



Producer - Consumer Dialogue - *Rising to New Challenges* -

Klaus Rehaag

*Head, Oil Industry &
Markets Division*

*Editor, Oil Market
Report*

*International Energy
Agency*

Paris, France

klaus.rehaag@iea.org



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Overview

- Question: is the dialogue working?
 - Is there life after Amsterdam (IEF)
 - What are the next steps?
- New challenges
 - Not just about crude
 - Capacity is tight throughout entire system
- Rising to the challenges





Is the Dialogue Working?

- Number of successes:
 - Venezuela supply disruption and build-up to Iraqi conflict
 - JODI data exercise
 - Riyadh Secretariat
 - Joint IEA-OPEC investment study
- Far better understanding of each other
 - Better lines of communication
 - “Technical” meetings
- Speak the same language
 - Market stability
 - “Fair” and “reasonable” prices
 - Conservation and efficiency (CO₂, flaring)
 - Need for investment
 - Expand energy access to developing nations





But Problems Remain

- **Commonality of *long-term* interests conflicts with *short-term* actions**
 - Low stock policy
 - Production quotas
 - High prices
 - Lack of data transparency
- **Speak the same language, but ...**
- **Belies underlying philosophic differences**
 - Supply management vs. market reliance
 - Deregulation vs. state monopolies
 - Price bands
 - “Fair” and “reasonable” price





Life After Amsterdam

■ International Energy Forum (IEF)

- Long-term investment focus
- Almost derailed by price environment & concern about impact on global economies
- Successes: JODI, Riyadh Secretariat, commitment to supply more physical barrels

■ Question:

- Where does the dialogue go next?
- Not enough to sit back and wait – *need to push agenda forward*

■ But philosophic differences unlikely to go away anytime soon

■ Imperative we find ways to work together, *in our mutual interests*

- Investment challenge, economic growth, environmental protection





Faced With New Challenges

- **Important structural changes taking place**

- **Previous 5 years (1998- 2002)**
 - Disconnect: economic growth and oil demand growth
 - Was attributed to shift in OPEC policies after Jakarta
 - OPEC sacrifice market share to maximize revenue
 - Non-OPEC capacity growth, particularly Russia
 - Consequence – rising OPEC spare production capacity
 - Successful - low stock, high price supply management policy
 - Consequence – low oil demand growth





FSU Oil Production 1991-2004

kb/d

12000

11000

10000

9000

8000

7000

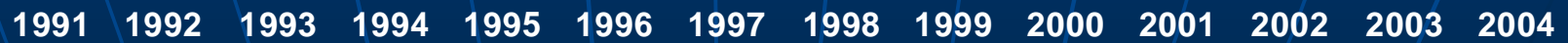
6000

5000

FSU, not simply Russia, has been the engine of non-OPEC supply growth

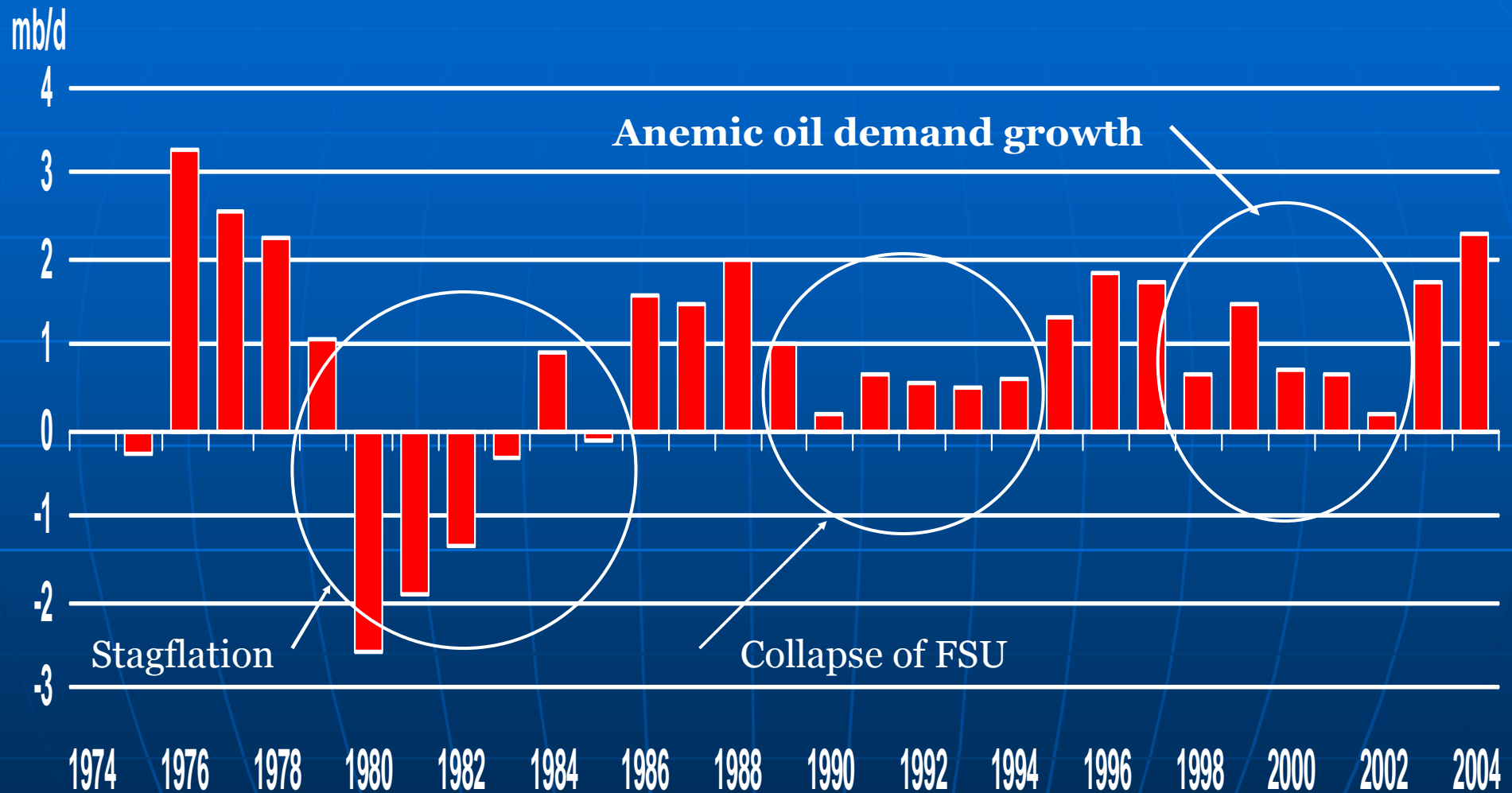
1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004

Russia Azerbaijan Kazakhstan Turkmenistan Others





Annual World Demand Growth – Mb/d



1998 – 2002 demand growth anemic, but not unprecedented





What has Changed?

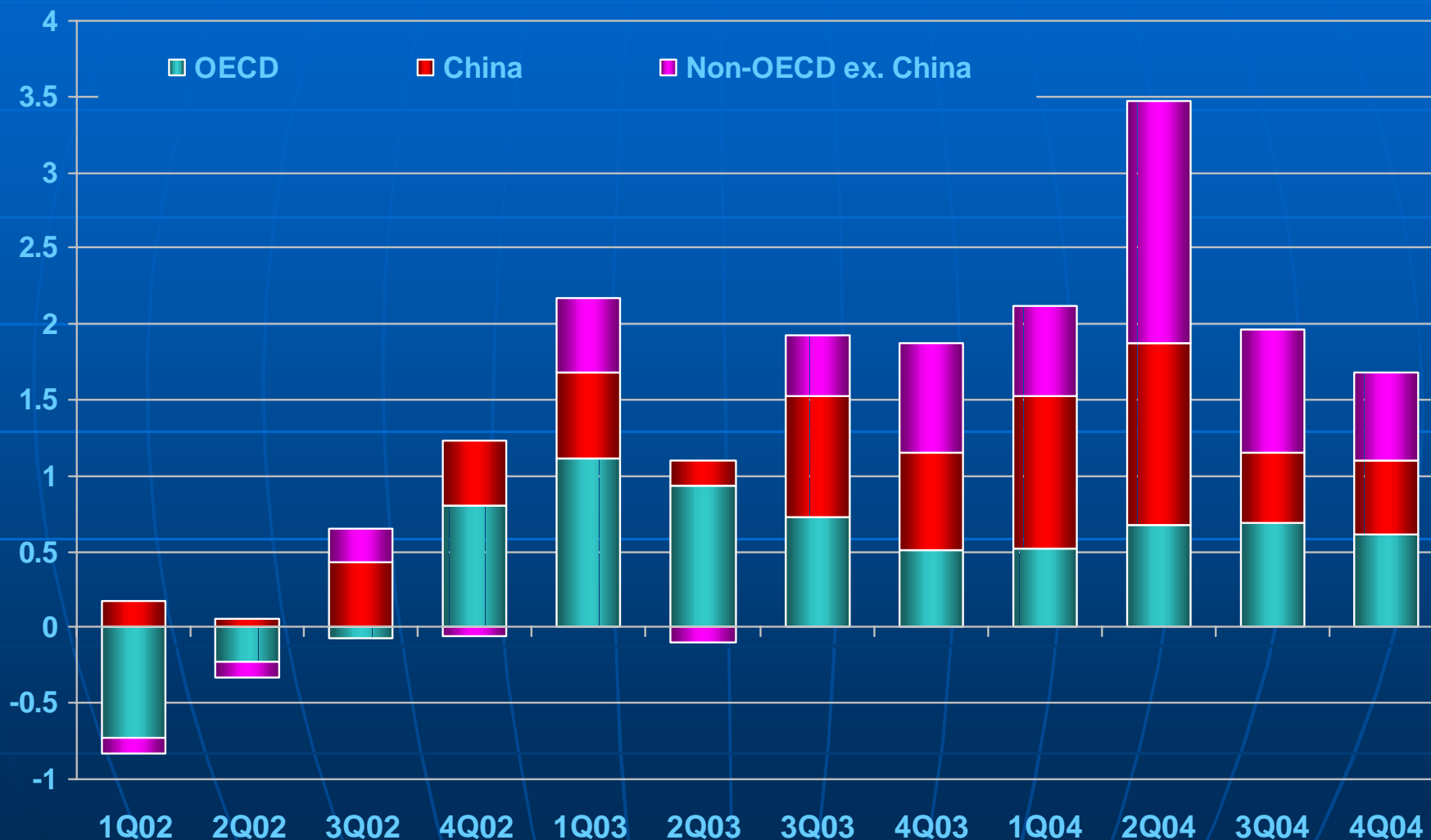
- **Economic growth & oil demand growth have exploded**
 - 2004: 2.3 mb/d oil demand growth and counting
 - Not just US and China, BUT China is a key driver
- **Higher call on crude as spare production capacity falling**
 - Iraq
 - Venezuela, Nigeria
- **Mature fields declining**
 - Indonesia
 - North Sea
- **Therefore, short-term spare production capacity is tight**





