11 July 2000

HIGHLIGHTS

- Oil markets need more product, especially gasoline for current use and heating oil for next winter. Although crude oil production has increased, refinery throughputs have been too low to reduce the deficits in OECD oil product stocks. Factors discouraging the refiners have been scheduled maintenance and uncertainty about future refining margins.

- Crude prices edged higher in June, pushed up by speculative interest, low crude and product inventories, and strong gasoline demand. Fuel switching from natural gas into oil and the limited availability of gasoline-rich sweet crude also contributed to the price strength.

- World oil production fell by 420 kb/d in June to 76.5 million b/d, pulled down by a 490 kb/d drop in Iraqi output. However, OPEC crude dropped by only 240 kb/d, as supply from other OPEC countries rose by 250 kb/d. Their output already exceeded the target of 25.4 million b/d agreed to by the producers on 21 June. Compared to a year earlier, global output in June was up by 3.8 million b/d, 2 million b/d from OPEC and 1.8 million b/d from non-OPEC countries.

- In an abrupt turnaround from the declines of March and April, preliminary figures for May show that product deliveries in nine large OECD markets grew by an average of 4.6%. Nonetheless, estimated global oil demand in the second quarter of 2000 was unchanged at 74.4 mb/d. A reduction in OECD demand was offset by higher-than-expected growth in non-OECD countries, mainly the FSU.

- OECD industry stocks rose by 1.7 million b/d in May, but April levels were revised downwards by a sharp 1 million b/d. Large negative adjustments in Japan and Europe more than offset an upward revision in North America. Stocks in North America and Europe remain substantially lower than last year.

Next issue: 9 August 2000

Letter from the Editor

After 6½ years of working on the Oil Market Report, the last 3½ as Editor, it is time for me to move on. I have enjoyed my tenure at the IEA immensely and I know I will have a hard time matching the excitement and productivity of the last several years. The oil market has provided a fertile, albeit sometimes swampy, ground for analysis. My predecessor Philip Starling's parting letter in January 1997 commented that our objective was to "act as a clearing house for the oil market" and to provide "a factual and unbiased account of market developments". He expressed confidence that progress on that score would continue. I hope that his confidence will be seen to have been justified. I now transfer the same burden to my successor Klaus Rehaag.

One of the greatest challenges has been to try to improve timeliness while maintaining the quality of the data and analysis. Timeliness means using preliminary data, which, even for relatively "hard" data such as OECD industry stocks, are often revised in later country submissions. We believe the readers want these preliminary data as soon as they are available, and understand their limitations. Similarly, the market commentary which has been added to the beginning of the Report is not meant to substitute for the detailed analysis in the rest of the Report, but to provide some quick pointers for the busy reader.

In my introductory "Letter from the Editor" in February 1997, I commented on the benefits of "creative criticism from our valued readers". In line with the volatility of the data and projections contained in the Report, and the oil market in general over the last three years, feedback from our readers and others has intensified. Be assured that it has been taken to heart. Trying to give plain answers to complicated questions is a daunting task.

The list of people for me to thank is a very long one. The support from the IEA Front Office, Robert Priddle and Bill Ramsay (and earlier John Ferriter), who read and comment on the first draft of each Report, is much appreciated, as is the review by Office Director Tatsuo Masuda, Legal Council Craig Bamberger, and especially Scott Sullivan, Head of the IEA Public Information Office, one of the best editors I have ever had the pleasure to work with, and his deputy, Fiona Davies. With Scott's help we have been able to shorten and focus the Report, improving its accessibility to more general audiences and hopefully doing a better job of communicating our message. It goes without saying that it all starts with the data. My heartfelt thanks go to Jean-Yves Garnier's staff in the Statistics Division, particularly Mieke Reece for member country statistics, Nina Kouznetsoff and now Sohbet Karbuz for non-member country statistics and Karen Treanton for price data and general energy statistics and the numerous statisticians working for them who have supported the OMR). Getting the "finished" Report to the readers is not always an easy task. Many long nights have been spent transmitting the Report to the printers, for which I thank Angela Gazar and the irrepressible Jim Murphy.

