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'Peak Oil' Is Back, but This Time It's a Peak in Demand

By Paul Tullis

(Bloomberg Businessweek) -- Remember peak oil? It's the theory—current about a decade ago—that global oil production would soon top out, leading to an inexorable rise in prices. Reports and books painted a grim picture of the effects this would have on the global economy; as fracking and seabe discoveries have unlocked new sources of the fossil fuel, most have dismissed peak oil as a flawed concept.

Now a pair of reports from energy-sector analysts say we're approaching peak oil from the opposite direction: demand.

Citigroup's commodities division's Seth M. Kleinman and colleagues write that "oil demand is approaching a tipping point" (PDF) and should level off by 2020. The Boston Company's Global Natural Resources Team was less certain and direct in its forecast (PDF), indicating that Asia's consumption growth rate would have to double to make up for shrinking North American demand, and flattening demand is among likely scenarios for the future.

Such stances are at odds with the U.S. Energy Information Agency's prognosis, which sees global demand growing from 98 million barrels a day in 2020 to 112 million in 2035.

Citi acknowledges this "broad consensus," but points to "several developments" that "give reason to question the consensus and raise the possibility that the tipping point for oil demand may come sooner" rather than later.

Chief among these factors are increasing fuel efficiency in vehicles, substitution of natural gas for crude oil, and the recent elasticity of demand in the U.S., the world's largest oil consumer and hence the market's chief demand-side driver of spot prices. Whereas in the past U.S. consumption marched ever higher almost in defiance of price swings, the Boston Company notes, since 2005 price and consumption have become more closely coupled. This is in line with a report several years ago by noted oil economist Daniel Yergin, of IHS-CERA, who wrote that when oil approaches \$120-\$150 per barrel, the market shifts in response.

With transportation accounting for 60 percent of global oil use, structural changes like those cited in the reports are likely to have outsize impacts in overall consumption. Both reports cite fuel-efficiency standards agreed to by U.S. auto manufacturers and President Obama last year, which will bring corporate average fuel economy to 54.5 mpg by 2025—enough to reduce demand by more than the U.S. gets from OPEC.

"If one assumes that the number of miles driven remains generally flat," writes the Boston Company, the new standards will push U.S. demand down by half a million barrels per day, or about 2.5 percent.

(The effect may be greater, in fact, as U.S. miles driven have continued to decline even after the end of the Great Recession.)

Substitution with natural gas in several areas of the economy that have historically used oil almost exclusively, including light-duty vehicles (which are 95 percent petroleum-\ fueled), shipping, and rail, is another factor cited in both reports. It takes a prolonged period of large price spreads between commodities before consumers make the switch, says Eric Lee, commodities strategist and co-author of the Citigroup report, because of the significant capital investment required.

This is happening now in the U.S., thanks to the shale boom, with fleets including United Parcel Service, FedEx, and Wal-Mart Stores, among others, moving to natural gas.

As U.S. gas is liquefied and exported, as is already in the works (PDF), this trend is likely to spread globally, the authors maintain. Petrochemical uses, heating oil, and electricity generation in the Middle East—where leaders will seek to export more of their oil—are other areas of potential substitution cited by the two reports. Citigroup analysts counted 20 million barrels a day that could be substituted.

That’s more than energy analysts at other banks and research institutions, as well as the EIA, probably believe, Lee says. Another area where his group sits outside the mainstream concerns assumptions regarding the relationship of GDP growth to oil consumption—and, more significant, the types and patterns of growth contained in that number.

“The rule of thumb is you take 2.3 percent off GDP growth and you get, roughly, oil demand growth,” Lee says. