AL MAJAL

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AL MAJAL OIL & GAS ROUNDUP

IN COLLABORATION WITH QAMAR ENERGY

Latest in the Iraqi & Global Energy Markets

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Oil Demand in the Middle East

Iraq's January oil demand remained virtually unchanged m-o-m from December 2023 at 872 kb/d, but still 6% higher than December 2022, indicative of an overall improved economy, requiring higher volumes of road fuels, primarily gasoline and diesel, although crude burn to meet power needs was down due to seasonal patterns (Iraq uses fuel oil, some crude oil and diesel for power, especially in the summer months). The start-up of the 140 kb/d Karbala Refinery last year, as well as the recent completion of a 70 kb/d expansion at the Shuaiba Refinery have contributed to reduced oil products' imports, although continued "technical" challenges at Karbala mean the refinery is still running below design capacity.

For the other major Middle East economies, oil demand declined slightly in January, as cooler weather and rainfall reduced power demand, especially for cooling needs. The start-up of the Al Zour LNG Terminal in 2021 in Kuwait has already cut the amount of crude oil the country uses to meet its peak summer demand.

Positive economic activity, led by higher manufacturing and construction activity, indicated by strong composite PMIs, primarily in the UAE and Saudi Arabia, and more air travel, are forecast to keep the region's annual demand elevated vis-à-vis 2023 and 2022. We expect 2024 demand from the region to average 4.6 Mb/d, 4% higher than 2023 figures, and 7% higher than 2022. Transportation fuels will also contribute to demand growth.

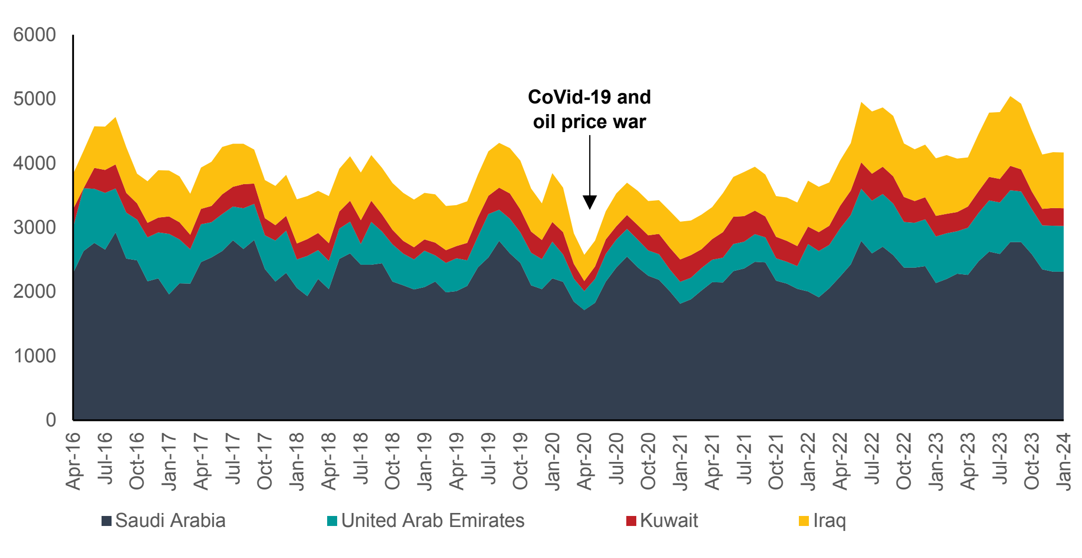


Figure 1 Oil Demand of Major Middle East Economies, kb/d

Iraq's Oil Production and Exports

The Iraq-Turkey pipeline (ITP) remained offline for the tenth month straight, although a decline in **Iraq's January exports of 147 kb/d from December to bring total oil sales to 3.34 Mb/d,** is being attributed to rough weather and maintenance at state-oil fields, as well as Iraq's new OPEC+ quota (which has been brought down to 4 Mb/d of production till March 2024 from the previous 4.22 Mb/d). Despite production breaching the quota limit in January, exports were down, due to higher offtake from domestic refineries (including the recently concluded 70 kb/d expansion at the Shuaiba refinery) and oil product exports.

