

Prospects and Challenges for the Asian and Global Oil Markets
– IEEJ’s 16th Regular Meeting with OPEC Secretariat –

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Introduction

The Institute of Energy Economics, Japan, has held regular annual meeting with the secretariat of the Organization of Petroleum Exporting Countries since 1987. The 16th meeting for the exchange of views took place at the OPEC Secretariat in Vienna, Austria, on January 13, 2006. Representatives from China’s Energy Research Institute (ERI) and the Korea Energy Economics Institute (KEEI) joined the meeting, as well as last year’s gathering¹. Participants in the latest meeting had active discussions on challenges and prospects for the Asian and global oil markets. The following is a summary of the discussions that took place.

1. Global Oil Market Prospects

- The OPEC side gave two presentations on short- and long-term oil market prospects².
- Regarding short-term oil market developments, the OPEC Secretariat cited two major factors behind the oil price hikes in 2005. First, non-OPEC oil producing countries failed to sufficiently expand production in spite of growing global oil demand. Second, U.S. oil refining capacity shortages became a background factor behind the high oil prices, in particular, the hurricane damages in the US Gulf coast resulted in the record high oil prices. Based on this analysis, the following prospects were made:
 - While global oil demand in 2006 will expand by 1.6 million barrels per day, demand for OPEC crude oil will level off or fall slightly due to an increase close to 1.4 million B/D in non-OPEC production and a rise in natural gas liquid output.
 - OPEC’s surplus production capacity will increase thanks to OPEC countries’ steady efforts to expand capacity.

¹ Some 20 experts from the OPEC Secretariat attended the meeting, including Mr. Mohamed Hamel, Head, Energy Studies Department, and Mr. Mohamed Alipour Jeddi, Head, Petroleum Market Analysis Department. The KEEI was represented by Mr. Moon-Bae Lee, Research Fellow, Department of Energy Information Analysis, and Dr. Dal-sok Lee, Senior Research Fellow, Division of Oil Strategy Research, the ERI by Ms. Xiaoli Liu, now at the Asia Pacific Energy Research Center, and the JEEI by the author.

² “The World Oil Market: An OPEC Perspective” was given as a short-term outlook by Mr. Mohamed Alipour Jeddi, and “The Long-term Energy Outlook” by Mr. Mohamed Hamel.

- OECD oil inventories have been increasing. Given these prospects, the global oil supply-demand balances is expected to ease in 2006.

- Based on the above prospects, it was discussed that crude oil prices would be under downward pressure reflecting these supply-demand fundamentals. But geopolitical risks and the possibility of speculative money flowing into the oil market will remain, along with petroleum product supply bottleneck problems mainly in the United States. Therefore, the OPEC side pointed out crude oil prices, which are very sensitive to these factors, could follow an upward trend depending on these factors.

- The OPEC side explained the member countries' plans to continue increasing crude oil production capacity for the stabilization of the world oil market. They also emphasized the importance of the member countries' plans to expanding refining capacity as well as upstream (crude oil production) capacity³. On the other hand, however, the OPEC Secretariat noted their concerns that oil demand growth in the future could be affected by economic growth and the policies of oil consuming countries over a medium and long term.

- As for long-term prospects, the presentation made by the OPEC side indicated that world oil demand, which has been increasing steadily despite the recent crude price hikes, would continue to rise over a long term⁴. However, it was emphasized by the OPEC side that downside risks were likely to be greater than upside risks with regard to the oil demand growth, because of the possible impact of the policies in oil consuming countries and technological development to reduce oil demand.

- Oil supply is expected to remain sufficient to meet increasing demand. Non-OPEC oil production is projected to remain at high levels until around 2025⁵. But the OPEC side emphasized that significant uncertainties for the long term posed big risks to investment in crude production capacity expansion. It was estimated that the cumulative investment to be required in crude oil production for OPEC until 2020 would range from \$200 billion to \$370 billion. The OPEC side emphasized that the \$170 billion gap between the maximum and minimum estimates would pose a very substantial investment risk for OPEC countries, thus

³ The OPEC side indicated their plans to expand crude oil production capacity to 38 million B/D and refining capacity by 3.8 million B/D by 2010.

