STATEMENT OF

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before the

SUBCOMMITTEE ON ENERGY AND AIR QUALITY

COMMITTEE ON ENERGY AND COMMERCE

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Summary

Despite several disruptions in supply since last November (Venezuela, Nigeria and Iraq) and reductions in inventories to low levels in the United States and elsewhere, the prospects for improvements in short-term world oil supply are good over the next several quarters. Inventories are expected to move into a more comfortable range as we move into 2004. Greater confidence that this development is likely has had a reassuring effect on the oil market, helping to bring crude oil price levels down significantly from pre-war levels. However, the low starting point for inventories means that real improvement will take time and that crude oil prices are likely to remain near current levels (about $27 per barrel for West Texas Intermediate) until some time in 2004. Thus, while prices have come down from high first-quarter levels, no near-term collapse is expected.

OPEC producers with spare capacity have contributed increases in production above quotas to make up for lost production from disrupted areas since last fall. It is assumed that as the disrupted sources move back toward normal production (now particularly Iraq) the increased production from those areas will be accommodated by reductions in supply from other OPEC producers. Thus, the development of excess supplies that might sharply pressure prices in the downward direction is not expected over the next several quarters.

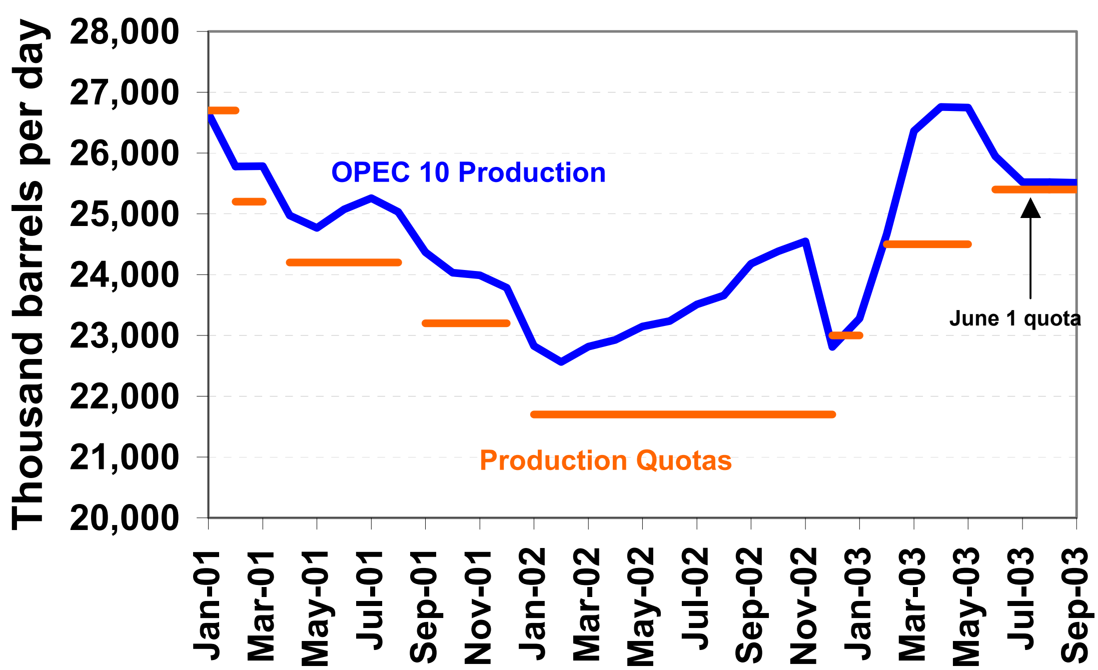
Mr. Chairman and Members of the Committee:

I appreciate the opportunity to appear before you today to summarize the world oil market outlook between now and the end of 2004. The source of these projections is the most recent release of the *Short-Term Energy Outlook*, published by the Energy Information Administration (EIA). These releases are updated monthly.

