

# Can Cambodia Become A Producer? Is This The Year of Reckoning?



Goldman Sachs Group Inc. has, in a recent report, said that oil supplies would become "critically tight" this year. Analysts of the bank predict that oil prices could go even higher as spare production capacity and inventories are "effectively exhausted." So, why not increase production, from say, Saudi Arabia?

Well, Goldman has also shared apprehension on the ability of Saudi Arabia to raise oil production in the face of eventual scarcity as it believes that Saudi Arabia won't be able to pump as much extra oil as many people believe. On a scary note, the scarcity could occur early in the year.

## First to the case of Saudi Arabia:

It's no secret that Saudi Arabia, in a desperate attempt to hold on to

power, is trying hard to win back its people. After all, the wave of massive protest for democracy did shake the Middle East. So what does it do?

Take this: King Abdullah's has announced generous subsidies to construct 500,000 houses for the poor, a friendly mortgage law for the common man to buy property, finances for infrastructure, religious organizations, and for improving the education and health system, a pay rise for workers in the public sector, unemployment benefits, and more education allowance for students.

To be sure, it also helps that the country has massive reserves for all the spending, thanks to oil. In two packages, the first announced last February for \$36 billion, and the second last March for \$94 billion,

the ruler is fighting to win back his people.

Together, the \$130 billion is equal to 30 percent of the kingdom's GDP, or revenues from oil export for eight months.

All this, the IMF predicted, would help Saudi Arabia's GDP growth by 7.5% (Since revised to 6.5 per cent). With 24.9 percent of the 1,000 billion barrels proven oil reserves of OPEC, the country has the largest oil reserves in the world and is also one of the largest producers of oil, next only to Russia.

IEA holds that Saudi Arabia is capable of producing up to 12 million barrels of oil a day, compared to nine million barrels a day in May. Early last year with tensions ranging in Libya, the

IEA's executive director, Nobuo Tanaka had said that Saudi Arabia could easily offset any shortfall in production from Libya.

With such huge reserves, Saudi Arabia, along with Kuwait, and the UAE pressed for increase in production quotas. But, countries like Libya, Algeria, Venezuela, Ecuador, Iraq, Iran, were against the move. Consequently, no decision was reached and the production quotas remained unchanged.

Of course, the last thing the Saudi government needs at this point is high inflation due to import of expensive food grain, offset by high transportation charges due to high oil prices. Some indicators to gauge the extent of price fluctuation in recent times:

The oil price hit \$101.08 (Brent crude) a barrel last February, the highest since October 2008 (In June 2008, they were jogging around \$147 a barrel). In June, 2011 they fell to \$90 a barrel amid fears of supply disruption due to the closure of Suez canal and Egypt unrest.

Hence, Saudi Arabia has, quite unilaterally, pledged to increase production, notwithstanding the OPEC decision. According to a Platt's survey, oil production from OPEC shot up by 530,000 barrels per day last June, at a total of 29.57 million barrels per day, compared to the 29.04 million b/d last May.

And guess what? Saudi Arabia's production was up by 450,000 barrels per day to reach a total of 9.5 million b/d. Kuwait, UAE too have increased production, according to the survey. And don't forget most of this increase is just enough to meet the growing demand at home.

Saudi Arabia, essentially, is putting more oil on the market to pay for generous welfare programs, basically "buying out" its population from joining in on the unrest that spread through other oil producing nations.

This is unsustainable and will accelerate well depletion. At this point, no one knows the actual reserves of the country, which is dangerous in itself.

### IEA's move

The twenty eight member IEA, announced its decision to would release oil, about 60 million barrel, from the strategic reserves last August.

This, it said, was to compensate for the loss due to the volatile situation

in Libya. It is only the third time since established in 1974 that the IEA has taken such a step.

One thing to be noted is that Libya, with less than two percent of the global oil output, isn't a huge player in the oil industry. In real terms, thus, the shortfall isn't going to make any significant changes to the oil supply.

From a short term perspective, this move would help lower the price of oil. (The news did ease the oil price, since regained.) However, in the long term, the reserves have to be replaced, and if the demand rises, this short term measure will push up oil prices.

### Demand

As a more affluent population in BRICs consumes more goods, fuel usage for transportation and farming also increases. According to a UN report last year, the world population would have reach seven billion late last year and increase to 14 billion by 2100, if left unchecked.

This doesn't necessarily abide by the math rule of 'the more people, the more pressure on the resources of the planet' theory, as people from the wealthy nations consume more, and waste more. However, what happens when the poor move higher on the economic scale.

They have every right to the resources too, don't they? Still, continued growth in BRIC countries means motorized vehicle usage will increase. IMF has, in its update of the WEO World Economic Outlook, predicts a growth rate of 7.8 percent for India, and 9.2 percent for China in 2012.. This will have a lever effect: less oil production capacity while the demand skyrockets.

According to Bureau of Economic analysis the US economy has declined by 1.8 percent in the first quarter. The latest U.S. job report showed a weak economic recovery with just 18,000 jobs created in last June, and in the revised World economic outlook, IMF has since adjusted the growth for advanced economies to 2.5 percent from 2.6 percent.

Indeed, the earthquake in Japan, the resultant disruption in the supply chain, and uncertainty with the varying pace of the economic recovery in the US economy's progress, are some of the reasons for the low demand for crude oil for the first half of 2011.

However, when US returns to faster growth, the Japanese economy bounces back, and Europe recovers

from the debt crisis and thus a global recovery, what do we have in our hands, a supply deficit for oil.

In fact, Goldman predicts that the world economy would accelerate in the second half of the year itself, increasing demand. "Prices and returns will rise further later this year," a report from the bank said, predicting that Brent crude would average at \$130 in 2012.

