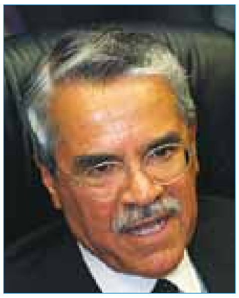
Seeking oil market stability



BY HIS EXCELLENCY ALI AL-NAIMI, MINISTER OF PETROLEUM AND MINERAL RESOURCES, KINGDOM OF SAUDI ARABIA

The themes of the 20th World Petroleum Congress in Qatar are cooperation, innovation and investment – three vital components for the energy industry as it looks to the future. The Kingdom of Saudi Arabia has continued to cooperate, innovate and invest in 2011 and will do so in 2012 and beyond. It is in all of our interests, and in the interests of consumers and producers around the world, that we all strive to further strengthen our ties, make additional investments in capacity and infrastructure, and continually innovate in an effort to seek more efficient and cleaner energy consumption.

And let me state for the record at the outset, whatever short-term issues arise, whatever the day's headlines or expert predictions, one thing is certain: global economic growth will continue to rely on oil – and in that, consumers can rely on Saudi Arabia.

I would like to reflect on the three themes of this conference, particularly regarding the future direction of the global economy and the challenges – as well as the opportunities – which lie ahead for the energy industry.

It is predicted that the global population will increase by another two billion people by 2030, predominantly in developing nations, with global energy demand growing by 40 per cent or more over the next two decades. This is a quite staggering proposition, presenting extraordinary prospects for the industry.

Estimates indicate that more than 200 million people will join the middle class this year in Asia, the Middle East, Latin America and Africa. Such economic and population growth, and rising living standards, will be accompanied by a considerable expansion of cities. In fact, the number of cities with one million people and above in the emerging economies is currently estimated at about 300 – and this number is continually rising.

This growth means rising demand for oil. It was only 20 years ago that industrialised countries accounted for 70 per cent of global oil demand. It is striking to note that emerging and developing economies are on course to surpass OECD industrialised countries in terms of oil demand – a first in the history of the oil industry.

It is clear that Asia's continued economic growth is the big driver. Saudi Arabia and other Gulf producers have already helped Asia's development by supplying much of the energy needed to fuel this prosperity – as Asia's economies have grown, so have our exports of petroleum to the region. This cooperation and investment is benefiting both sides. Roughly two-thirds of the Kingdom's crude oil exports now go to Asia, and we are the largest single supplier to major markets like China, Japan, Korea and India. And given the scale of our reserves and production capacity, our continued investment in technology and talent, as well as infrastructure, our clear and consistent energy policies, and our collaborative relationships with producers and consumers, we are determined to be Asia's petroleum supplier of choice for many decades to come.

Key to satisfying future global demand will be price. However, volatility in commodity markets continues, despite efforts from all parties to reduce fluctuations to a minimum. The economic crisis of 2008 proved we are more interconnected than ever, and sharp commodity price rises and falls in 2011 underline the fact. Yet regardless of attempts to increase cooperation and coordination between producers and consumers, price stability remains elusive.

Over the past decade, we have witnessed dramatic shifts in the global economy, and consequently in commodity markets, including oil. Shifts in commodity markets, in recent memory alone, give us a snapshot of oil price unpredictability, with prices per barrel for WTI crude-oil swinging from the historic low in 1998 of US$11 to an all-time peak of US$147 in 2008.

But oil was not suddenly scarce during that decade, nor during 2011, so what was the problem? Of course there are many factors – both real and imagined – which impact on the price of oil. But I continue to believe that it can be explained, in part, by the fact that in recent years oil has become well established as an attractive asset class for a growing and diverse set of investors.

This trend appears unlikely to abate any time soon. In fact, it will likely contribute to ongoing volatility as investor money moves in and out of oil futures markets based on a variety of factors which may have very little to do with basic oil market supply and demand fundamentals.

This is a serious challenge for the industry – and for governments around the world. Oil producers and consumers share a common interest in promoting stable markets and ensuring affordable and fair prices. Petroleum is a long-term, capital-intensive industry, with exploration, discovery and development taking long lead times of many years to bring new fields and increments to production.

As such, adequate financial returns, stable prices, and transparency and predictability of future demand are required. Wildly fluctuating prices are not conducive to future investments to ensure that crude oil, refined products and natural gas supplies are delivered when and where they are needed.

Like all businesses, the oil industry needs a reasonable level of certainty to undertake massive investments in new capacity. Efforts by the International Energy Forum, particularly its Joint Oil Data Initiative, certainly help take producer-consumer cooperation to a higher level.

Such dialogue encourages the greater openness and understanding necessary to reduce volatility, because transparency is vital for both producers and consumers, so that they can collect, exchange and consider reliable and timely data.

Ongoing innovations in dialogue and the study of volatility and transparency issues within the G20 framework have also been constructive, allowing the international community to improve its understanding of various factors that contribute to energy market instability.

So as we head into 2012, where is the global economy heading and what role for oil producers? After a period of turmoil and severe economic downturn, recovery may be underway in large parts of the world, although it remains patchy. Many developed countries have unacceptable levels of unemployment and some nations are struggling with outsized national deficits and debts. Against this backdrop concerns remain about global economic growth.

Some have also expressed worries that rises in oil prices in 2011 could signal a return to the conditions of 2008, when prices approached US$150 per barrel, and there are those who are anxious that a significant rise in oil prices could send the global economy back into recession.

While there is reason to be vigilant about price, the current situation is different from 2008. In the short term, I am confident that oil markets are relatively balanced and that recent price rises have less to do with supply-demand fundamentals than with other factors, such as gyrations in the value of the dollar and in traders seeking to test new price levels.