Oil Demand Recovery: OECD Vs Non-OECD (mb/d)

Non-OECD, notably China, drives oil demand growth

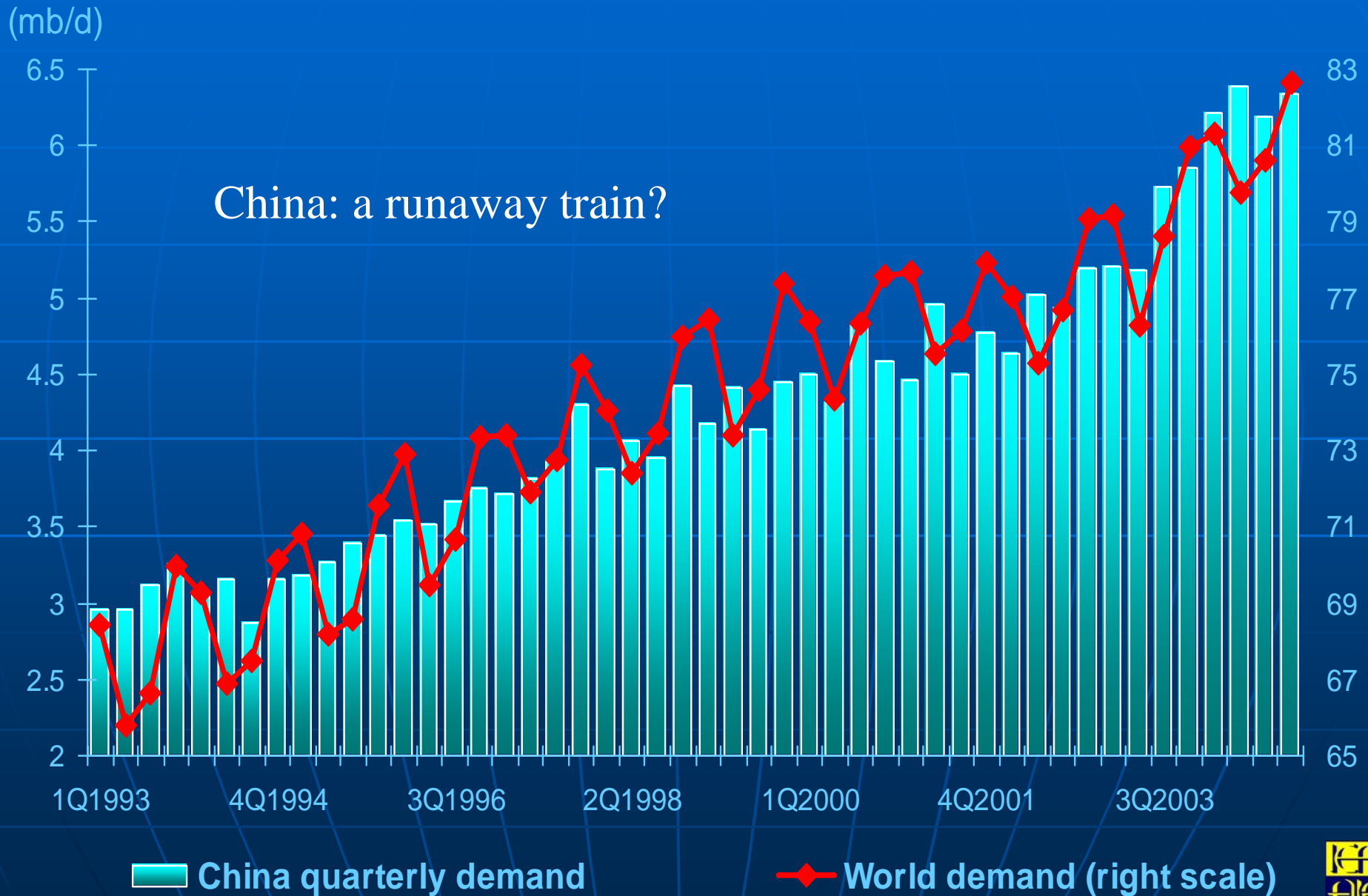


