# Oil production increases amid signs of political optimism in Libya

Libya's elected parliament (there are technically two of them – the elected one operating from Tobruk and a competing one dominated by Islamist rebels in Tripoli) has a new government headed by Prime Minister al-Thani. It is a small bit of good news from Libya, which has struggled to reign in the chaos resulting from the end of the Qadhafi regime in 2011. The new government will have to confront the continuous clashes and violence but it will also ease the current oil export conditions, as the National Oil Company will resume its role as the sole legitimate oil trading agency. Meanwhile, in New York, on the sidelines of the UN summit, the General Assembly reiterated that there can be no "military solution" to the crisis in Libya, demanding an "immediate ceasefire".

The successful formation of a new government, after an initial rejection, has raised optimism that institutional progress is possible and that dialogue to reach a political solution acceptable to all parties, or by all the tribes, is possible (if not probable in the short term). The most desirable outcome, under the present circumstances, is for the Libyan leadership to be able to find a peaceful solution that would allow a ceasefire and then the disarmament of militias and jihadist groups. In order for such a process to even begin, over the next few weeks, the official Parliament will have to absorb the old Parliament (heavily influenced by Qatar) in order to strengthen the institutions. It will not be easy and the chances of such a process succeeding will be tested next week.

The clash between Islamist militias and the "nationalists"

(the more secular and ‘West’ friendly groups) in Libya has shifted in favor of the latter thanks to the intervention of ethnic guerrillas from the Tubu tribe in the oil rich region of Kufra in the south. The Tubu have fought alongside the “Operation Dignity” forces, led by General Khakifa Haftar, as part of the effort to challenge the Ansar al-Sharia and other Islamist formations which have taken up strong positions in Benghazi, the regional capital. The Tubu’s intervention is very important for Libya’s oil production prospects as this tribe, rather discriminated during the Qadhafi years, controls an area which produces 65% of the country’s oil. The Tuareg tribes present in southern Libya also control some important oil fields, such as those of Murzuq and Ghadames. The Tuareg have maintained their neutrality in the ongoing civil war in Libya Despite efforts from the “Operation Libya Dawn” group, the Islamist coalition that has taken control of much of Tripoli, Libya’s capital, to the contrary. Many of Libya’s neighbors fear that finally Islamist groups who control Benghazi could proclaim a caliphate in imitation of what has happened northern Iraq and northern Nigeria (and Mali in 2012).

Libya needs stability in order to increase oil production, not to mention exploration, which has dropped to less than half the last levels recorded before the start of the civil war in 2011. There are still international oil companies operating in Libya, and even though most of them have sent their staff home, they have maintained a ‘wait and see’ attitude rather than outright abandonment. The oil companies with significant operations in Libya can be divided into two categories: those with sufficiently important stakes, forcing them to endure the political/anarchy crisis and those which could not sell their operations fast enough. Italy’s Eni is the largest foreign investor in Libya’s oil sector (planned investments of about USD$ 8 billion over the next decade and Eni also operates the Greenstream pipeline line in western Libya that supplies gas to the Italian mainland).

Eni has not left and it is still producing at its key oil fields around Wafa in the southwest, which also supplies gas to the Green Stream pipeline and the 130,000 bpd Elephant field, which has recently resumed production. There is no risk of Eni leaving, considering that its Libyan oil & gas portfolio accounts for some 16% of the Company's total production. Similarly, Spain's Repsol has large enough ties with Libya that it cannot walk away despite the threat of another civil war. Repsol owns 10% of the el-Sharara field runs the El-Sharara field, which has interrupted and resumed activity various times during the past summer. The oil field is capable of delivering 150,000 bpd at the beginning of this year. Repsol has a 10% of El Sharara while the Austrian OMV, which has a market share of 7.5% in the sector, Libyan production is worth 10% of its nearly 300,000 barrels of oil equivalent per day.

The situation is different for oil companies from the United States (which acquired oil rights in Libya starting in 2004 at a high price) such as Hess, Marathon Oil and ConocoPhillips, all of which have investments they would prefer selling now – perhaps to Russian or Chinese companies. Meanwhile, the price of oil in New York ended lower Monday, in a market fearing over-production and an abundance of supply. A barrel of "light sweet crude" (WTI) for delivery in October, which was the last trading day fell to USD$ 91.52 dollars/barrel on the New York Mercantile Exchange (Nymex). In London, the Brent barrel of North Sea crude for delivery in November stood at USD$ 96.97/barrel, down 1.42 dollars compared with Friday's close. Libya's higher production potential has added to fears of lower demand from China, as investors worried that Beijing has done too little to stimulate the economy and also considering that it is the second largest oil consumer. Oil supplies from non-OPEC producers – including the United States – have been putting downward pressure on prices.

