Opening remarks, Medium Term Oil Market Report launch, 17 June 2014

Good morning.

Thank you for joining us today. Our Medium-Term Market Reports look forward over five years. But we can’t ignore what’s going on right now so I will say a few words about Iraq and OPEC. I’ll then add some perspective to the global picture as we look out over the medium term.

It’s not the IEA’s role to get into the politics. However, we do have a role to play in promoting transparency around oil markets, in quantifying the amount of oil involved and of course helping to co-ordinate responses in the event of an actual major disruption to supply.

Current events in Iraq have already had an impact on oil markets. The situation is obviously very fluid on the ground, and it is too early to draw long-term conclusions. While not a single barrel of oil has been displaced compared with the situation a week ago, it is clear that the market is worried about the longer term consequences. The oil price is already up about USD 4/bbl since last Tuesday.

Iraq has always mattered to the oil market not only because of its current production and exports – it is the second-largest OPEC crude exporter today – but also because of its huge reserves and untapped potential (detailed in the World Energy Outlook Special Report on Iraq of 2012).

But sectarian conflict is not the only challenge that Iraq or for that matter other OPEC counties face. Even before the events of the last few days, we had taken a conservative approach to our forecast for Iraq and OPEC capacity growth, taking into account prevailing security, institutional and investment risks. As such, we reduced our forecast of Iraqi production growth to 1.3 mb/d from 2013-19, which would bring total Iraqi production to 4.5 mb/d by the end of the decade. Most of this production growth will come from southern fields, rather than from ones in the north where the fighting of the last few days has centred.
This growth of 1.3 mb/d day would account for 60% of OPEC supply growth over the period. OPEC faces particular challenges in delivering this, not least in securing the investment required to replace current production from diminishing fields, as we detailed last month in our World Energy Investment Outlook.

Again, it is too early to say how events on the ground will alter production out to 2019 and what steps OPEC might take to cover any shortfall and to ensure that the necessary investment is made in replacing diminishing fields, but clearly there is significant additional downside risk.

I now want to focus on the major structural trends we highlight in the Report over the next five years.

Firstly, as in the last few years, we are continuing to see unprecedented production growth from North America, and the United States in particular. By the end of the decade, North America will have the capacity to become a net exporter of oil liquids.

But the unconventional supply story is evolving. While we don’t expect to see the sheer scale and speed of the unconventional boom that the United States is going through replicated elsewhere, we certainly do expect to see significant progress being made in other regions. By the end of the decade, while we see a slowdown in the rate of growth of US production, we expect to see unconventional production pick-up elsewhere, including in Canada, Russia and Argentina. This is the beginning of a shift which we expect to gain momentum in the following decade – the globalisation, so to speak, of the unconventional supply revolution.

Overall, global supply capacity is expected to grow to a nominal 105 mb/d by 2019, though effective capacity will almost certainly be less than that.

Secondly, let’s turn to demand. Demand is expected to rise to almost 100 mb/d on a quarterly basis by the end of the decade on the back of economic recovery – but is undergoing a shift.

Sustained high prices, inter-fuel competition, environmental concerns coupled with improved efficiency and heightened security concerns all weigh on
demand growth. More mature, typically OECD countries, are seeing demand fall while the non-OECD region is leading demand growth.

But in aggregate, we expect to see the rate at which global demand is growing peak during the reporting period. It will continue to grow, albeit at a slower rate into the next decade. This is by no means peak demand. Yet while there are regional differences, peak oil demand growth for the market as a whole may already be in sight.

Third, China is set to overtake the United States as the largest gross importer of crude as early as this year, while non-OECD countries are expected to overtake OECD countries in terms of crude imports potentially as soon as 2017.

This concentration of growth in Asia, coupled with North America’s swing to becoming a net oil exporter, focuses crude trade flow towards Asia. Asian imports surge 16% to more than 22 mb/d to account for around 65% of the international crude market by the end of the decade.

Fourth, the report includes updated forecasts around product supply, reflecting the consequences of shifts in demand, geographic consolidation in the refining sector and the characteristics of the crude being produced, particularly in North America. As such, the market faces a looming glut of light distillates like gasoline and naphtha as a by-product of needed diesel and jet fuel. This will be a challenge for refiners, and the cycle of consolidation and restructuring that started after the financial crisis has yet to run its course.

Fifth, as I mentioned earlier, investment needs to be made now if we are to ensure steady supply growth into the next decade. As last month’s World Energy Investment Outlook said, annual investment in upstream oil and gas needs to rise to around $850 billion by 2035. More than 80% of this is required simply to compensate for declines in existing oil and gas fields.

Much of this will need to be focused in the Middle East. If we don’t see sufficient investment in this region over the next few years, the result will be tighter and more volatile oil markets, with an average prices USD 15/bbl higher in 2025.
Before I hand over to our Head of Oil Markets and Industry Division, Antoine Halff, to take you through the report in a little more detail, I would like to make one further point on Iraq. One of the main drivers for the establishment of the IEA some 40 years ago was to create a body through which its members could respond in the event of a major supply disruption. IEA members hold strategic reserves for this reason. We will continue to monitor the situation closely and keep in close touch with our members; ready to respond in the event of a major disruption in physical supplies of oil.