Undercompliance with its OPEC+ quota is not unusual for Iraq, who typically tasks state-run fields to bear the brunt of cuts, while IOC-operated fields continue producing and in many cases expanding. There has also been a slight uptick in KRI-controlled fields, where DNO has returned production from its Tawke field back to pre-ITP shutdown levels of 80 kb/d, which is being routed to domestic market sales at extremely discounted prices of US$ 30-35/b.

Production in January averaged 4.2 Mb/d, ~0.2 Mb/d higher than its OPEC quota, mainly due to KRI production recovering to >50% of its capacity since August 2023, but still lower than December's production levels of 4.3 Mb/d, due to lower consumption requirements overall that allowed for older federally controlled fields to enter maintenance. Most of the KRI's 14 producing fields are now operational again, although the reduced output is being sold in the domestic market at substantial discounts. Current production is just above 0.2 Mb/d, well below the February 2023 average of 0.43 Mb/d, the last full month of production before the ITP's closure.

So far the continued shutdown of half of the KRI's production capacity has allowed Federal Iraq to sustain higher output levels to adhere to Iraq's previous 4.2 Mb/d quota, but with Iraq now committing to a quota of 3.99 Mb/d till March 2024, higher undercompliance could return. Conversely, the lower quota could spell additional difficulties for the KRI in resolving the issues that are keeping its exports offline, as the quota would appear to reduce the sense of urgency in Baghdad to reinstate pipeline flows via Turkey, since offline volumes would allow it to maintain a high enough compliance without compromising on output from its strategic southern fields. Federal Iraq has already "promised" to make up for its previous compliance transgressions over the next couple of months, which might not bode well for a resumption of northern exports. On the other hand, Baghdad is likely incurring substantial penalties to Turkey for not shipping committed volumes of oil through the ITP.

Figure 2 Federal Iraq production vs capacity, kb/d

Revenues from January exports clocked in at US$ 8 B, down almost US$275 M from December 2023, as prices softened to US$ 74/b, due to slowing demand in major world economies such as China and weakerthan-expected economic indicators in other emerging regions. Federal Iraq typically prices its crude to international markets at a 3-5% discount to Brent. Current international oil prices are hovering around US$ 82/b, which should also be reflected in pricing for February-loading cargoes. Exports are expected to continue flowing solely from the Basra Gulf for the next 3 months, till a definitive decision on the resumption of the ITP is reached.

This raises concerns over Iraq's ability to maintain its southern export infrastructure's maximum sustainable capacity or risk bottlenecks that could shrink valuable export flows.

If the ITP does resume operations, Iraq might face a challenge in balancing its commitments to the OPEC+ coalition, forcing it to either reduce federal production, or exceed quota limits, potentially dampening global oil prices, which could impact the revenues coming into the country.

Figure 3 Iraq production vs exports, kb/d

Iraq's Oil & Gas Developments

Could the Nassiriya Integrated Project Finally Take Off in 2024 under Gazprom?

A combined upstream development and refinery deal for the Nassiriya oilfield currently operated by state-owned Dhi Qar Oil Company (DQOC) might be on the brink of take off with talks between the Ministry of Oil and Russia's Gazprom "advancing" beyond initial EOIs after the Iraqi Cabinet granted an exemption to the Ministry from regulations that would typically require a competitive bidding process for the project.
Gazprom had expressed notional interest in the integrated project, although it has been showing preference for a wider scope than the one currently proposed by the Ministry, including the comprehensive development of the Nassiriya oil field, as well as other value-added projects for Dhi Qar, including refining, petrochemicals, downstreamgas monetisation, and a new power plant.

At the moment, the Ministry is seeking the development of the Nassiriya oil field and the development of a refinery with a capacity of 100-150 kb/d. So far both parties have met only once, after the Ministry received the heads-up from the Cabinet to negotiate on a single-bid basis with Gazprom, meaning that the complete scope, commercial terms, and economic model for the project are yet to be decided.