The United States produced an average 8.6 million barrels per

day in August, their highest monthly production since July 1986 and plan of achieving 9.5 MBD in 2015 – which would be the highest level since 1970. The Secretary General of OPEC, Abdullah El-Badri, spoke of a possible decline in year-end supplies, prompting a brief rebound in crude prices last week but news that Libya would resume production at its Sharara field by up to 250,000 barrels per day have added to the 'sell' pressure. It remains to be seen for how long the predictions about Libya's oil production prospects continue. The situation, while apparently improving, remains volatile as the militias have not agreed to any of the proposed compromises yet.

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# The EU risks a very frosty winter as tensions in Ukraine rise

Oil prices rose again in Asia because of the crisis in Ukraine, where fighting between government forces with pro-Russian rebels have left dozens dead in the east, which is a key transit route for gas. A barrel of 'sweet light crude' (WTI) for July delivery gained 7 cents to reach USD$ 104.18 a barrel while the Brent price hit USD$ 110.3. The increases were prompted by the tensions in Donetsk following the results of Sunday's presidential election, won by candy magnate Petro Poroshenko. Donetsk is the bastion of Ukraine's pro-Russian population, resulting in dozens of dead combatants on both side and two civilians between Monday and Tuesday. Poroshenko has dismissed plans to visit Moscow to discuss the standoff with President Vladimir Putin, who, in turn called for an end to the government forces' 'punitive' operation in the East.

The situation in Ukraine has added to the oil and gas risk resulting from recent developments in Libya, where there is a high risk of a resumption of fighting on a large scale. The oil and gas markets are reacting to concerns that a prolonged civil war in Ukraine, a transit country for Russian gas exported to Europe, disrupting exports and causing a surge in energy prices. The crisis in Ukraine has served as a reminder of the extent to which the European Union, where many of its member States are struggling to recover from recession, relies on Russian gas for survival: over 50 % of needs.

Today, the European Commission, therefore, presented a new strategy for energy security, aimed at diversifying sources of external energy supply, modernizing the energy infrastructure and stimulating savings in energy consumption. Of these, however, diversification will be the main target.  The EU plans to accelerate the diversification of external energy suppliers, especially for gas. Russia supplies 39% of the gas consumed in the EU, Norway 33% and the remaining 22% is imported 22 from North Africa (Algeria and Libya – which is wrought with its own supply risks. The EU could seek new supply routes, for example in the basin of the Caspian Sea, through the extension of the Southern Gas Corridor, the development of Mediterranean gas hub and more LNG supply sources.

The EU also plans to strengthen its energy independence through renewable energy and fossil fuels. Energy efficiency should be strengthened. However, the EU has little time and it must find short term as well as long term solutions. In the short term, the EU will have to carry out comprehensive risk assessments ahead of next winter in order to anticipate and provide mechanisms for relief, given that the scale of the tensions in Ukraine and Libya are more likely to intensify than to resolve. The EU may consider such options as increasing gas stocks this summer, reduce demand through the use of alternative fuels (a return to coal or nuclear in

Germany…?), or releasing some of the current emergency stocks.

The energy risk emanating from Ukraine to Western Europe is high. Should, Russia shut off the gas taps to Europe, due to its concerns in Ukraine – especially concerns that Ukraine will be offered a fast track into NATO – almost the whole of the EU, except the Iberian Peninsula and the South of France (which is supplied from Algeria), would be affected in a direct way. Europe risks a very frosty winter 2014-2015, especially South-Eastern Europe where over 60-80% of gas supplies are Russian. Former Soviet Republics or Warsaw pact members – and current NATO and EU members – such as Poland and Romania may need to compensate as much as an 80% supply disruption.