An EIA report estimates that the oil demand will surpass production by 1.16 million barrels per day this year. The reports also suggests that the oil demand around the world to rise by 1.6 million bbl/d in 2012, a gap of 0.5 million barrels per day (only with increased production).

The IMF, for its part, in the updated World Economic Outlook (WEO) for 2011, puts the assumed price for oil based on futures market at \$105.25 in 2012. Analyst Hussein Allidina, from Morgan Stanley, said "We remain bullish on oil, particularly in the second half, and expect inventory draws will prompt OPEC to increase production, at the expense of spare capacity".

Of course, now that we are in 2012, we'll know which of these predictions come true, though wishful thinking hopes that, somehow, we've got it all wrong. Banks are bullish, you know why. But can we sit back, wait and watch as oil prices spiral, because spare capacity was exhausted?

### Bullish indicators

At press time, sweet crude prices are creeping past \$100/bbl on the futures market and Brent crude is weighing in at just over \$111/bbl. This is a strong trend, although of indefinite duration.

Recent economic reports in the United States show that consumer spending increased for electronics, appliances, hardware, building supplies and at grocery stores, restaurants and health care stores, suggesting a healthier economy and growing energy demand.

The economies of Asia, specifically India and China, continue to expand, increasing energy demand.

In addition, the strength of the US dollar continues to fall. Since oil is priced in dollars, the less they are worth, the more it takes to buy something, including a barrel of oil.

Although the US dollar is currently trading slightly above its 200-day moving average, it has been in a steady decline since May of last year.

Current fiscal policy by the US administration and the Federal Reserve won't change that trend.

### Bearish indicators

Reports from Libya maintain that all factions, still red in tooth and claw from violent disagreements, can at least agree that it behooves them to sell oil, and that hence a supply of 1.6 MMb/d will return to the market by June of this year. This increased supply will put downward pressure on prices.

As the long-running drama of European government debt continues to unfold, we find that now even France, the Netherlands, Finland, Spain, Belgium, and Austria are at risk of rising interest rates and in danger of joining Greece and Italy in approaching unsustainable debt service costs.

If that happens, Europe could see a ripple effect of defaults or write-downs that would result in widespread recession. Analysts say that oil traders have priced in the potential for a slowdown in the euro zone.

New reserves from the shale oil and gas plays in the US are a double-edged sword. While the new sources of supply will reduce American reliance on imports – helping the US balance of payments and relieving the impact of higher energy prices on the US economy – they will have a downward influence on prices (something already occurring for gas).

Gas is expected to gradually replace oil for some energy uses, bringing further downward pressure on crude prices. There is little doubt that the shale boom in the US is significant. Anadarko Petroleum, for example, says its horizontal Niobrara program in the Wattenberg field in Colorado generates returns competitive with its best projects.

Anadarko says reserve potential in Wattenberg alone is 500 MM to 1.5 Bboe. It is the tip of a very large iceberg.

OPEC has traditionally held the trump hand on oil prices, able to increase or reduce supply when price gets out of hand in one direction or the other. It has been the strategy of oil-consuming nations for years to find sources outside the OPEC cartel and therefore more responsive to market forces.

Witness China, which, steeped in the Confucian wisdom of peering far into the future and planning accordingly, has taken E&P and purchasing positions throughout the globe in

such oil-rich environs as Brazil, Venezuela, most of West Africa, Australia, and Canada.

Leaving no stone unturned, CNOOC is even now exploring off Cuba. Even so, OPEC still controls an estimated 70% of supply, clearly enough to control prices if all the members follow policy. It is OPEC's policy to not allow oil to price itself out of the market.

### Cambodia

In the world of \$90-\$130- a-barrel oil price, oil companies have plenty of incentive to search in unusual places for the fossil fuel. Hopefully, one of the newest energy frontiers is in the clear blue waters off the coast of Cambodia will be materialized in December this year.

Among scattered, picturesque islands in the Gulf of Thailand, a consortium led by U.S. oil giant Chevron has drilled an ample number of exploratory wells 150 kilometers offshore from the tourist town of Sihanoukville. If all goes according to plan, Chevron will begin extracting oil and gas from these wells by 12th December, 2012.

Onshore, many Cambodians are watching—some hopefully, others nervously—about what oil might mean for one of the world's poorest nations. Prime Minister Hun Sen has recently called discussion about the oil finds "premature" and "speculative," and will say little about the prospects, which Chevron initially estimated at 400 million barrels.

That's not much compared to neighboring Indonesia, with 4.3 billion barrels in reserve, or Malaysia, with 3 billion. But for a poor country like Cambodia, which has precious few energy resources, it's a big deal.

How important is oil for Cambodia? The International Monetary Fund had previously in 2008) produced a "moderate economic scenario" last year that showed revenues to the government from oil could be \$174 million when Chevron's production starts in 2012, peaking at \$1.7 billion annually after 10 years (based on 2008 prices).

Of course, the size of the estimated oil reserves hardly ranks Cambodia with the big leagues. But the current picture in Cambodia is slowly changing, far from the probing eyes of one and all.

In addition to Chevron's Block A, five other blocks licensed for exploration are under various stages of exploration and the Chinese oil giant, CNOOC, has quietly recommenced work off shore, mindful of the Chinese' unquenchable thirst for energy resources from all corners of the world.

China National Offshore Oil Corporation began drilling last month on an up-to-US\$20 million exploratory oil well in Cambodia's offshore Block F oil field. The drilling is taking place 40 kms off the coast in the 7,000 square kilometre concession – awarded to the Chinese company in 2007.

