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Ladies and Gentlemen:

I am very pleased to be with you at this the 14th Northeast Asia Economic Forum. The company I work for, Energy Intelligence, is honoured to be invited to this event and participate in the worthy task of fostering regional cooperation and understanding. My particular thanks go to Ms Karla Fallon and Governor Cowper for their kind invitation and generous support in getting me here to Shenyang today.

To introduce the company I work for, Energy Intelligence publishes news and analysis on the global energy industry, focusing on crude oil, petroleum products and natural gas. We write about oil prices, company strategies, political decisions, and the global markets for energy.

The organisers of your Forum have asked me to give you a brief talk today on oil. The astonishing leap in international oil prices have forced everyone—from politicians to car owners—to think more carefully about their oil consumption. High oil prices impact economies differently—primarily depending on whether your country is a net importer or exporter of oil. But in North East Asia's net importing countries, you share a great deal of common ground in that high oil prices are an important challenge for your politicians, your oil companies, and your car owners. The cooperation and understanding that your Northeast Asia Economic Forum promotes is surely an excellent platform for analysing your common problems, and possibly even coming up with common solutions.

In my speech to you this afternoon I will first outline how and why we managed to reach $70 for a barrel of oil. I will then explore oil demand growth and oil import growth in Northeast Asia's biggest consuming economies; China, Japan and South Korea. Within this context I will show that these oil consumers have a heavy reliance on oil from the Mideast, and outline how and why alternative sources of oil—from Russia, Kazakstan, the Mediterranean and even Canada are important developments and should be encouraged by your governments. I sincerely welcome any questions that arise from my presentation.

As you can see from this chart, oil prices have soared over the last 2 years. More than tripling from just under $20 per barrel in January 2002 to a peak of $70/bbl just last month. There are a range of factors which explain this rise. First is strong global demand outstripping supply. Ignoring all other factors, this alone is enough to send prices higher. Strong demand growth, primarily in China and the US, but also in Europe and elsewhere in Asia, first exceeded expectations and then outpaced the world's ability to supply.

This imbalance caused the second set of factors driving prices higher; strained production capacity and reduced inventories. As oil demand grew, Opec ramped up production. But even this increase was not enough to cool prices, and the global market began to realise that even Saudi Arabia did not have a limitless capacity to pump oil. At the same time, refiners began to run down their crude oil inventories, reducing their buffer against future price increases. The markets saw this drop in inventories and realised that if and when refiners needed more crude, they would have to seek it in the increasingly strained international spot market, inevitably driving prices higher. Not just production capacity, but the whole supply chain was stretched. Not enough refining capacity - especially in the US, and not enough of the clean gasoline US consumers demand.

On top of this situation, a new set of political factors was introduced; political risk. In a market strained for supply, any political event which could remove crude oil from the market was assessed as a reason to bid prices higher. The market now believes that political events in Venezuela, Nigeria, Iraq, Russia and Saudi Arabia all have the potential to cut supply of crude to the market.

These three factors allowed the fourth actor to come into play; speculators. Without demand exceeding supply, capacity constraints, and political risk, speculators would have little to work with. But these factors cause volatility along a strong upward trend, a prime market for hedge and commodity fund managers to make a huge amount of money in.

These four factors remain the case today. For that reason, and due to the fact that the global economy seems able to afford higher oil prices, we do not expect oil prices to fall back to $30/bbl any time soon. Instead we see oil prices with a firm floor of $40/bbl for the medium term, and therefore oil price spikes to $70/bbl should be expected, and to $80/bbl or higher should be considered by your planners.

In Northeast Asia, China has shown the greatest increase in crude oil demand and crude oil imports. Because Chinese domestic oil production is virtually flat, any increase in oil demand must be met by imports. As we can see from this chart, China's oil demand growth is expected to continue for some time to come. By 2010, China's oil demand is forecast to be 10 million b/d, with imports of perhaps 7 million b/d. Over the same period Japan's oil demand is forecast to actually shrink by nearly 4% to an average of 5.6 million b/d. Clearly, China will be the dominant driving force in the Northeast Asian oil markets in the decades to come .

Where is this extra crude oil to supply Chinese demand to come from? If China takes more crude oil from the international market, does this mean less for Japan, or less for South Korea? Fortunately, crude oil supply is not always a zero-sum game. And fortunately, China is better placed than either Japan or South Korea to make the adjustments necessary to source its crude needs.

