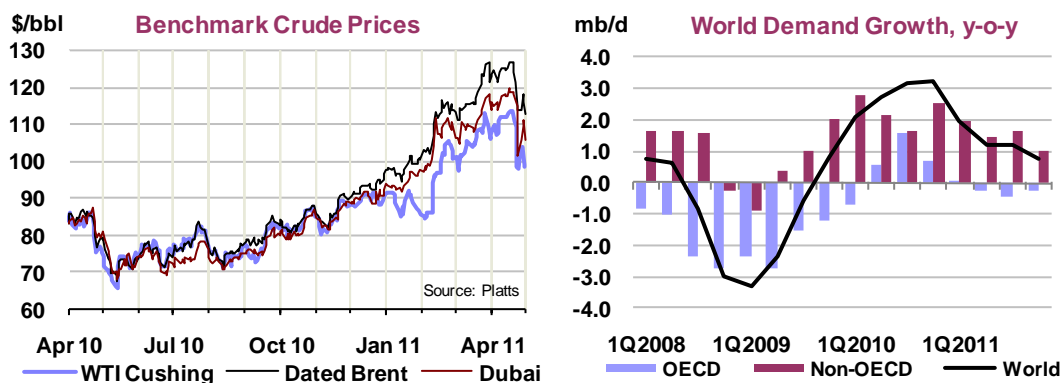


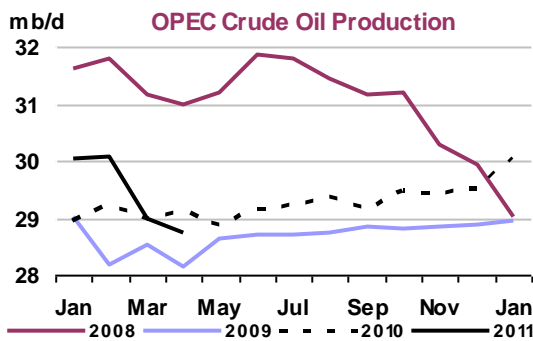
IEA Secretariat Note: Short term oil market assessment and the potential economic impact of sustained high prices

1. Market Assessment

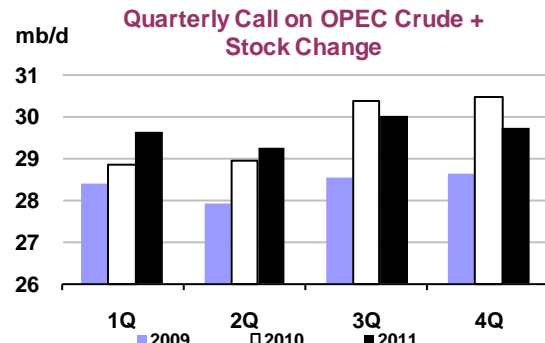
As of the second week of May crude oil futures prices stood at \$115/bbl for Brent and \$100/bbl for WTI, having earlier scaled levels around \$10/bbl higher. A sharp commodity-wide downward correction in prices occurred on 5 May, but has been followed by further strengthening since. Current prices are 35% to 45% above year-ago levels, and 15% higher than the January 2011 average. Global oil demand growth remains robust for now, notwithstanding that for several months our own projections have suggested growth slowing from post-recessionary highs of +2.8 mb/d in 2010 to nearer +1.3 mb/d in 2011. This outlook for a slowing trend in 2011 pre-dates the recent surge in oil prices, and there is a clear potential for global oil demand growth to eventually slow further if prices remain high and further undermine economic recovery. Major institutions continue to foresee GDP growth of around 4.3% in 2011, even though, as noted below, crude prices are approaching levels which compounded the economic recession of 2008/2009. However, economic impacts take time to feed through; robust emerging market growth could sustain global oil demand growth for some months even while other countries' recoveries begin stalling.



Our analysis shows that the move in prices from around \$75/bbl in September to near \$100/bbl at end-2010 had a clear foundation in market fundamentals, with demand running ahead of supply by around 1 mb/d. Further price increases in 2011 have been augmented by the loss of 1.5 mb/d of Libyan crude supply since late-February, and fears that political instability sweeping the Middle East and North Africa (MENA) could spread to other major producers. A weakening dollar and other financial market factors have also contributed. IEA estimates suggest April OPEC production of 28.8 mb/d was 1.3 mb/d below pre-Libyan crisis levels.