The Nassiriya Integrated Project was first proposed in 2011 as a solution to Iraq's inability to close large greenfield refinery deals, but failed to move past the initial EOIs and MoUs due to would-be investors universally failing to find solid sources of international financing, thanks to the country's uncertain commercial framework for downstream investments.

The offering of the Nassiriya oilfield as collateral against the development of the refinery was done due to the more secure economics of upstream development contracts, with the field proposed to reach 300 kb/d, although this was never formally sanctioned. For one, the 300 kb/d field would have to be paired with a 300 kb/d refinery, which made project costs prohibitive, as in the case of PetroChina and CNOOC's offer for the project in 2017, where they projected total costs to be about US$ 9 B.

The project size was scaled down in 2018 to reduce costs, and attracted interest from smaller Western players like Pacific Future Energy, but since the deal was awarded during a period of caretaker governance, it did not move forward under the new administration, who wanted to strike a deal with a bigger group. Chevron signed a non-binding letter of cooperation with DQOC the same year to conduct studies of its state-run fields, but this never came to pass, even after the Ministry signed a separate MoU with Chevron for the creation of a joint venture with DQOC and the state-run Oil Exploration Company (OEC) for exploration in Dhi Qar, in which Nassiriya would also be included.

The Ministry's push for Chevron was understandable, due to its large financial resources, reputation, and the potential to help develop the technical capacity of Iraq's state-run companies that would join the development consortium. Yet disagreements on which fields would be developed stalled progress, eventually resulting in Chevron disengaging from talks.

Engaging with Gazprom on the project might be a tactic to reinvigorate discussions with Chevron, although the likelihood of Chevron returning to the negotiating table appear slim for the time being, due to the major's overall portfolio shift towards other assets with relatively shorter lead times, such as in the Mediterranean, US Permian Basin and Guyana.

Although Nassiriya may not be developed to the previously-proposed 300 kb/d, the project remains an important precursor to the development of an integrated downstream sector in Iraq. Signing off on it would lend confidence to future investors as well as existing partners in Iraq's upstream sector, who have not really been involved in the development of its refineries. Iraq has long been seeking self-sufficiency in oil products to reduce the burden on its government coffers from costly oil product imports, which the Karbala refinery and recent expansion of the Shuaiba refinery have somewhat alleviated, but continue to run below capacity.

A Fixed OSP Reimbursement Deal Might be the Answer to Resolving Baghdad-Erbil Misgivings

Federal Iraq and the KRI are currently discussing a deal that would see the KRI being reimbursed with a fixed amount selling price for all crude produced in Kurdistan, moving closer to resolving a political dispute that has kept 450 kb/d of crude exports off the international market for almost a year. Preliminary estimates for the amount that will be reimbursed to Kurdistan are around US$ 21/b for all crude oil produced, although details of how this mechanism would exactly work are yet to be broken down.

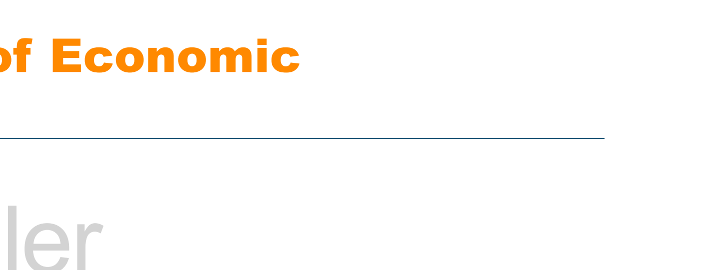
Industry players are regarding the fixed fee reimbursement to be "problematic", as it "doesn't adjust for changes in oil market prices and is inconsistent with the manner [in which] IOCs are reimbursed in federal Iraq or around the world". More importantly, it might fail to provide IOCs with the confidence that their contractual right to recover costs and receive profit payments would be upheld.