As we can see from this table, Japan takes 88% of its crude oil from the Mideast, an overwhelming majority of its supply. South Korea takes 78%. In contrast, China only takes 49% of its crude oil from the Mideast. China's significantly wider range of crude oil suppliers means it is better placed to take additional supply from all of its sources, rather than rely on just the Mideast.

In addition to these supplies from ships, China also has several options to take fresh supplies of oil via pipeline. I understand that your Northeast Asia Economic Forum has heard a great deal about the possibility of piping oil from Russia to China, so I will not go into too much detail here. The details are still far from clear, but our understanding is that a first stage pipeline is planned to carry 600,000 b/d of oil from Taishet in eastern Siberia to Skovorodino, 70 kilometres north of the Chinese border, and then to Daqing. A second stage pipeline could then carry another 1 million b/d all the way to the Pacific Coast.

The assessment from our journalists in Moscow is that the first stage will almost certainly get built, but that the second stage requires a significant effort to prove the oil fields have enough reserves in them to justify such a massive construction effort. We understand that Japan is eager to see the pipeline reach Nakhodka. We understand that China is eager to see oil reach Daqing. We understand that Russia has in the past not had positive relations with pipeline offtakers to the west of the country, and is not eager to repeat the experience of being reliant on a single customer to the east. The two routes do not have to be mutually exclusive. It is certainly a question of there being adequate reserves. It may be just a question of timing. Your forum can play an important role in fostering the mutual understanding required to ensure at least one of these pipeline plans becomes reality.

Mutual understanding and cooperation in the energy sector is being clearly demonstrated today between China and Kazakstan. You will all be aware from the newspapers that CNPC is planning to buy PetroKazakstan. Current plans are for a 200,000 b/d pipeline to carry Kazak oil to China by the end of next year, with the potential to double to 400,000 b/d. This is a splendid example of two countries in this region cooperating swiftly and efficiently to satisfy oil needs in both countries. Moreover, I read last week in the China Daily that two Chinese companies are planning to build a 20,000 b/d refinery in Ulan Bator, Mongolia, with the aim of sending surplus products over the border into China. These examples should, I suggest, be warmly supported and encouraged by the members of this Forum.

Russian and Kazak oil is already making its way to Northeast Asia via a more circuitous route. A 254 kilometre pipeline in Israel runs from Eilat on the Red Sea to the Mediterranean port of Ashkelon, was modified in June 2003 so that crude would flow in reverse, toward Eilat - and then onward to Asia. Tengiz crude from Kazakstan and Urals from Russia make their way to refineries in China, South Korea and Japan.

There are even thoughts of building a pipeline in western Canada to bring oil to Asia. A trickle of inland Canadian crude already flows to the West Coast, but exports could rise to 300,000 b/d by the end of the decade, according to Canadian pipeline firm Enbridge.

The point of these example is this. Northeast Asia does have real and potential alternative supplies of crude oil. In the end, its probably not a question of oil, or even a question of money. The oil reserves are mostly there. The financing is nearly always possible. But cooperation and mutual understanding among your countries is critical to make these potential alternatives a reality.

There are real, tangible benefits to be enjoyed if you can make them work. Imagine the consternation in the Mideast if a pipeline from Russia reaches Daqing or Nakhodka. Suddenly China, Japan and South Korea have real alternatives. Suddenly Saudi Arabia, the UAE, Iran and Kuwait have competition in their biggest market. And, usually, competition leads to lower prices. Your refiners will thank you for making a pipeline from Russia a reality.

There are also less tangible, but perhaps no less important benefits. Finding new sources of crude to supply Asia's oil demand growth could ease concerns about security of supply in Northeast Asia and in the West. Some in the West worry that China's growing oil demand - and China's "peaceful rise" more generally - means an inevitable conflict over oil resources - witness the noisy opposition to CNOOC's bid for Unocal earlier this year. Clearly acting in cooperation with your closest neighbours is perhaps the best way to send the message westwards that Northeast Asia's future energy needs can be accommodated without impinging on anyone's - possibly even reinforcing everyone's - energy security.

Ladies and gentlemen. In my speech to you this afternoon I first outlined how and why we managed to reach $70 for a barrel of oil. Then I explored oil demand growth and oil import growth in Northeast Asia's biggest consuming economies; China, Japan and South Korea. Within this context I showed that these oil consumers have a heavy reliance on oil from the Mideast, and outlined how and why alternative sources of oil - from Russia, Kazakstan, the Mediterranean and even Canada are important developments and should be encouraged by your governments. There are clear, tangible benefits to be gained from Northeast Asian countries cooperating in the energy sector.

I wish your Forum every success.

Thank you for listening.