The EIA is the statutorily chartered statistical and analytical agency within the Department of Energy. We are charged with providing objective, timely, and relevant data, analysis, and projections for the use of the Department of Energy, other Government agencies, the U.S. Congress, and the public. We do not take positions on policy issues. We produce data and analysis reports that are meant to help policy makers determine energy policy. Because we have an element of statutory independence with respect to the analyses that we publish, our views are strictly those of EIA. We do not speak for the Department or for any particular point of view with respect to energy policy, and our views should not be construed as representing those of the Department or the Administration. EIA's baseline projections on energy trends are widely used by Government agencies, the private sector, and academia for their own energy analyses.

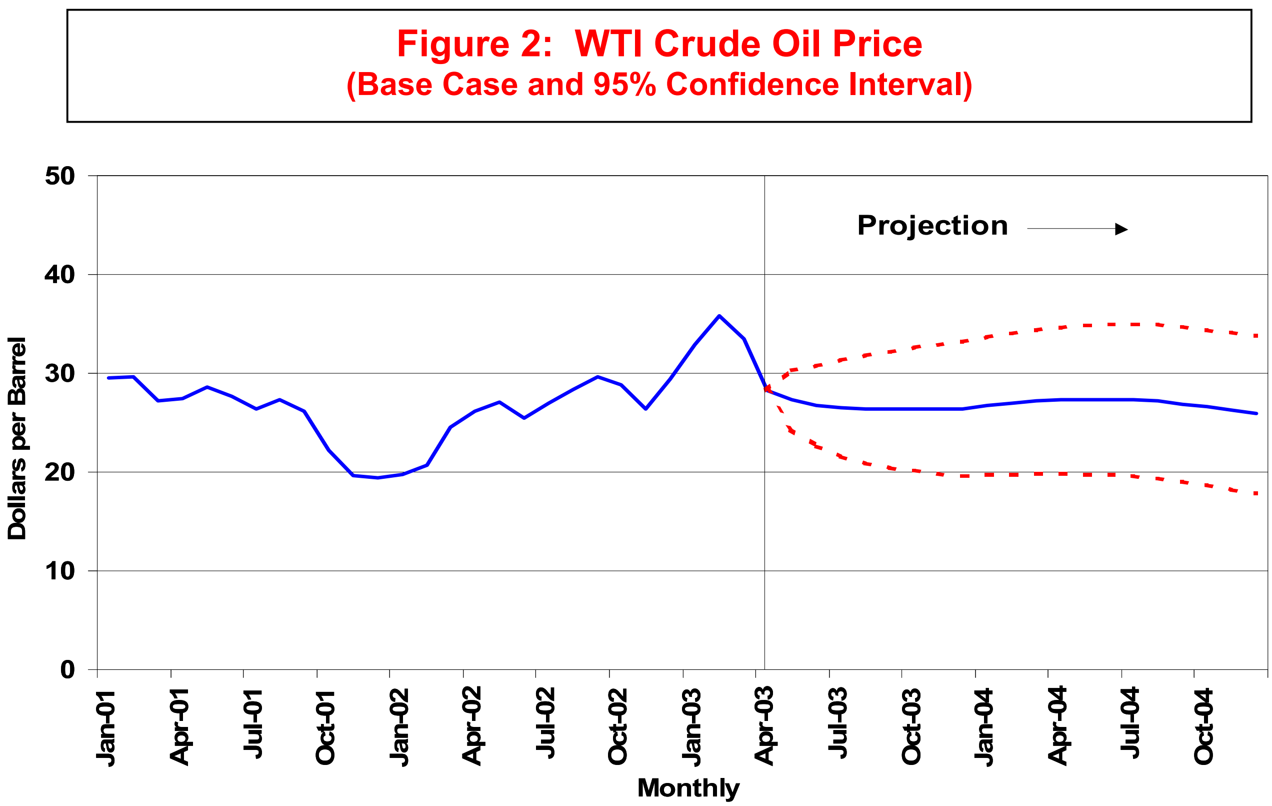
World Oil Markets. The April 24 meeting of the Organization of Petroleum Exporting Countries (OPEC) raised official quotas for members (excluding Iraq) by 0.9 million barrels per day from the previous (suspended) quota to 25.4 million barrels per day. OPEC members also sought tighter compliance with quotas, calling for production cuts of 2 million barrels per day from April levels. We expect these measures to result in an average total OPEC (including Iraq) crude oil production rate of about 26.7 million barrels per day in the second and third quarters. Individual OPEC country shares of these output levels will depend upon the speed with which Iraqi production recovers through 2003 and the extent to which Nigerian and Venezuelan production return to more normal levels (Figure 1).

