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LRP's *Project Asia*:

The world's economic "center of gravity" continues to shift from the Atlantic region towards the Pacific region, and the economic prospects of the United States are becoming more intertwined with those of Asia than ever before. The objective of *Project Asia* research and analysis from Laguna Research Partners is to provide our research users and consulting clients with proprietary, actionable insights regarding this important shift.

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## China Rim Brief

### China's Crude Oil Consumption and Imports Continue to Surge July 25, 2006

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Laguna Research Partners issued in April 2005 a major new study titled *Crisis on the China Rim: An Economic, Crude Oil, and Military Analysis*. That 85-page report provided our research users and consulting clients with a radically new context for analyzing the emergence of the Chinese economy, the impact of that emergence on global energy markets, and the implications of China's rise for the People's Liberation Army, the ultimate guarantor of China's energy security.

Our *China Rim Briefs* provide updates to our original China Rim thesis.

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"Based on our analysis of the intense economic, crude oil, and military confrontations developing among the China Rim region's largest economies, we believe that the most aggressive crude oil price targets calling for \$100 per barrel within the next three years will prove to be conservative."

*Crisis on the China Rim:  
An Economic, Crude Oil, and Military Analysis*  
Analyst: Kevin B. Skislock  
Laguna Research Partners LLC  
April 14, 2005

Surging energy resource demand from China continues to be a significant factor in driving world energy prices to record high levels. Here are the details.

- Data recently released by China's General Administration of Customs indicates that, during H1:06, China's **crude oil net imports** rose a powerful 17.6% year-over-year to 70.33 million tons. During the same timeframe, the country's **crude oil production** rose 2.1% to 91.664 million tons. The sum of net imports and domestic production indicates that China's H1:06 **apparent consumption of crude oil** increased at an 8.2% pace to 161.994 million tons.

In our estimation, growth in China's **real consumption of crude oil** during H1:06 was likely somewhat slower than growth in apparent consumption, reflecting the fact that the country's **domestic crude oil inventory** expanded year-over-year during the period as new oil refining and chemical production facilities came on stream. This compares with a drawdown in domestic crude oil inventory during H1:05.

In sum, *China's imports of crude oil are tracking ahead of our expectations.*

- The figures cited above indicate that *China's H1:06 crude oil imports accounted for 43.4% of apparent crude oil consumption*, somewhat higher than the 40.0%

ceiling that Chinese officials are generally believed to be targeting. During 2005, China's crude oil imports accounted for an estimated 42.9% of consumption.

- Recently released data also indicates that China's *refined oil products net imports* surged 48.3% year-over-year to 12.03 million tons during H1:06. During the same period, *refined oil products production* was up 5.6% to 84.822 million tons. Combined, these figures indicate that China's *apparent consumption of refined oil products* jumped 19.2% to 96.852 million tons during the first half of 2006.
- China's National Bureau of Statistics reports that China's *GDP* expanded by 10.9% year-over-year during H1:06, representing acceleration from the 10.0% year-over-year pace of GDP growth achieved during H1:05.

China's rate of *GDP* growth also accelerated during H1:06 to an 11.3% rate during Q2:06, up from the 10.3% rate of Q1:06. This unexpectedly high rate of Q2 GDP growth has prompted government officials to clamp down on investment and lending amid early hints of rising price inflation.

*Laguna Research Partners expects that incremental crude oil demand will come from China as that country adds to its own strategic reserve.*

- We estimate that *crude oil stockpiles* currently maintained by the China National Petroleum Corporation and the China National Petrochemical Corporation, two industry leaders in China, amount to approximately 20 days of China's crude oil imports. In contrast, strategic crude oil reserves in Japan and the US amount to an estimated 160 days of those respective countries' crude oil imports.

China's recently created National Energy Office expects that the first four locations comprising "phase one" of China's strategic petroleum reserve build-out will be completed during 2006. These first four locations are expected to have a total storage capacity of *10 million to 12 million tons*. During the second and third phases of this build-out, China is expected to increase its reserves to *the 28 million-ton level*.

- Finally, as a further indication of the Chinese economy's rapidly expanding thirst for crude oil, Chinese officials currently anticipate that China will need an incremental 40 to 50 270,000-ton to 300,000-ton *crude oil tankers* through 2011.

*In general, China's per capita consumption of crude oil remains below the world average and well below the per capita consumption rates of the world's industrialized countries.* While we expect that China's crude oil consumption and import data will continue to fluctuate significantly on a quarterly basis—import growth could slacken during H2:06 in response to higher domestic inventories—we continue to expect that the long-term trend line in the country's consumption and import of crude oil will surprise observers to the upside and provide on-going upward pressure on world energy prices.

Clients of Laguna Research Partners are invited to contact our firm for additional details.

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