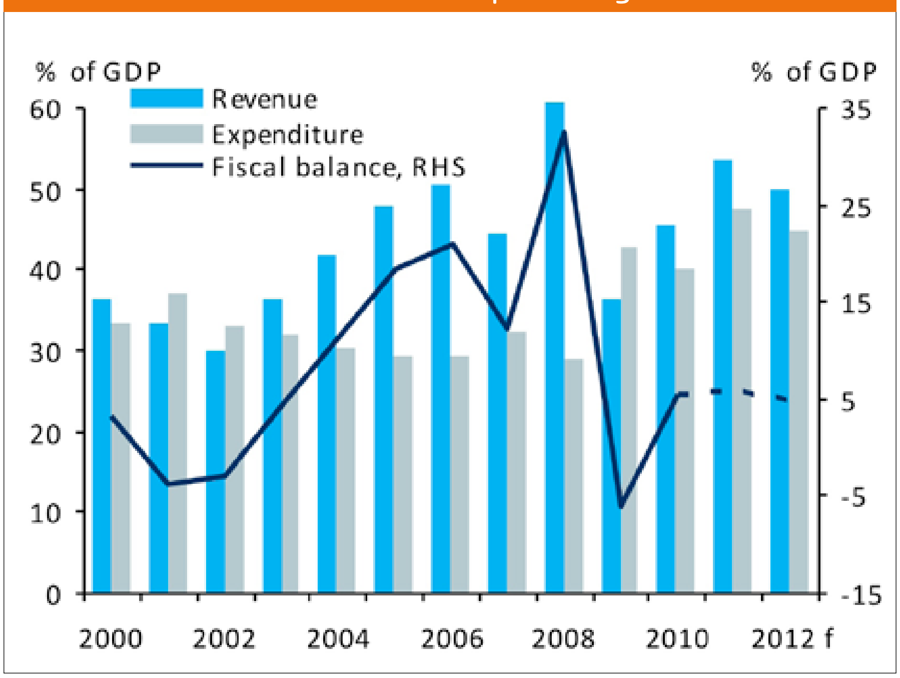
There is definitely adequate spare capacity in the system. Inventories in all key markets are ample, and there is significant spare capacity in Saudi Arabia.

It is clear that markets and higher oil prices are being driven by doubts and uncertainties. These include the future of non-OPEC conventional supplies, whether OPEC will make investments to significantly expand production capacity, and whether non-conventional sources, such as oil sands, can meet growing demand without passing on their higher costs to the consumer.

These questions are not new, and there will always be some who discount the role of technological progress in making vast new reserves economical to produce in the future. We have heard talk about peak oil for decades, but peak demand may well arrive before we ever reach a peak in supplies. After all, the world turned away from whale oil long before the end of whales.

There has always been a level of doubt about the industry's ability to meet growing global requirements for energy – and there always will be. But time and time again, the petroleum industry has risen to the challenge, and it will continue to do so in the future. Again, dialogue and cooperation between consuming nations and producers will be vital.

Saudi fiscal balance as a percentage of GDP



Source: Ministry of Finance, Haver, Barclays Capital

Of course, meeting future energy needs will require contributions from across the spectrum of sources – including renewables, nuclear, natural gas, coal, and of course, oil. Such great demand will mean that the more established energy sources will be called to the fore, given their known quantities including supply, infrastructure and end-use technologies.

But the gap between the readiness of fossil fuels and that of renewables, which still must overcome hurdles on the way to making an appreciable contribution, makes a compelling argument for the place of oil in the energy mix.

The world does not have the luxury of discarding any particular energy source, marginalising or penalising its competitiveness through policy, public opinion, regulatory measures, or distribution of subsidies and incentives to unfair advantage. The effect of such an approach would be damaging to global economic development and to efforts to raise living standards for the billions of people still living in poverty.

A level playing field that encourages the investment needed for all viable energy sources to fully contribute is vital for a secure energy future. Likewise, that level playing field should seek to minimise government intervention policies as these tend to manipulate demand and create uncertainties through artificial means rather than market signals.

The traditional fossil fuel energy sources, especially oil, will continue to serve as the "base-load" for meeting growing world energy demand for decades to come. Just as energy outlooks concur on a 40 per cent jump in energy demand over the next 20 years, they also indicate that more than 80 per cent of that demand will be met by fossil fuels – of which oil will deliver the lion's share. This will be true at least through mid-century, and perhaps even longer, thanks to human creativity.

One fact remains clear, and I make no apologies for repeating myself. Saudi petroleum policy, implemented under the directions and direct supervision of the Custodian of the Two Holy Mosques King 'Abd Allah ibn 'Abd al-'Aziz, remains constant. It stresses moderation, cooperation and stability.

Moderation means the Kingdom's ongoing efforts to promote peace, justice, international cooperation, regional and international stability, and human prosperity, as well as employment of all resources to achieve such objectives. Cooperation means working with companies and countries, both with OPEC and non-OPEC producers, and with consuming countries. This cooperation is crucial to guaranteeing oil's positive contribution to global economic growth and prosperity. And stability means creating the conditions for additional investments in capacity and infrastructure, which will also lead to further advances and innovations as the world's demand for energy grows.

Whatever the future holds, it is clear that sustained cooperation, unceasing innovation and continual investment will be essential. If we can seek to dampen price fluctuations – by increased dialogue and transparency – the better for the industry, producers and, ultimately, consumers.

A supertanker berths at the Ras Tanura Sea Island Terminal, the main Saudi loading port