➤ Oil Demand Growth: 2003: 1.7 mb/d (2.3%); 2004: 2.3 mb/d (2.9%)





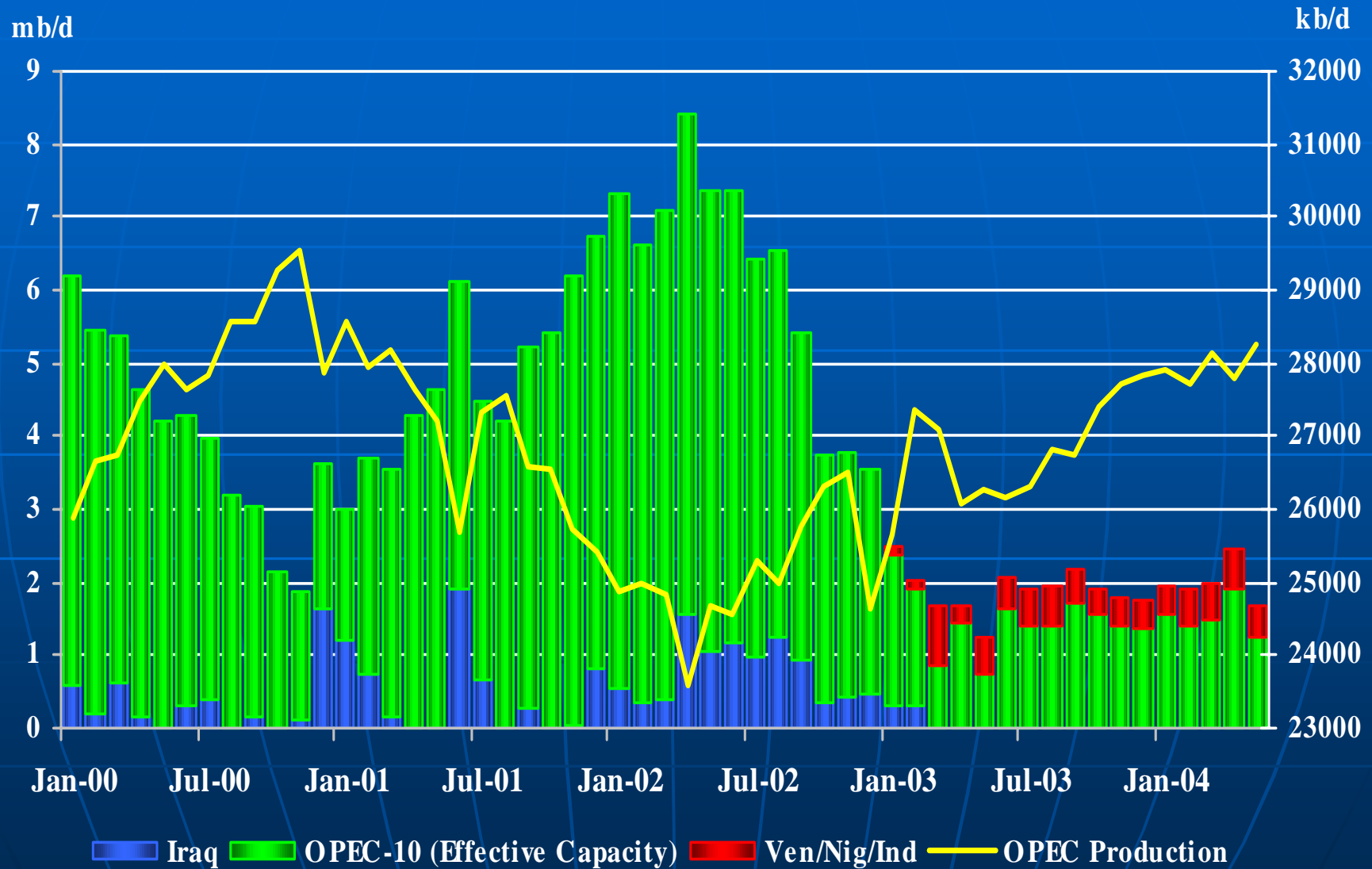
Chinese Vs Global Demand (Mb/d)





