

Energy Watchdog Warns Of Oil-Production Crunch

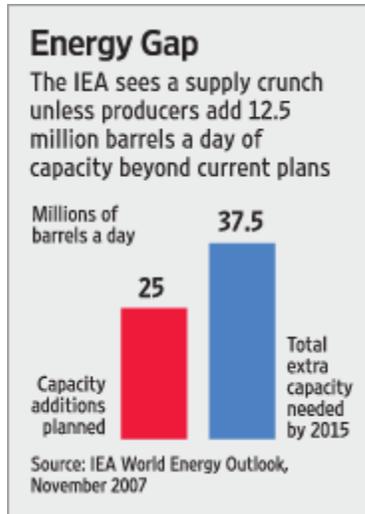
IEA Official Says Supplies

May Plateau Below

Expected Demand

By NEIL KING JR. and PETER FRITSCH

May 22, 2008; Page A1



The world's premier energy monitor is preparing a sharp downward revision of its oil-supply forecast, a shift that reflects deepening pessimism over whether oil companies can keep abreast of booming demand.

The Paris-based International Energy Agency is in the middle of its first attempt to comprehensively assess the condition of the world's top 400 oil fields. Its findings won't be released until November, but the bottom line is already clear: Future crude supplies could be far tighter than previously thought.

A pessimistic supply outlook from the IEA could further rattle an oil market that already has seen crude prices rocket over \$130 a barrel, double what they were a year ago. U.S. benchmark crude broke a record for the fourth day in a row, rising 3.3% Wednesday to close at \$133.17 a barrel on the New York Mercantile Exchange.

For several years, the IEA has predicted that supplies of crude and other liquid fuels will arc gently upward to keep pace with rising demand, topping 116 million barrels a day by 2030, up from around 87 million barrels a day currently. Now, the agency is worried that aging oil fields and diminished investment mean that companies could struggle to surpass 100 million barrels a day over the next two decades.

The decision to rigorously survey supply -- instead of just demand, as in the past -- reflects an increasing fear within the agency and elsewhere that oil-producing regions aren't on track to meet future needs.

"The oil investments required may be much, much higher than what people assume," said Fatih Birol, the IEA's chief economist and the leader of the study, in an interview with The Wall Street Journal. "This is a dangerous situation."

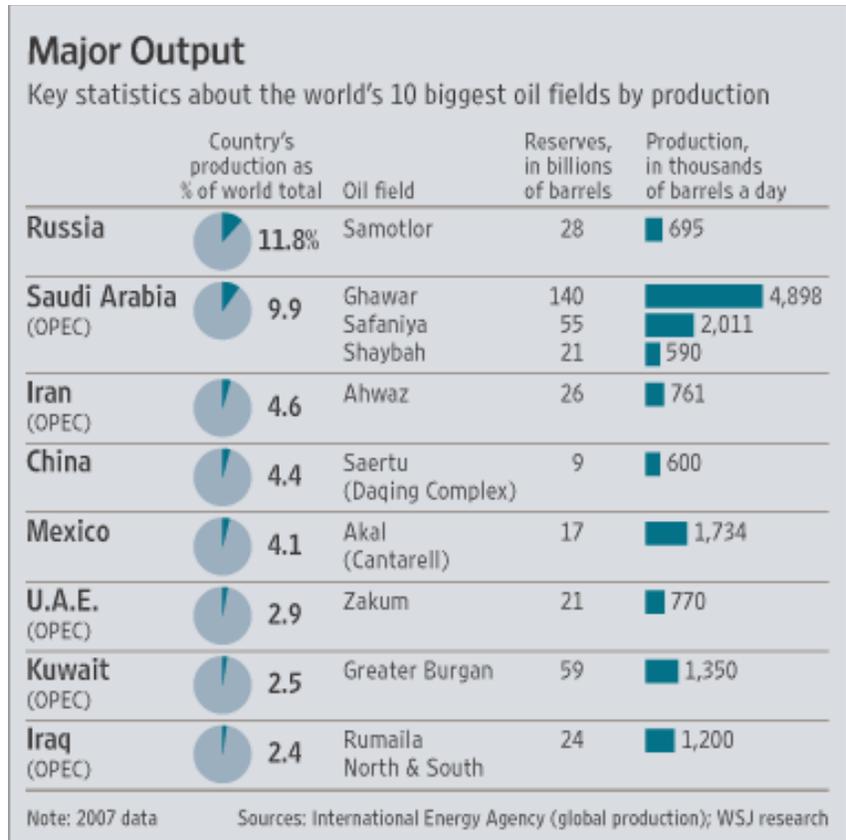
The agency's forecasts are widely followed by the industry, Wall Street and the big oil-consuming countries that fund its work.

The IEA monitors energy markets for the world's 26 most-advanced economies, including the U.S., Japan and all of Europe. It acts as a counterweight in the market to the views of the Organization of Petroleum Exporting Countries. The IEA's endorsement of a crimped supply scenario likely will be interpreted by the cartel as yet another call to pump more oil -- a call it will have a difficult time answering. Last week, the Saudis gave President Bush a lukewarm response to his plea for more oil,

saying they were already adding 300,000 barrels a day to the market, an announcement that did nothing to cool prices.

At the same time, the IEA's conclusions likely will be seized on by advocates of expanded drilling in prohibited areas like the U.S. outer continental shelf or the Alaska National Wildlife Refuge.

The IEA, employing a team of 25 analysts, is trying to shed light on some of the industry's best-kept secrets by assessing the health of major fields scattered from Venezuela and Mexico to Saudi Arabia, Kuwait and Iraq. The fields supply over two-thirds of daily world production.



