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Global Energy Wire

Iraqi oil woes

Over the past few weeks we have had an opportunity to meet in London, Washington and New York with a number of experts on Iraq, including analysts, journalists, government officials, and contractors. The composite picture for Iraqi oil production and exports that emerges from these discussions is rather pessimistic. Iraq is currently producing about 2.0-2.1mmb/d, consuming 0.4-5mmb/d for domestic use, and exporting about 1.6mmb/d. A quick oil output recovery to the 2.5-3.0mmb/d level achieved in 2000-01 (that supported exports over 2.0mmb/d) seems unlikely and the prospects for civil disorder rising.

- Virtually every barrel of oil leaving Iraq since the end of the 2003 war is being loaded at the southern port of Basrah, which appears to have reached a maximum near 1.6-1.7mmb/d.
- The Kirkuk-Ceyhan pipeline is still not operating. The poor state of the facilities appears to be at least as much of a problem as sabotage, and the timing of the restart seems to be on indefinite hold. Even if it could operate, flows above 0.5mmb/d would be unlikely.
- Iranian commandos destroyed the Gulf port loading facilities at Khor al-Amaya in November of 1980. Under the supervision of the coalition authority (CPA), work on rebuilding is underway and some 0.35-0.50mmb/d of exports could be flowing as early as March.
- The population in south Iraq is supportive toward the coalition. However, there have been indications recently that insurgents are trying to move south. If the protection of the Shia population becomes questionable, their support for the coalition could wane and southern oil facilities might then be vulnerable.
- Iraq's oil fields are in dire need of reservoir management. Ultimate recovery has been reduced with field abuse, particularly at Kirkuk in the north. Until wells have been rehabilitated and new investment takes place, it may be futile to talk about output growth as any rise to pre-invasion levels may not be sustainable.
- We expect production to rise much more slowly than does Iraq's oil ministry, to only 2.2mmb/d in Q2 and 2.4mmb/d in Q3 before reaching a pre-war 2.5mmb/d in Q4. Iraq's delayed return adds yet another bullish element to the oil price outlook.

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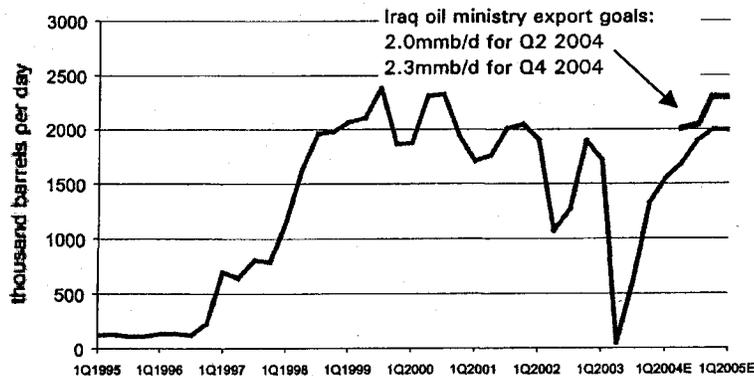
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Virtually every drop of oil leaving Iraq since the end of the 2003 war is being loaded at Port Basrah, formerly known as Mina al-Bakr. The port was renamed by the coalition authorities to strike the reference to Iraq's Baathist president, Ahmed Hasan al-Bakr, who ruled from 1968-79 and directed the nationalization of the Iraq Oil Company in 1972. Loadings at Basrah appear to have reached a maximum near 1.6-1.7mmb/d and further increases in exports are likely to require either a restart of the northern pipeline or the facilities at the second southern port of Khor al-Amaya.

Iraq's exports not expected to hit oil ministry targets



Source: IEA; Deutsche Bank estimates

Iraq's main northern oil artery, the Kirkuk-Ceyhan pipeline is not operating. Vandalism and sabotage have plagued the line. In theory, the dual pipeline could move 1.5mmb/d. In practice (with damaged pump stations and maintenance issues) the northern line never pumped much more than about 1.0mmb/d to Ceyhan and in many pre-war weeks only three or four tanker loadings there would average out to exports of about 0.5mmb/d. Security on the northern pipeline may be getting a bit better. Under Saddam, the government paid local tribes to protect the line. The original strategy of the CPA was to set up "exclusion zones" but this approach has now given way to a system of tribal-based defence that appears to be more effective. **The poor state of the facilities appears to be at least as much of a problem as sabotage,** and the timing of the restart seems to be on indefinite hold.