OPEC Spare Production Capacity *

Effective spare capacity of around 1.5 mb/d



* IEA definition: available in 30 days and sustainable for 90 days





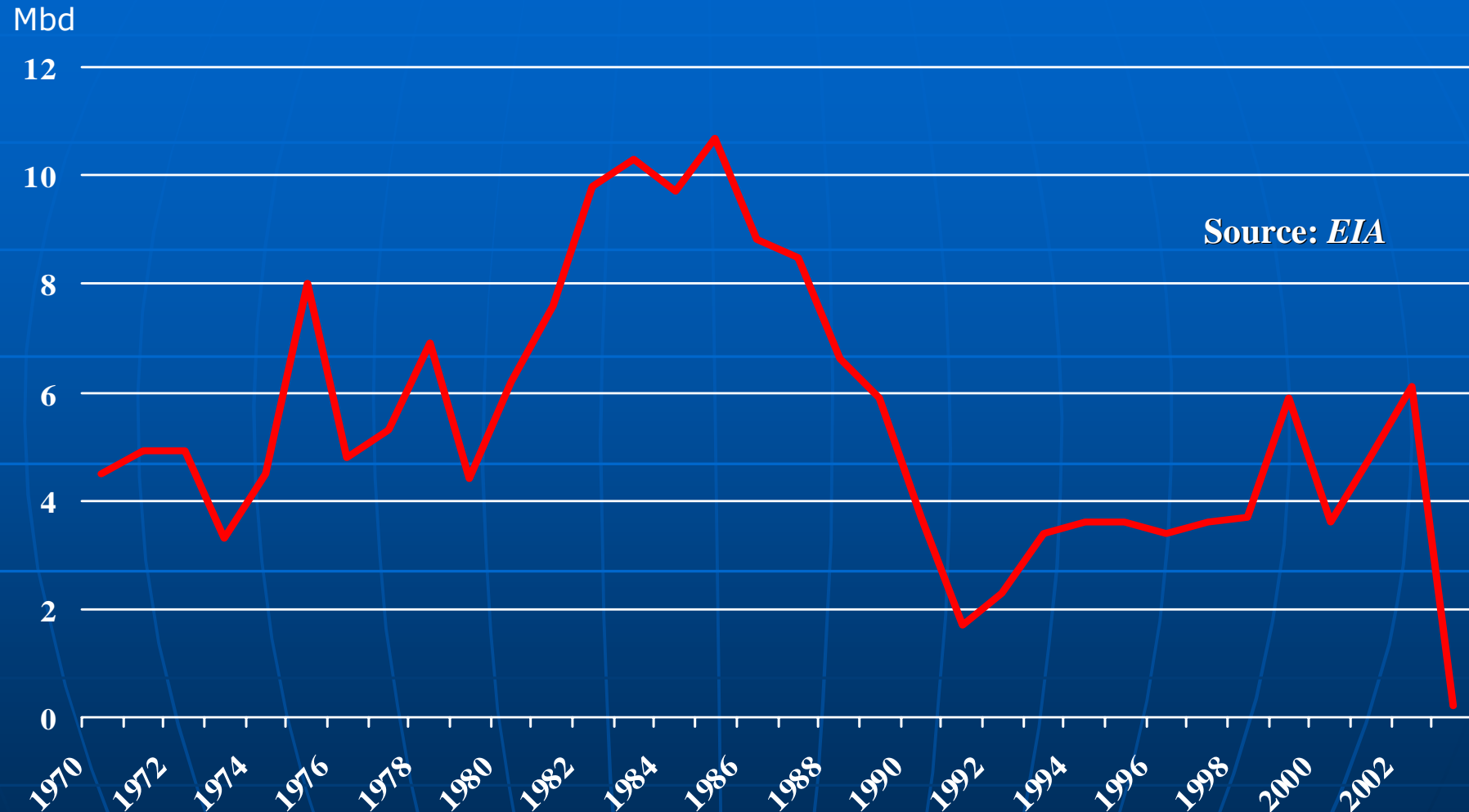
OPEC has the Reserves, but ...

- **Cost money to build and maintain spare capacity**
 - Money which is often needed elsewhere
- **Given uncertainties, may be reluctant to investing**
 - Demand growth real, here to stay?
 - What about Iraq?
 - Russia capacity & infrastructure constrained or continue relentless expansion?
- **Growth in OPEC spare capacity historically associated with:**
 - Internal political discord
 - Pressure on prices
- **Notwithstanding, supply growth in Nigeria, Algeria**





Historical OPEC Spare Production Capacity - Tells a Much Different Story -



Costs money to build & maintain spare capacity. Given internal OPEC policies, may contribute to market tension and potential downward pressure on price.