Figure 1: OPEC 10 Crude Oil Production vs Quotas, January 2000 to September 2003



OPEC 10 Production for May-December 2003 is a Projection. Source: EIA

Crude Oil Prices. Average crude oil prices for April fell about $5 per barrel from March averages. The market reacted to prospects for greater oil supplies from Iraq, Nigeria and Venezuela as well as OPEC's surprise increases in production quotas. For example, West Texas Intermediate (WTI) spot prices averaged about $28 per barrel in April, $5 per barrel lower than the March average, and by end-April WTI prices were $12 per barrel lower than levels reached just two months earlier in anticipation of the start of the war in Iraq (Figure 2). Prices have since stabilized as people realize that, while the war was quick, it may take several months for Iraqi oil exports to resume in large volumes. Oil markets will be watching how other OPEC members respond to the return of supplies



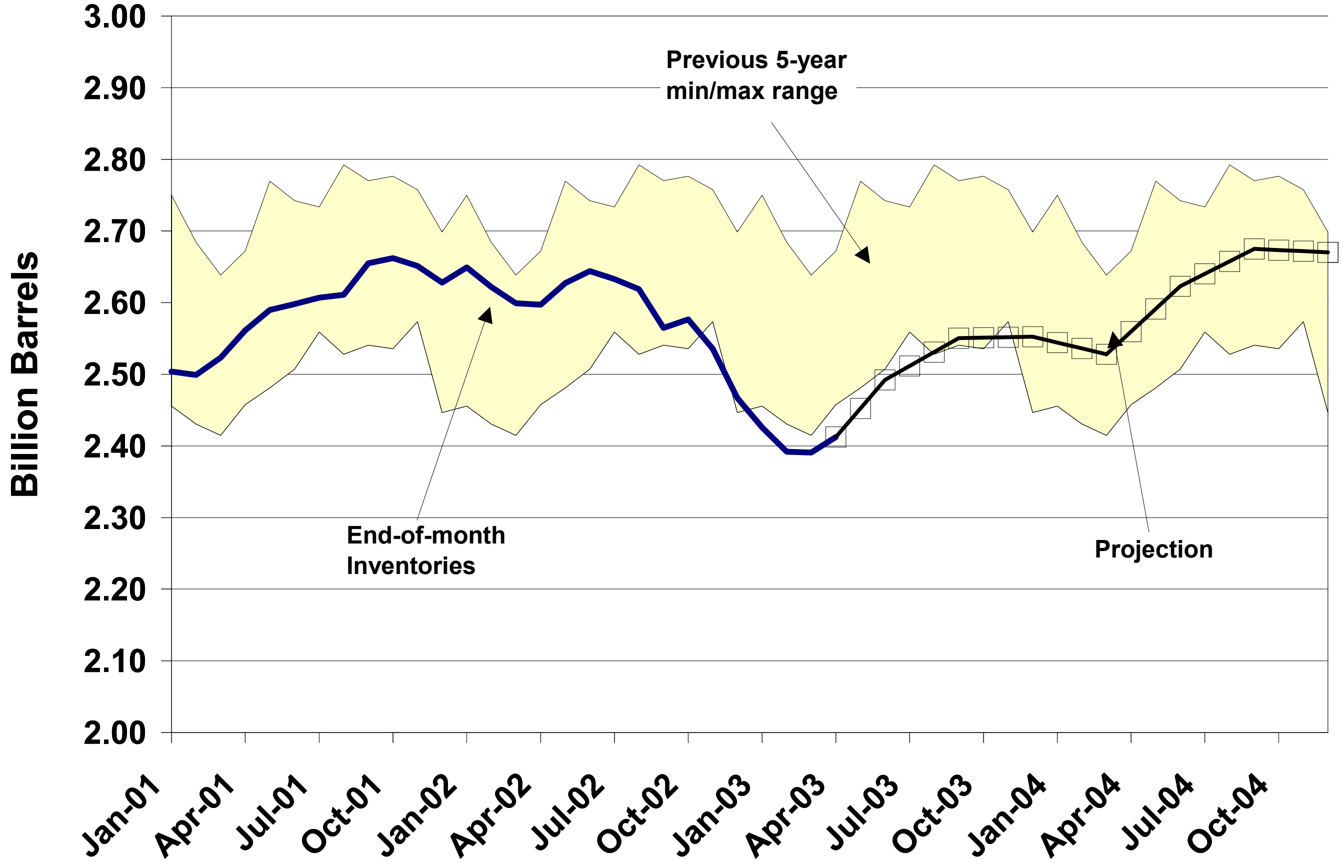
**The confidence intervals show +/- 2 standard errors based on the properties of the model. The ranges do not include the effects of major supply disruptions.*

