Exploration Operations Co. (OEOC) and a well has been also drilled in the oilfield.

Mahshahr reservoir lies northwest of the Persian Gulf, 50 km off Mahshahr port and stretches from the northwest to the southeast.

Khangiran gas refinery capacity to be boosted

Shahid Hashemi Nejad (Khangiran) Gas Refining Co. in Khorasan province intends to expand the refinery and boost its gas sweetening capacity to 10 mcm/d, reported the PR office of Khangiran Gas Refining Co.

Masoud Hasani, managing director of the company stated that the refinery presently treats 50 mcm/d of sour gas at its sweetening unit, and continued: "National Iranian Gas Co. (NIGC) has given the preliminary green light to the refinery to boost its production capacity by 10 mcm/d, which upon receiving the required permission, the project will get implemented." Hasani added: "This project which is estimated to take 2 years to complete, will cost Rials 1 Bln."

Iran private sector asks to be in crude oil swap

Hamid Hosseini, head of Iranian Oil, Gas and Petrochemical Products Exporters Union, referred to the talks between the union and oil ministry over the presence of private sector in crude oil swap and said: "We hope the oil minister's support for the members of the union will pave the way for the expansion of their activities," reported the news agency of Iran oil ministry.

Hosseini added: "One of the proposals offered by the union is to put the swapped crude oil up for sale at Iran's oil bourse so that the private sector can be more active in the bourse and improve the transactions."

"There are at least 6 Iranian companies which can get involved in crude oil swap program. Iran's oil swap capacity is up to about 600,000 bpd," continued Hosseini.

Referring to the swap of oil products, Hosseini said: "The highest volume of swap is that of Fuel oil and naphtha which takes place via Iraq and Turkmenistan."

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Iraq's Kurdish Upstream

The restart of oil exports from the Kurdistan Regional Government (KRG) area has catalyzed investor interest in Iraq's Kurdish north, with a string of new deals being struck as operators prepare for first production. Exploration activity is white hot, with OMV, Western Zagros, Aspect, DNO, Gulf Keystone and US independent Hillwood International all making commercial discoveries since the beginning of the year.

Hillwood, owned by former US presidential candidate Ross Perot, is the latest company to decide to start up production, an industry source tells MEES . Its Swara Tika-1 well on the Sarsang block, which it shares with Marathon (25%) and OMV (30%), struck oil earlier this year. It will join OMV (on its Bina Bawi block), ShaMaran (Pulkhana block), Gulf Keystone (Shaikan), Afren (Bardarash), and Western Zagros at its Garmian block (formerly Kalaar Bawanoor) as KRG operators who have or are planning to put into place early production facilities of 5,000-15,000 b/d capacity. With the possible exception of Afren, all these projects, if not already in place, should be fully operational by the end of the first quarter of 2012.

DNO should expand output at Tawke to 100,000 b/d by year-end and Genel Enerji is looking to boost capacity at

Taq Taq to around 120,000 b/d by end-2011.

Output at the Khurmala Dome, operated by private Kurdish firm Kar Group, should rise from around 70,000 b/d to 160,000 b/d within the next year.

Sharjah-based Crescent Petroleum also produces around 15,000 b/d of condensate at Khor Mor.

A resolution to the KRG's long-standing oil dispute with Baghdad does not appear imminent, but the region's oil industry has acquired critical mass. Even former skeptics now find it hard to envisage Baghdad simply pulling the plug on what is a vital and growing source of federal Iraqi finance. It is noteworthy that US firm Hess, which in July announced it had won operatorship of two KRG blocks, was included in Baghdad's list of 41 pre-qualified firms for its latest bidding round.

The federal Ministry of Oil has traditionally blacklisted

firms that sign upstream deals in the KRG. To date, Gulf Keystone's Shaikan field is the stand-out success story of the KRG exploration bonanza, with gross oil in place volumes currently estimated at 4.86-10.8bn barrels.

And on 18 August, the London-based independent announced a new discovery at Shaikan, with the Shaikan-2 well testing 4,450 b/d of 36° API oil. On 10 August, Gulf Keystone said an independent preliminary evaluation put proven plus probable (P50) oil reserves on its Shaikh Adi block at 1.9bn barrels.

Further drilling has boosted reserves at Tawke, with DNO in July announcing a doubling of P50 reserves to 636mn barrels. In June, the Norwegian firm made a declaration of commerciality on its Erbil license. It estimates P50 reserves there at 136mn barrels (36mn barrels at its Benenan discovery and 100mn barrels at its Bastora discovery). A development plan is to be presented by year-end. In April it started drilling its first well, Summail-1, on its Dihok block.

The next source of KRG discovery announcements could be in the south of the region, where Western Zagros, Talisman and ShaMaran all are drilling or about to start. ShaMaran spudded a well at its Pulkhana block in April and Talisman has just started drilling at its K39 block, where a highly prospective structure is believed to be linked to Western Zagros' Kurdamir gas discovery.

One source tells MEES : "I don't think it is just gas. I think it is going to be big, really big, and there is going to be oil." On 2 August, Western Zagros announced that its Kalaar Bawanoor block, in which Talisman had a 40% stake, would be split in two, with Talisman taking over operatorship of the northern section, covering Kurdamir.

Western Zagros retains its 40% stake in Kurdamir and operatorship of the southern section, named Garmian, which contains its Sarqala-1 discovery well. Talisman has relinquished its 40% stake in Garmian, giving the KRG some fresh acreage to award. MEES understands that the reasons behind this are linked to Talisman's desire to renegotiate or reschedule a contractual payment to the KRG.

Firms that have been looking to get into the KRG upstream include: UK independent Melrose Resources; ConocoPhillips; Nigerian independent Sahara; and Oryx Petroleum, owned by Jean-Claude Gandur, who founded KRG investorAddax before it was sold to Sinopec.

Repsol-YPF, previously linked with a KRG oil investment, has now made good on its ambitions. On 28 July the Spanish firm announced it had won the Piramgrun and Qala Dze blocks, following Hess, PetroCeltic and Afren as July entrants to the KRG oil sector.

Also on 28 July, Oil Search and ShaMaran announced they were exercising their option to convert their seismic contract on the Taza block (K42) into a full blown production sharing contract