Capacity is Tight Elsewhere In System

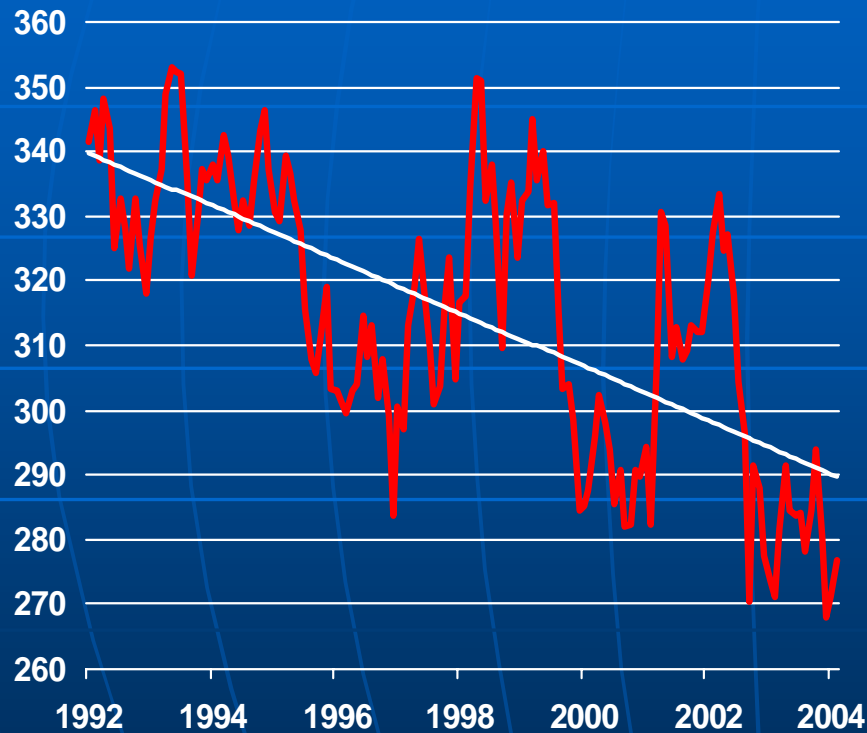
- *Not just limited spare production capacity*
- **Refining, transportation logistics constrained**
- **Crude & product stocks low**
- **In a deregulated environment, pressure to reduce costs, maximize efficiency, minimize spare capacity**
- **Shareholders demand competitive returns (ROCE)**
- **Trends to minimizing spare capacity unlikely to reverse**



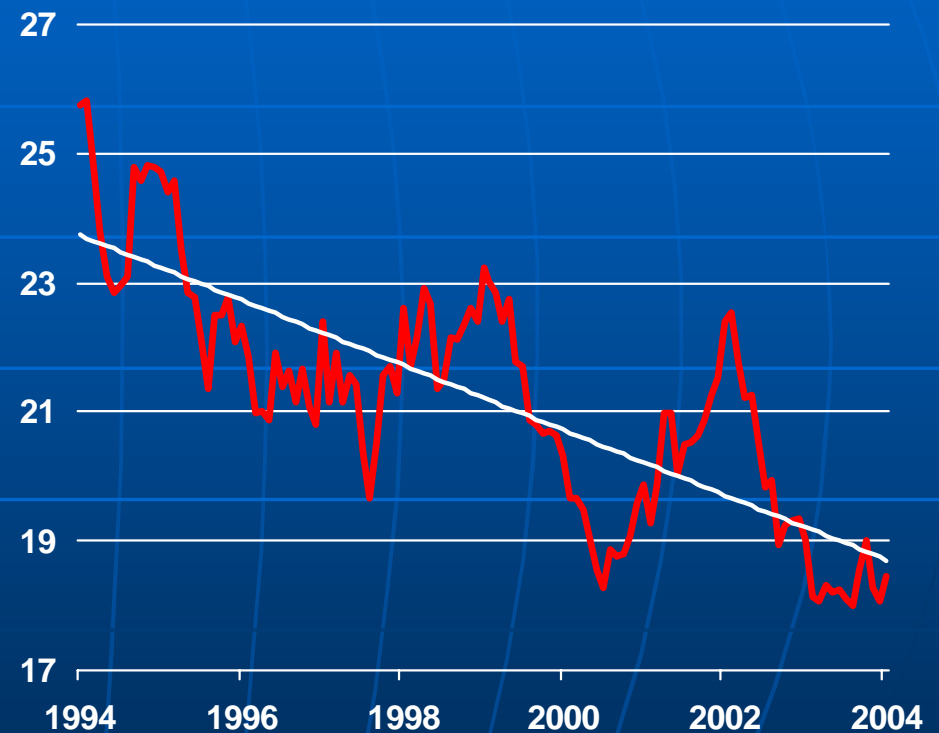


Unmistakable Downward Trend - US-50 Crude Stocks -

US-50 Industry Crude Oil Stocks (mb)



US-50 Industry Crude Oil Stocks (days of forward demand)