Sources: History: EIA; Projections: Short-Term Energy Outlook, May 2003.

from Iraq, Nigeria and Venezuela. EIA's baseline outlook assumes that OPEC production will be sufficient to allow commercial oil inventories in the Organization for Economic Co-operation and Development (OECD) countries to build from their current very low levels (Figure 3), but that OPEC will cut back production to accommodate the return of Iraqi oil exports. Until these inventories are rebuilt above observed 5-year lows, WTI oil futures prices should remain around current levels and then gradually slide toward about $24 per barrel by the end of 2004 as Iraqi oil exports return. These projections always assume that OPEC members will completely accommodate a return of Iraqi exports with no regard to the timing and the volumes that are produced.

International Oil Supply. OPEC crude oil production (including Iraq) fell by 0.9 million barrels per day in April to below 27 million barrels per day, as further production increases from the OPEC 10 were not sufficient to offset the loss of Iraqi production following the war in that country. OPEC production is expected to remain at about the same level in May before declining in response to OPEC's efforts to adhere to the new production quotas in June. However, even with this cutback, year-over-year increases of 1.1 million barrels per day for OPEC crude oil production are still expected for the third quarter (albeit from low 2002 levels). This trend, combined with an expected aggregate increase in non-OPEC supply in 2003 of 1.1 million barrels per day, indicate a total world oil supply increase in 2003 of 2.5 million barrels per day, which is expected to allow for a global stock build this year.