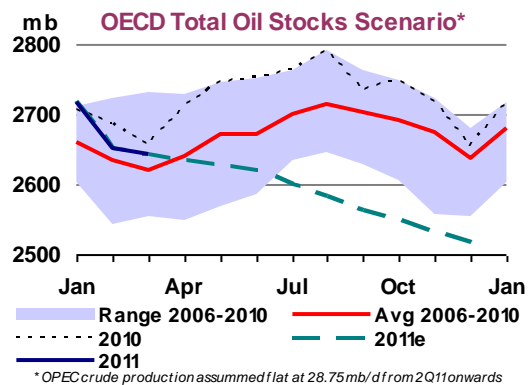
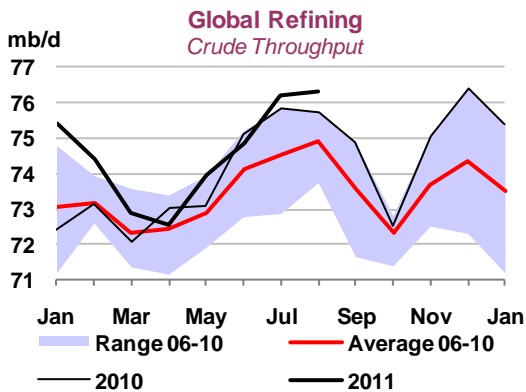


Entire series based on OPEC Composition as of January 2009 onwards (including Angola & Ecuador & excluding Indonesia)



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The loss of Libyan crude volumes now looks likely to be a protracted one. Oil demand growth in 2011, while moderating from 2010's heady levels, is likely to remain substantial, and the implied 'call on OPEC crude and/or stock change' (based on refined products demand) looks likely to rebound to nearly 30 mb/d in the second half of 2011, after a seasonal dip in 2Q. A seasonal increase could increase throughputs by 2.3 mb/d from an April low to an August high. It is important that rising demand from refiners be met on a timely basis. The hypothetical scenario shown below, of OPEC production remaining at April's 28.8 mb/d through 2011, implies a further sharp tightening in market fundamentals, which could see a renewed and highly damaging surge in prices.



*OPEC crude production assumed flat at 28.75 mb/d from 2Q11 onwards

2. Economic Consequences of Current Price Levels

As noted by the IEA Secretariat early in the year, oil prices have entered a danger zone for the global economy. High oil prices represent a significant redistribution of wealth from oil importers to oil exporters. The IEA estimates that if oil prices average \$100/bbl in 2011, spending on oil imports in many countries will reach or exceed the record levels of 2008. For the OECD – which is set to import almost 60% of its oil needs in 2011 – spending on imports would reach 2.3% of GDP, with each additional \$10 increase in price raising this by 0.2%. The share of GDP spent on oil imports is generally even higher in oil-importing developing countries because their economies are often more dependent on imported oil and more energy-intensive, and because their energy use in a given sector is sometimes less efficient than the global average.

Furthermore, in many developing countries high oil prices are placing a particular burden on government finances due to the presence of fossil-fuel subsidies (which the IEA estimates amounted to \$312 billion in 2009, down from \$558 billion in 2008).

Although the world is now using half as much oil per unit of economic output than it did prior to the first oil shock, oil prices still matter to the health of the global economy, particularly at present given the fragile state of the economic recovery. There is growing evidence that the dramatic rise in oil prices since last September has already begun to slow the recovery by widening global imbalances, reducing household and business income, and putting upward pressure on inflation and interest rates. Furthermore, the longer prices remain at current levels or higher, the greater the threat that the global economy could slide into a double-dip recession.

Rising oil prices are already posing inflationary costs. These include direct effects through increases in fuel prices and indirect effects as prices of other goods (particularly food) rise to reflect higher input costs. So far inflationary impacts have been most pronounced in the emerging economies in Asia, but have also started to become a concern in several OECD countries. Central banks, once again particularly in the emerging economies, have responded by raising interest rates in a bid to curb inflationary pressures, which could dampen growth prospects.

There are also some “positive” implications of high oil prices for consumer countries. As with the impact of fuel taxes, sustained high oil prices boost the competitiveness of alternative fuels and encourage the uptake of more efficient vehicles. However, unlike fuel taxes, these positive implications often come at a steep cost and can be short lived if prices subsequently decline. And of course where fuel subsidies are in place, high prices will do little to affect consumer behaviour, while imposing a significant fiscal burden on the state.