The Gulf port loading facilities at Khor al-Amaya, destroyed by Iranian commandos in November of 1980, are being rebuilt and some 0.35-0.50mmb/d of exports could be flowing as early as March. The population in south Iraq is supportive toward the coalition. However, there have been indications recently that insurgents are trying to move to the south. If the personal protection of the Shia population becomes questionable, their support for the coalition could wane and oil facilities could then come under attack. The situation in the south is complicated by the desire of Shia leaders for direct elections to form the replacement for the interim council by June 30. The UN is unlikely to decide in favour of elections, but the handling of this sensitive situation may be critical to the security situation.

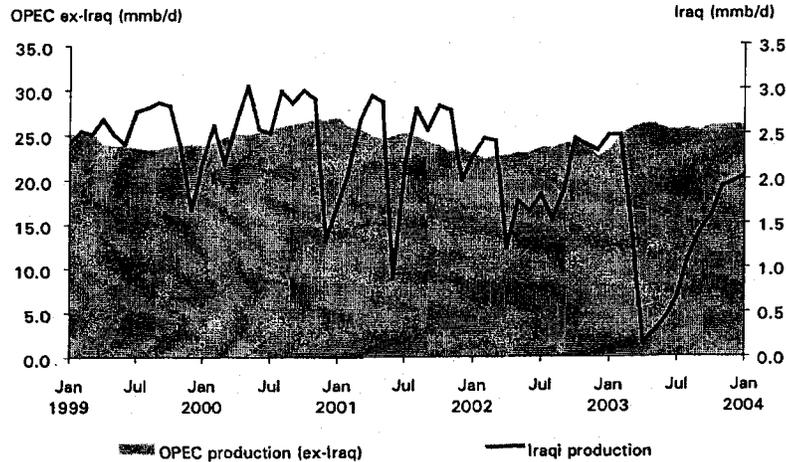
What are the threats?

The sabotage and terrorism being experienced in Iraq originate from several sources. Although much public discussion has focused on external terrorism (al-Qaeda), internal violence (Baathists, freedom fighters) are responsible for many attacks. Many of these dissidents lost relatives through friendly fire. Heavily armed coalition troops using high calibre weapons caused unintended deaths and set off cycles of revenge. Urban unrest over the lack of electricity, water, and security contributes to the unease. With insufficient controls and inspections on the Iraqi borders, we believe domestic troublemakers are undoubtedly being reinforced by radicals from abroad. Lack of organised local infrastructure and management to oversee a hand-over to a new Iraqi government, or public urban unrest following a premature coalition withdrawal could mean trouble.

Unrest is a problem not only in the north but the south as well near Basra, which British forces seemed to be successfully stabilising directly after the invasion. If the US and Britain pull back from and transfer power to Iraq on July 1, the coalition may inadvertently encourage an outcropping of local militias. These groups could terrorize the locals, often enforcing Islamic tenets. The militias in turn may compete for geographic control, and start revenge killings on former Baathists (Saddam's party) lending credence to the possibility for a civil war. Head Shia cleric Grand Ayatollah Ali Sistani's call for elections to validate the July 1 power transfer, which would assumedly lead to take-over by the Shia majority, could aggravate the violence along religious lines.

On a counter note, one consultant indicated that the duty cycles for recent CPA postings have been set at 12 months- suggesting that the CPA expects that many of its forces are going to remain in Iraq past July 1.

Iraqi production vs the rest of OPEC: Not yet back to former 1 to 10 ratio



Source: IEA; Deutsche Bank estimates

Status of the oil fields

The potential pullback of the CPA threatens to aggravate oil issues, too. Money for funding the industry has been fleeting and, when approved, inadequate. Refineries are running at 60% utilisation, products are being imported despite 350kb/d of demand (excluding military) and 700kb/d of refinery capacity. Electricity blackouts

are not likely to end for many more months. To take care of these and other problems, the oil ministry received approval from the CPA of \$1.5bn last year, but despite having conducted tenders for the work, the CPA has delayed funding.

Iraq's oil fields are in dire need of reservoir management, and well work-overs are not happening. The old reports from Saybolt (the UN-appointed firm owned by service company Core Labs to monitor Iraq's oil industry under the oil-for-food program) were once suspected of being overly pessimistic. A number of consultants now believe that the Saybolt findings were on target. Ultimate recovery has been reduced with field abuse, particularly at Kirkuk in the north. Until wells have been rehabilitated, and subsurface work has been performed in an effort to increase production, it may be futile to talk about output growth, as any rise to pre-invasion levels would not be sustainable.

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