The findings won't be definitive. Big producers including Venezuela, Iran and China aren't cooperating, and others like Saudi Arabia typically treat the detailed production data of individual fields as closely guarded state secrets, so it's not clear how specific their contributions will be. To try to compensate, the IEA will use computer modeling to make estimates. It will also collect information gathered by IHS Inc., a major data and analysis provider based in Colorado, as well as the US. Geologic Survey, a smattering of oil and oil-service companies, and national petroleum councils.

Supply-Side Gloom

But the direction of the IEA's work echoes the gathering supply-side gloom articulated by some Big Oil executives in recent months. A growing number of people in the industry are endorsing a version of the "peak-oil" theory: that oil production will plateau in coming years, as suppliers fail to replace depleted fields with enough fresh ones to boost overall output. All of that has prompted numerous upward revisions to long-term oil-price forecasts on Wall Street.

Goldman Sachs grabbed headlines recently with a forecast saying that oil could top \$140 a barrel this summer and could average \$200 a barrel next year. Prices that high would add to the inflationary pressures weighing on the world economy and to the woes of fuel-sensitive industries such as airlines and autos.

The IEA's study marks a big change in the agency's efforts to peer into the future. In the past, the IEA focused mainly on assessing future demand, and then looked at how much non-OPEC countries were

likely to produce to meet that demand. Any gap, it was assumed, would then be met by big OPEC producers such as Saudi Arabia, Iran or Kuwait.

But the IEA's pessimism over future supplies has been building for some time. Last summer, the agency warned that OPEC's spare capacity could shrink "to minimal levels by 2012." In November, it said its analysis of projects known to be in the works suggested that the world could face a shortfall by 2015 of as much as 12.5 million barrels a day, unless there was a sharp drop in expected demand. The current IEA work aims to tally the range of investments and projects under way to boost production from the fields in question to get a clearer sense of what to expect in production flows.

"This is very important, because the IEA is treated as the world's only serious independent guardian of energy data and forecasts," says Edward Morse, chief energy economist at Lehman Brothers. Examining the state of the world's big oil fields could prod their owners into unaccustomed transparency, he says.

Some critics of the IEA, while praising its new study, say a revision in the agency's long-term forecasting is long overdue. The agency has failed to anticipate many of the big energy developments in recent years, such as the surge in Chinese demand in 2004 and this year's skyrocketing prices. "The IEA is always conflicted by political pressures," says Chris Skrebowski, a London-based oil analyst who keeps his own database on big petroleum projects and is pessimistic about supply. "In this case I think they want to make as incontrovertible as possible the fact that we are facing a real crunch."

U.S. Forecasts

The U.S. Energy Department's own forecasting shop, the Energy Information Administration, has long stuck to the same demand-driven methodology as the IEA, assuming that supply will keep up with the world's growing hunger for oil. But the U.S. agency also has embarked on its own supply study, which it hopes to complete this summer. Like the IEA, its preliminary findings are somewhat gloomy: They suggest daily output of conventional crude oil alone, now about 73 million barrels, will plateau at 84 million barrels, and that it will take a significant uptick in production of nonconventional fuels such as ethanol to push global fuel supplies over 100 million barrels a day by 2030.

"We are optimistic in terms of resource availability, but wary about whether the investments get made in the right places and at a pace that will bring on supply to meet demand," says Guy Caruso, the U.S. agency's administrator.

In Paris, analysts at IEA also fret that a lack of investment in many OPEC countries, combined with a diminished incentive to ramp up output, casts serious doubt over how much the cartel will expand its production in the future. The big OPEC producers have been raking in record profits, creating a disincentive in many countries to sink more billions into increased oil production.

Meanwhile, politics and other forces are delaying projects that could bring more oil on-stream. Continued fighting in Iraq has stymied efforts to revive aging fields, while international sanctions on Iran have kept investments there from moving forward. Rebel attacks in Nigeria and political turmoil in Venezuela have cut into both countries' output. Big non-OPEC producers such as Mexico and Russia, which have either barred or sidelined international operators, are seeing production slump. The U.S.,

with a legal moratorium barring exploration in 85% of its offshore waters, is struggling to keep its output steady.

The IEA study will try to answer one question that bedevils those trying to forecast future prices and the supply-demand balance: How rapidly are the world's top fields declining? The rates at which their production dwindles over time are a much-debated barometer of the health of the world's oil patch.

Depletion Rate

A study released earlier this year by the Cambridge Energy Research Associates, a consulting firm and unit of IHS, concluded that the depletion rate of the world's 811 biggest fields is around 4.5% a year. At that rate, oil companies have to make huge investments just to keep overall production steady. Others say the depletion rate could be higher.

"We are of the opinion that the public isn't aware of the role of the decline rate of existing fields in the energy supply balance, and that this rate will accelerate in the future," says the IEA's Mr. Birol.

Some analysts, however, contend that scarcity isn't the issue -- only access to reserves and investment in tapping them. "We know there is plenty of oil and gas resource in the world," says Pete Stark, vice president for industry relations at IHS. He says the difficulties of supply aren't buried in oil fields, but are "above ground."

Mr. Morse at Lehman Brothers notes that there are plenty of questions about supply yet to be answered. "However confident the IEA may be about the data it has, they know nothing about the resources we've yet to discover in the deep waters or in the arctic," he says.

Write to Neil King Jr. at neil.king@wsj.com and Peter Fritsch at peter.fritsch@wsj.com