The federal government had previously allocated a US$ 6/b oil production cost in the national budget, which is far too little to account for the production costs of Kurdish fields, for which Erbil wants Baghdad to pay around US$ 30/b, similar to what it pays for its northern field Qayyarah. IOCs currently operating in Erbil have confirmed that the US$ 6/b production cost determined by Baghdad is much too low, and would not allow them to cover even basic operating costs.

For its part, Baghdad has taken the feedback in its stride, with recent reports indicating that the government realises "something needs to be done" due to the cost of production in Kurdistan being much higher than in southern Iraq. Although it is not clear whether Kurdistan will agree to the US$ 21/b fee just yet, the development highlights improving relations between both sides, which might have indirectly been influenced by a rare show of unity against Iran's missile and drone strikes on Iraqi Kurdistan in recent weeks.

For Kurdistan, any deal where it can secure a reimbursement fee above US$ 25/b would be ideal, as that would almost entirely remove its burden of paying IOCs, allowing it to focus on returns from other sectors of the economy, although these are miniscule compared to what it earned up to February 2023 from its independent oil exports. The arrangement also does not clarify how the budget transfers would work if the fee were agreed to, and if the reimbursement is contingent on IOCs in Kurdistan moving from production sharing contracts to the profit sharing model of federal Iraq.

TOP ENERGY DEALS IN THE MENA REGION



Project
Abu Dhabi Renewable Energy Industrial Complex

Client / Buyer
Abu Dhabi Department of Economic Development

Contractor / Seller
HYCAP Group

Implications

- Abu Dhabi's Department of Economic Development (ADDED) and HYCAP Group, a net-zero asset management company, have partnered to develop the production, storage, and transport of green hydrogen, spearheading the transition to net-zero in line with the UAE Net Zero Strategy 2050 and the National Hydrogen Strategy
- As part of the agreement, an industrial complex will be established in Abu Dhabi and will include an electrolysis plant, a hydrogen storage facility, and hydrogen tankers for transportation, contributing to the development of the value chain, including electrolyser manufacturing, electrical charging manufacturing, fuel cell manufacturing, as well as bus and truck manufacturing facilities
- The project will help align supply and demand for hydrogen locally, and scale up to create a viable proposition for export sales growth
- As part of its National Hydrogen Strategy, the UAE is targeting both exports and domestic offtake as strategic considerations, with recent reports suggesting a larger role for the low-carbon fuel domestically, due to the UAE's existing large-scale sophisticated infrastructure that can be more readily retrofitted to carry hydrogen and its derivatives, rather than wait on offtake commitments from foreign partners to kick-start large-scale exports, many of whom have been slower moving than expected to commit to project volumes

Project
Iraq South Refineries Green Hydrogen Project

Client / Buyer
South Refineries Company

Contractor / Seller
Iraq Ministry of Oil

Implications

- Iraq's Minister of Oil Hayan Abdul-Ghani has announced a plan to establish a green hydrogen project for the South Refineries Company alongside a solar energy plant to underscore Iraq's commitment to diversifying its energy portfolio and reducing its carbon footprint
- The project will produce 800 tonnes of green hydrogen annually by harnessing solar power, and will serve as a blueprint for scaling and developing similar projects in and around the south of Iraq, who so far, has not really progressed in the hydrogen space compared to its other Middle Eastern peers
- Iraq has excellent renewable resources that have so far remained relatively underdeveloped, although the government has recently made announcements of funding four of several solar power projects awarded over the past months as part of a strategy to boost the share of renewable sources to nearly 33% of generated power in 2025

Iraq Oil Market Highlights

Crude Oil Prices
As of February 5th, 2024

WTI: USD 77.84
Brent: USD 81.30

Iraq Rig Count

December 2023: 59
November 2023: 59

Iraq Oil Exports

February 2024: 3.434 Mbpd
January 2024: 3.339 Mbpd

Oil Exports Revenue

February 2024: 8.026 USD Billion
January 2024: 8.025 USD Billion