Figure 3: OECD Commercial Oil Stocks

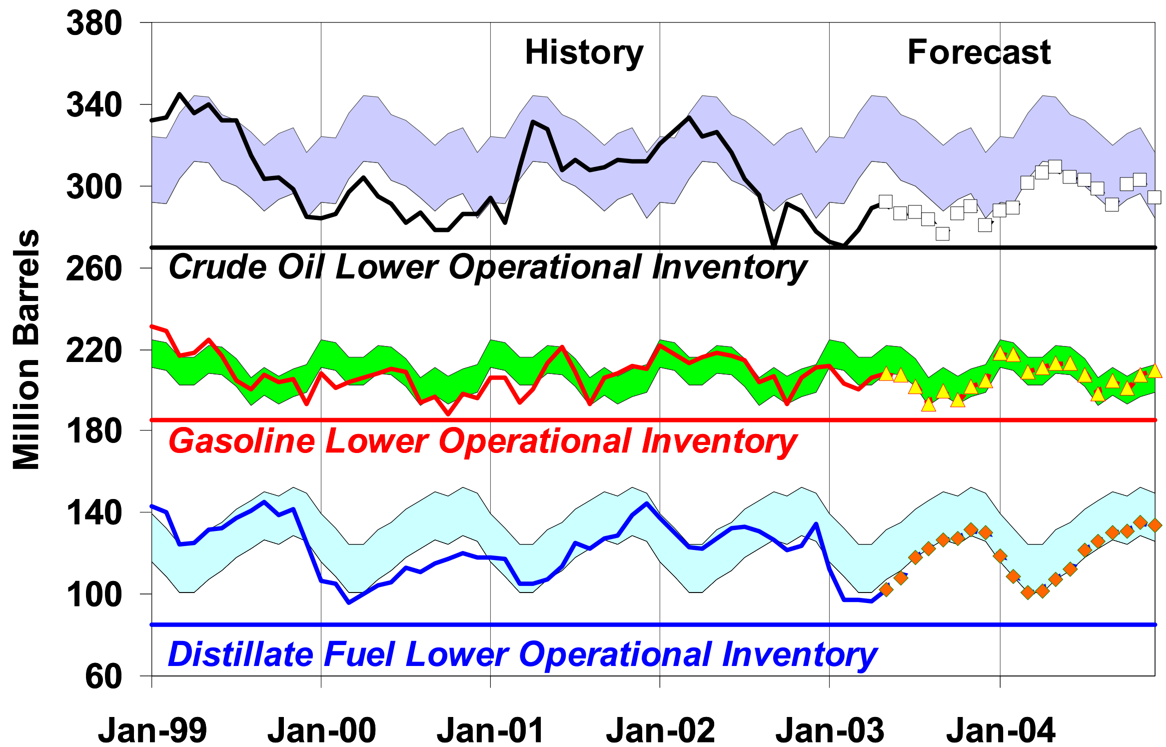


Sources: History: EIA: Projections: Short-Term Energy Outlook, May 2003.

Figure 4 depicts U.S. crude oil, motor gasoline and distillate inventories. Although reflective of the international picture as previously described, the figure shows that, for the next several months, supplies are going to be tighter than normal. Projected stocks are either at or below the lower ends of their respective 5-year average ranges. In response to low prices at the beginning of 2002, OPEC tightened production for much of that year. In addition, the impact of the

Venezuelan disruptions has been relatively larger in the U.S. than elsewhere. These are

Figure 4: U.S. Crude Oil, Motor Gasoline and Distillate Stocks



NOTE: Colored Bands are Normal Stock Ranges

Sources: History: EIA; Projections: Short-Term Energy Outlook, May 2003.

likely to contribute to the tightness of stocks during the next several months even though OPEC has been raising its quotas and Venezuelan production has partially recovered from its recent lows. Inventories are expected to recover only slowly during the forecast interval. Although the low inventory levels are a source of concern, the following points should be noted.

First, the actual and projected stock series are still higher than their record lows and above the minimum estimated by the petroleum industry to minimize the likelihood of interruptions in the distribution of products to the retail level. Second, the stock figures shown here are commercial inventories only: they exclude stocks in the Strategic Petroleum Reserve, currently containing 600 million barrels, and the Federally mandated Regional Petroleum Reserve of heating oil stocks in the Northeast, currently standing at 2 million barrels. Third, refineries, as a result of several years of upgrading, have displayed increasing flexibility in increasing output during periods of low inventories. Fourth, product imports are, and will continue to be, readily available from both Caribbean and European refineries.

Thank you, Mr. Chairman and members of the Committee. I will be happy to answer any questions that you might have. Attached to this statement is a complete copy of the most recent *Short-Term Energy Outlook* on which this testimony is based. The *Outlook* is also accessible on the internet on the Energy Information Administration's website http://www.eia.doe.gov.