Honourable Ministers, Ladies and Gentlemen, it is a pleasure to address you today.

I am also pleased to follow my friend and colleague, His Excellency Abdallah el-Badri of OPEC, with whom the IEA has a productive and mutually beneficial programme of work at all levels.

I would like to share with you the IEA’s views on the current state of oil markets, and particularly to comment on what we are seeing in terms of prices, which are of concern to us all.

We meet today at this International Oil Summit in an environment of uncertainty –

...on the supply side due to factors both above and below ground...

and, on the demand side as economic recovery is threatened by high prices.

In the end, it is those high prices which we are all worried about. Even though over the long term supply and demand will naturally balance, we don’t want that to happen because of the risk of a double-dip recession.

Given that environment, today I want to -

- summarize our views on the oil market;
- address the challenge that current oil prices place on the recovering economy; and
- discuss those prices themselves and how they come about.

**Oil Market Synthesis**

So how does the market look now?

Preliminary data on the supply and demand side showed a slight loosening of the market in the first quarter 2012.

- Given the nature of this data, it is too early to say that fundamentals are easing.

But preliminary indications are that global stock-build is up, including crude stockpiling by Saudi Arabia and China.
• Of course the market may appear looser now because we are entering what is usually a low-demand season.
• And, this news should not make us complacent – after all, there are still key risks on the supply side.
  o Unplanned non-OPEC outages reduced output by 1.1 million barrels per day (b/d) in the first quarter, and in the North Sea they have an amplified effect on Brent benchmark prices.
  o Political factors in Yemen, Syria, Sudan and South Sudan and elsewhere have removed over 1 million b/d from the market.
  o This being said, we are cautiously optimistic that production in non-OPEC countries will pick up in the second half of the year.
• When it comes to OPEC, of course we need to discuss the impact of recently enacted EU and US sanctions on Iran which are already affecting shipping and trade flows, with a knock-on effect on Iranian output.
  o In Iran exports are already 200-300 thousand barrels per day (kb/d) below last year’s average and are expected to continue to decline in coming months.
  o Exports might also be reduced this summer when OPEC oil-fired power demand swings higher.
  o To offset these declines, we are pleased that Libyan production has recovered faster than we had anticipated, and we welcome additional production from OPEC producers in the Gulf.
  o On the other hand, if increased OPEC production does materialize, this comes at a cost to spare capacity levels, which went south of 4% of global demand in March.
• Unplanned outages and geopolitical uncertainty amidst dwindling spare capacity is a recipe for the high price environment we find ourselves in.
• And so we cannot discount the possibility that prices will remain high so long as these uncertainties in both OPEC and non-OPEC countries remain.
• In light of this tight market situation, the IEA stands ready to act if a major supply disruption coincides with an inability of alternative market supplies to fill the gap.

Oil Burden
• These supply and demand factors will be the key drivers of prices for the upcoming months.
• In fact, Brent oil prices reached a record high of USD112 per barrel (bbl) in 2011, the highest nominal price in history.
• Monthly prices rose even higher in the first part of this year, reaching around USD125/bbl in March, and they have fallen back to around USD115 in April.
• The sustained price level since the beginning of 2011 poses a very real threat to economic recovery.
• On average last year, global oil expenditures again breached 5% of GDP, as they did in 2008 and during previous periods of sharp economic slowdown.
  o Just as the world was beginning to pull out of the 2009 recession, the pressures deriving from higher crude prices have re-emerged.
• Nor is this simply a case of richer countries grumbling about high oil prices. The emerging markets are also vulnerable.
• So we should all be worried about recent increases in prices.