I have had the pleasure of working with a very interesting and talented group of oil market analysts in my time at the IEA. Besides Philip Starling, the initial team of analysts included Marshall Hall and Tatsuo Sato. Since then, Administrators Koji Nakui, Gareth Lewis-Davies and Roberto Sieber have come and gone, each leaving their personal impact on me and the OMR. I hired all of the current OMR team of Klaus Rehaag, Mike Wittner, Deborah White, Miharu Kanai and Statistical Assistant Isabelle Ynesta and I am very proud of them. I owe a very special thanks to my Secretary/Editorial Assistant Anne Mayne who, with help from Brid Deely, has not only been policewoman for proper British English, but also has been unstinting in pursuit of a visually appealing document. Finally, but not certainly not least, thanks go to the valued readers of the Report. Especially to those in the IEA Member governments, who are after all the original and continuing primary *raison d'être* for this Report, for their attention and feedback, and to those in the oil industry who educate us regularly on what is happening in oil markets and what it might mean.

With best regards,

David Knapp

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Head of Administrative Unit
International Energy Agency
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OIL MARKET REPORT CONTACTS

WHAT THE WORLD NEEDS NOW: MORE PRODUCT

What is needed to take the heat out of oil markets is more oil product, and soon. When crude oil is available, refiners can to refine and deliver more product to consumers. But there is no guarantee that they will do so. Refiners require clear, favourable economic signals before they will raise output.

The trouble is that the market is confused and nervous: a new focus for speculation is which way the crude producers might jump at their periodic meetings. A quick and relatively harmonious meeting of producers on 21 June resulted in an increase in production quotas. But how much actual new production will there be? Refiners do not really believe today's prices are sustainable, and hesitate to run crude for product restocking; but product stocks are already unacceptably low because of similar uncertainties earlier in the year and today's supply obligations must be met.

The gasoline season is now underway, in both the US and Europe, with stocks below historical norms. Refiners in both regions are confronted with difficult new environmental standards. Differences in standards between the regions complicate trade. The new US gasoline standards specify the amount and type of oxygen compounds in the gasoline to be sold in areas with high ozone concentrations. Under a set of US patents, a royalty of 5.75 cents per gallon ($2.415 per barrel) is due on almost every type of high octane gasoline that meets the new US standards, enough to wipe out most of refiners' margins. With refineries and distribution pipelines operating near capacity, unplanned refinery or pipeline outages could cause real shortages. In the last few months there have been major problems in the refining and distribution systems in the US and Europe. Elsewhere, a serious explosion and fire at Kuwait's 428 kb/d Mina al-Ahmadi refinery could take months to repair.

World Supply and Demand Balances Second to Fourth Quarters 2000

Global Balances (mb/d)	2Q (p)	3Q (e)	*Change*	4Q (e)	*Change*
Demand	74.42	76.36	*+1.94*	78.41	*+2.04*
Non-OPEC Supply*	48.47	48.59	*+0.12*	49.39	*0.80*
OPEC Crude**	28.03	28.25	*+0.23*	28.35	*0.10*
Difference	*+2.07*	*0.48*		*-0.66*	
* including OPEC NGLs ** assuming OPEC 10 @ 21 June levels in 3Q, 4Q and a small increase from Iraq					
Inventory Situation (mb) * **					
Gasoline stocks vs. 99 – US	-6	-6		-37	
Gasoline stocks vs. 99 – Europe	-12	-12		-27	
Distillate Stocks vs. 99 – US	-28	-52		-57	
Distillate stocks vs. 99 – Europe	-47	-51		-58	

*** assuming maximum gasoline yields in 3Q, maximum distillates in 4Q

But continuing high prices are not just a matter of refining capacity. Much of the new crude oil coming on the market is heavier and higher in sulphur than the light crudes usually used to make gasoline. It will be difficult and expensive to refine into gasoline, particularly gasoline meeting the new standards. In fact, the weekly average prices of some of these crudes (Urals and Iranian Heavy) have actually declined over the last five weeks and others, such as Dubai and West Texas Sour, have increased only slightly. Although the US Gulf Coast has a large number of coking units that can process the heavy crude into gasoline, little of this capacity is idle and other refining centres do not have much coking. Because of low gasoline stock levels in the US and Europe, refiners are maximising gasoline production at the expense of heating oil.

The picture emerging from the top half of the table above looks reasonably comfortable, especially if Saudi Arabia, with or without others, adds an extra 0.5 mb/d to third and fourth quarter supply. This could help cool market anxieties. But the stock situation depicted in the bottom half of the table warrants serious attention. If gasoline production were maximised on both sides of the Atlantic, further erosion of gasoline stocks could be prevented. But the distillate gaps would widen to over 50 million barrels. Maximising distillate output at the expense of gasoline in the fourth quarter could hold down the distillate deficit, but would result in an expanding gap for gasoline, even compared to the end-1999 lows. In any case, colder than normal weather could trigger heating oil shortages: some driving is discretionary, heating is not.