Two reports released last month help explain the dramatic rise in oil prices this year. The price of Brent, the world’s dominant marker crude, has almost doubled in the past year and is up more than 40% since the start of this year. The weak dollar, the flow of money from other financial sectors to oil, and geopolitical blips may be responsible for some of the increase, but the real reason appears to be the basic fundamentals of supply and demand.

The 57th edition of BP’s annual Statistical Review of World Energy shows a global market tightly balanced, with little room for error. Last year, global oil production fell by 0.2%, the first decline in world output since 2002, while consumption increased 1.1%. World production decreased 150,000 BOPD to 81.53 million BOPD. OPEC production cuts accounted for some of that drop, but output in OECD countries fell 300,000 BOPD, reflecting aging oil fields. Some of the world’s major oil provinces are posting production declines—including the North Sea, Russia, and Mexico—and may continue to fall. North Sea output has been declining since 1999 and Mexico’s giant Cantarell field is in rapid decline. During this year’s Offshore Technology Conference, Pemex Director General Jesús Reyes-Heroles acknowledged that the company’s objective of maintaining crude output at 3.1 million BOPD through 2012 will be severely tested by the challenge to compensate for Cantarell’s decline.

Demand grew by approximately 1 million BOPD, according to BP’s review, with consumption strong not only in Asia but in large oil-exporting regions such as the Middle East, South America, and Africa, which could limit exports to major consuming centers. Consumption growth slowed last year, due to weaker economies and higher prices, but was still above the 10-year average for the fifth year in a row. Oil prices have risen for 6 years in a row, the longest period of rising prices on record, according to BP, and are certainly on track to finish the year higher again.

Similarly, the International Energy Agency’s (IEA) most recent report notes lower global consumption than previously forecast, but predicts demand this year rising to almost 87 million BOPD, about 1% higher than last year. The IEA also revised down its estimates of non-OPEC production for this year, bad news for a tight global supply balance. Demand from developing countries continues to rise, which has pushed the energy sector into a whole new realm, according to Lane Sloan, a longtime Shell executive and author of the new book, Terra Incognita: A Navigation Aid for Energy Leaders. The population of China and India together is 2.4 billion, compared to the OECD population of 1.2 billion, and those nations are going through the industrialization process that OECD countries went through last century. As historian Daniel Yergin has noted, of all the interesting characters in the history of the oil industry, perhaps the two most significant are supply and demand.
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PetroWiki was initially created from the seven volume Petroleum Engineering Handbook (PEH) published by the Society of Petroleum Engineers (SPE).
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