⁴ For the "Dynamic as Usual (DAU)" standard case, OPEC projects global oil demand to increase from 83.6 million B/D in 2005 to 113.4 million B/D in 2025.

⁵ For the DAU case, non-OPEC crude output is projected to increase from 50.5 million B/D in 2005 to 56.4 million B/D in 2025. The projected output in 2025 is close to the estimated OPEC output at 57 million B/D for the same year.

OPEC should examine future developments more accurately when making investment decisions.

- The OPEC side pointed out that the downstream sector would also face significant investment challenges over a long term. They estimated that \$127 billion in new oil refinery investment (excluding investment in maintenance services) would be required in the world between 2004 and 2015. Our discussion as to whether the required investment can be made in the world resulted in a conclusion that the future remains uncertain, although some regions including Asia are making real progress in the downstream investment.
- The OPEC side also emphasized that OPEC would continue to give serious considerations to environmental and sustainability problems for the world energy market and thus would continue to analyze the future of not only oil but also other fossil fuels like natural gas and coal, and nuclear energy and renewable energy.

2. Northeast Asian Oil Market and Possible Cooperation in Energy

- Under the circumstances, oil demand and market trends in Asia have become a matter of great concern to OPEC in their analysis of the global oil and energy markets. Many questions and comments were made by the OPEC experts to the Asian participants' presentations on Asian oil market prospects and challenges⁶, a Chinese oil market outlook⁷ and a South Korean oil market forecast⁸.
- The discussions focused on the following topics:
 - The position of coal in the long-term Asian energy supply-demand prospects;
 - The extent of natural gas demand growth in Asia;
 - Serious downside risks for oil demand growth in Asia;
 - The impact of growing concern for energy security issues in Asia;
 - The future development of oil refinery investment in Asia and the roles of state-run oil companies in the Middle East OPEC countries;
 - Whether major Asian countries (including Japan, China, Korea and India) would compete or cooperate to enhance oil supply security;
 - The analysis of oil demand growth pattern in China in 2004 and 2005 and outlook for

⁶ Two presentations were made on this topic: "Outlook for Asian Oil Market" by the author and "Oil Demand and Supply in Northeast Asia – Major Issues of Crude Oil Procurement" by Dr. Dal-sok Lee.

⁷ Ms. Xiaoli Liu made a presentation titled "China's Energy Supply-Demand Outlook."

⁸ Mr. Moon-Bae Lee made a presentation titled "Energy Supply and Demand in Korea: Trends and Outlook."

future Chinese oil demand.

- The discussions indicated that the outlook of oil demand in the Asian Market is the biggest matter of concern to the OPEC Secretariat in respect to long-term investment decisions.
- Through the discussions, both participants from Asian oil consuming countries and the OPEC Secretariat reaffirmed that global oil market stability is very important for both consuming and producing countries. The participants agreed that Asian oil consuming countries and the OPEC countries would deepen their interdependence because: (A) Asian consuming countries need stable energy supply for their sustainable development; and (B) Asia is very important for the OPEC countries in securing stable oil revenues and economic development. The participants indicated that dialogue or exchanges of opinions between Asia and OPEC countries would become more important for mutual understanding and facilitation of the perception of the interdependence.
- At this regular exchange of opinions, the participants had very active and frank discussions on the factors behind the recent crude oil price hikes, future oil price prospects, the present and future factors and policy measures affecting Asian oil demand, the importance of energy supply security to Asian oil consuming nations like Japan, China and Korea, and the significance of energy demand security to OPEC.
- As noted above, the 16th meeting with the OPEC Secretariat seemed to produce extremely substantial, frank discussion. The OPEC Secretariat also seems to value the discussions with IEEJ and delegates from China and Korea very highly, and the past 18 years of opinion exchange have helped ferment strong ties between both parties. We believe it very important to further develop these regular discussions with the OPEC Secretariat into opportunities to improve understanding and analysis of international energy and petroleum market, and develop the discussions into a conduit for presenting and exchanging opinions from Asia.

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