Adding 'fuel to the fire', Gazprom President Alexei Miller has insinuated that China and other Asian countries are willing to pay a higher price for Russian liquefied natural gas, meaning that Europeans will have to adapt if they want to keep their LNG terminals full. Gazprom plans to squeeze every possible dollar out of the crisis in Ukraine, which has been exacerbated by Sunday's elections – despite the defeat of the extreme right. Miller suggested that the significant differences in tariffs gas between Europe and the Asian markets has resulted in a shift of gas originally destined for EU export to be shifted toward the Asian market. Miller's statements were delivered in a delicate geopolitical context; however, his warnings have some 'bite' because Gazprom and China's CNPC have just signed a thirty year LNG supply deal that will surely herald a competition for Russian gas between China and the EU, which will ultimately have an impact on gas supplies in Europe. The suggestion, from the White House, that the US will be able to compensate for the loss of Russian gas remains rather fanciful, which further strengthens Moscow's stance.

# Libyan unrest will force oil prices higher

Industrialized countries may be faced with the prospect of a shrinking oil supply and higher prices in the second half of the year unless a solution is found to increase production due to higher than expected demand. OPEC controls about 40% of world oil reserves and includes members such as Libya and Iraq, which have struggled to maintain their export output due to severe domestic instability and intensifiying political unrest in some non-OPEC countries such as Colombia and South Sudan, not to mention the tensions between Russia and Ukraine that had already served to raise oil prices in recent weeks. Chinese demand, despite rumors of a slowing economy, is having a significant impact on demand as imports have reached record levels of 6.8 million barrels a day (bpd) last April. China has actually been increasing strategic oil reserves and refining capacity as two new giant facilities have been built.

Brent crude actually shot up to above USD$ 109 in London in response to the rising uncertainty in Libya, where crude oil production has fallen to about 210,000 barrels per day, well below the pre-crisis levels of 1.4 million barrels, with the deposits of the western regions that remain idle. The resumption of heavy fighting using artillery and aircraft around the area of Benghazi is to blame. Indeed, the exacerbation of Libyan unrest and the prospect of a potential return of military dictatorship have effectively eroded any hope that the post-Qadhafi government, might yet survive much longer. The Libyan situation is made all the worse by the fact that the clashes in Tripoli and Benghazi have been far more complex than simply those between the good – non- Islamists – and the bad – the Islamists. The main rivalry is between the

militias of the town of Zintan, who backed former Prime Minister Mahmoud Jibril – and then the anti-Islamist component of the National Congress general (GNC) – and the militia that prevails in the city of Misrata, in turn, generally associated with the political forces closer to the Islamist component.

The rivalry between these two groups dates back to the times of the revolution against the Qadhafi regime and all attempts so far exercised by politicians to find an agreement between these two actors have failed. Libya has also endured the collapse of public order and especially in the oil rich east of the country, where the weak security forces of the Libyan state have been repeatedly attacked by groups ranging from the simple to the more structured criminal organizations jihadist cells. In the past year, armed groups have occupied and blocked production at all major oil fields in eastern Libya, contributing to the paralysis of the State. It is against this sorted background that emerges General Khalifah Haftar. The man who could attempt to defeat the majority of the militias to form a military government, restoring order and stability. Haftar is controversial due to his role in the coup led by Qadhafi against King Idris in 1969 and his odd alliance with the CIA after a failed military mission in Chad, where he was a unit commander, in 1986.

Gen. Haftar and secular militias in the western part of Libya, Zintan, were very displeased by the appointment for new prime minister, Ahmed Maiteeq, whose ties – or alleged ties – to the pro-islamist parliament made him intolerable. Haftar is not alone in his battle against the Islamists and the government. The berber militias of Zintan, Saif al-Islam would be directly responsible for the attack on the Parliament. The government, while being unable to do anything, accused Haftar of wanting to stage a coup.

In the face of all this we can say that the already dramatic situation in Libya has worsened to the point where no return to stability is likely without radical changes of the status

quo. A federal option was on the table a few months ago but this would still need a strong central government to implement. Moreover, since Qadhafi's demise, Libya has experienced a vast gap between poor and rich. The combination of tribal, religious and wealth struggles suggests that the situation is not likely to improve in the short term. In oil terms, after the first armed clashes of last week, mostly concentrated in Benghazi, the price of oil has increased by about USD$ 0.30 in a few hours, demonstrating the importance of Libyan production to the world market. Consequently, a new intensification of the Libyan conflict – unless resolved quickly and in such a way as to ensure stability rather than the more idealistic 'democracy' could damage the international oil market in general.