Policy (investment, subsidies, taxes)

• So much for the way we analyse the physical markets, but are there also improvements that can be made by industry and government to the way physical markets operate?
  o Governments need to work harder to ensure that stable, flexible and consistent investment terms are in place, whether for the drilling of an oil well, or the construction of a power grid.
  o These terms must respect the sanctity of contracts.
• And we need a level playing field that ensures investment in natural resources is open to all...
  o ...national oil companies, multinationals and the independents alike.
  o Particularly in light of World Energy Outlook estimates that upstream oil and gas investment between now and 2035 needs to average USD619 billion per year, and has hit a new record of USD550 billion in 2011.
Investment is increasing in harder-to-develop (and higher cost) unconventional resources.

Competitive investment frameworks are needed to bring those resources to market.

And, considerable investment must take place in resource-rich countries in the Middle East and North Africa where a whole host of political, financial, physical, and economic issues reduce investment.

- Environmental policies and targets need to be predictable, practical, economic, and internationally coordinated.
  - Governments also need to think carefully about price subsidies.
  - The public will not respond to triple digit international prices if it is paying only a fraction of that at the pump. Too low prices encourage excessive demand growth in many producing countries.
  - In large consuming countries maintaining taxation levels is important to wean consumers away from long-term over-reliance on hydrocarbons and encourage oil conservation.

**Physical/Financial Interdependence**

- That volatility is often blamed on another factor – so let us discuss the growing interdependence between the physical and financial markets for oil and other commodities.

- Much has been made of the huge influx of capital in the last decade into crude oil and other commodity derivatives.
  - In 2011 that influx breached USD430 billion, compared to only around USD55 billion in late-2004.

- Commodities emerged as a distinct asset class, and represented a good hedge against underperforming equities or dollar depreciation.

- This capital influx into derivatives has caused some analysts to suggest that the “financialisation” of commodities must therefore have underpinned the concurrent general price rise – particularly for crude.

**Speculation?**
• But few studies have found any meaningful causality between so-called ‘speculative’ activity and prices.
• In addition, some of our own analysis at the IEA tends to cast doubt on the ill-defined concept of ‘excessive’ speculation within the crude market.
• The ratio of speculation to hedging demand in the crude futures market, though generally on the rise in the past decade, is both…
  o consistent with that for other commodities...
  o and has in fact flattened off or declined since 2008.

• Finally, the supposed ‘smoking gun’ singling out speculation – crude prices rising with derivatives - is much less evident if we consider other commodities not traded on futures exchanges – whose price rises exceeded oil’s over 2006-2008.
• Our analysis, and joint workshops with OPEC over the past two years, has therefore suggested that the price influence of derivative market activity is largely confined to the very short term.
• Over longer time spans, many factors at at play like
  o supply and demand;
  o inventories and spare capacity;
  o refining and transportation;
  o crude and products qualities;
    The complex web of interactions between these various factors and expectations of how these physical parameters will develop in future...
  o ...play a much greater price determining role than derivative market activity itself.
• That said, we wholeheartedly support the efforts of regulators worldwide to enhance market transparency in commodity derivative markets.
• Moves to make commodity financial markets more transparent, more liquid, and more efficient – including better and more consistent international regulation – will help everyone in the energy business.
• But we must avoid moves that excessively restrict the ability of participants on the physical side of the business from hedging their price risks.
• After all, the speculator in the market is simply taking an equal and opposite position to that of the bona fide commercial participant...
  o ...while at the same time performing essential liquidity and price discovery roles.

**Conclusion**

• To sum up -
• Uncertainty has been a major driver of current price levels, and we should be ready for further surprises.
• The physical market has appeared to loosen in the first quarter, but we cannot ignore risks that lie ahead – because the market certainly isn’t.
• We are particularly concerned about the high level of supply outages, and we therefore welcome pledges to increase production by OPEC producers.
• Looking beyond the short term, we need well regulated and transparent platforms on which to hedge price risks, and a better understanding about how physical and financial markets interact.
• And finally we need to promote a steady and increasing flow of investment in physical markets, to ensure that the world’s energy needs for the 21st century and beyond are met in an affordable, clean and sustainable way.

Thank you for your attention.