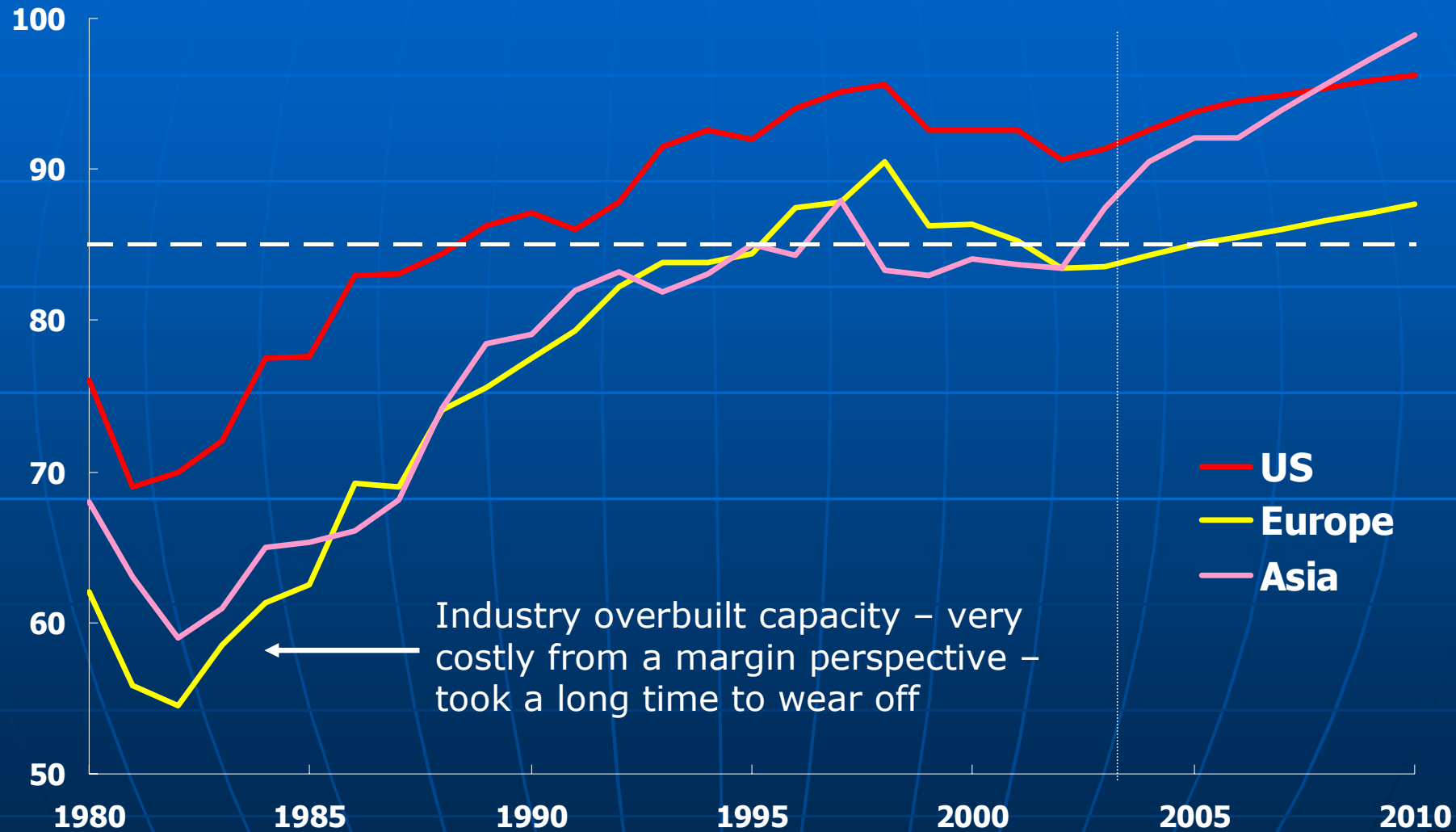
Industry more efficient (mergers & acquisitions, information technology, just-in-time inventory management practices)





Refinery Utilization Rates Already High in U.S. & Europe, Set to Improve in Asia . . .

Percent



Industry overbuilt capacity - very costly from a margin perspective - took a long time to wear off

Who will process incremental crude?

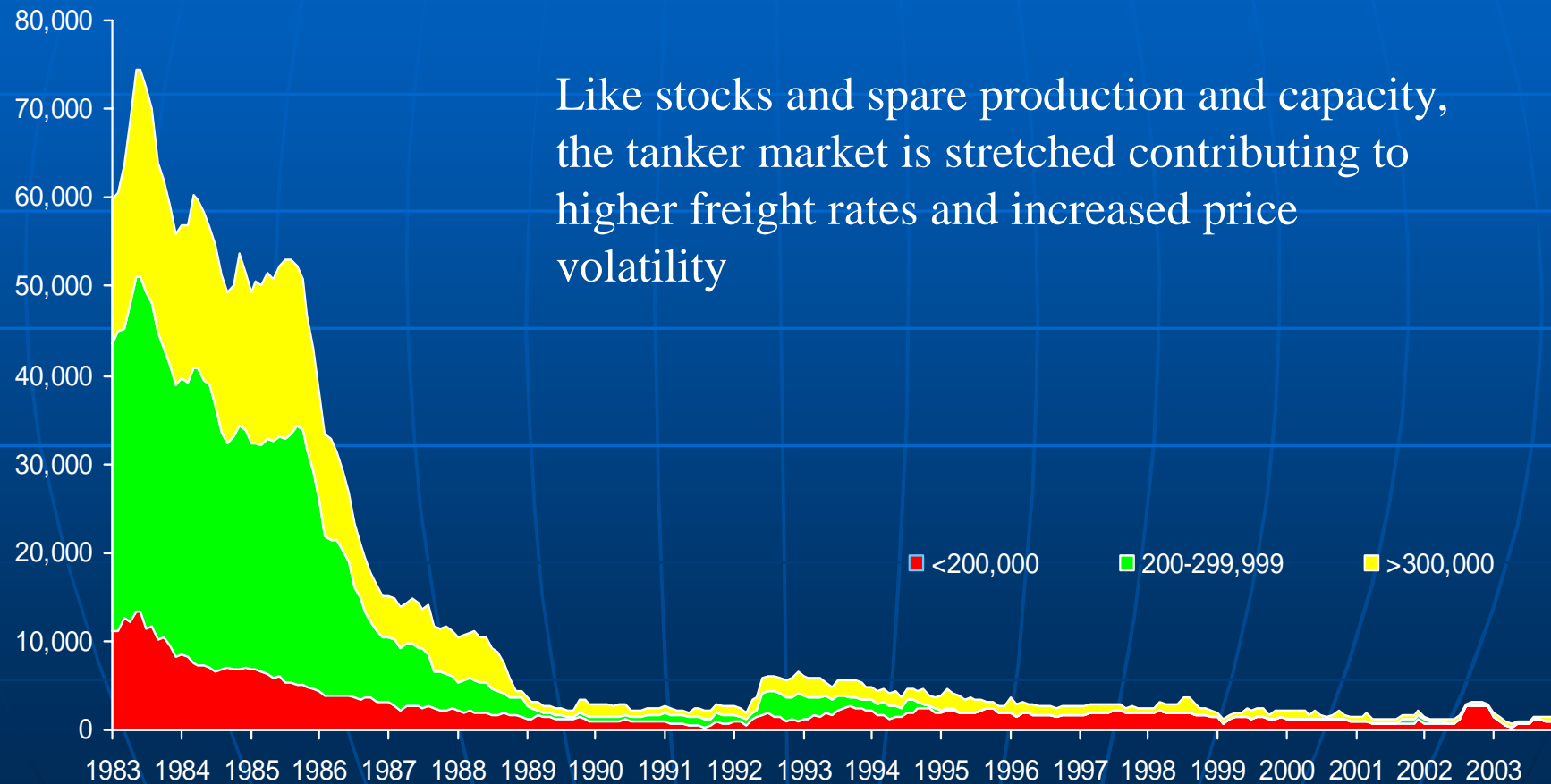
Source: Purvin and Gertz INC.





Limited Surplus Capacity – Tanker Market Oil Tankers in Lay-Up – Waiting For Contract

Contango %



Who will ship incremental barrels (primary yards full)?

Source: Kearney





Not Just About Production

- **Tight capacity, in a period of uncertainty, *fuels speculation and drives prices***
- **Concern NOT simply about spare production capacity:**
 - **Need ships and pipelines to transport crude**
 - **Need refineries to process crude**
 - **Need market structures to support building stocks**
- ***Takes TIME to increase capacity* – need to plan and invest in advance, not wait until faced with critical shortages**
- **Adequately “supplying the market” is key**





Rising to New Challenges

- **Investments in upstream and downstream are critical:**
 - Re-gain control over the market - add spare capacity to cope with uncertainty and diminish speculative influence
 - Keep up with surging economic growth and oil demand
 - Provide access to energy for developing nations
- **Question:**
 - Who is prepared to finance this investment, and under what terms?
- **Notwithstanding our differences, producers and consumers must find a way to work together and cooperate**
- **Investors will shy away unless we collectively establish that *the oil industry is viable, and has a healthy future***





Conclusions

- **Philosophic differences will remain – but imperative to push the *producer–consumer agenda* forward**
- **Need to mobilize investment to generate spare capacity and restore confidence and market stability**
- **Need to act on commitments to data transparency, technical meetings and collaborative studies**
- **Need to fund R&D and promote conservation**
- **But most important, need to supply the market – restore confidence in the integrity of the dialogue process**

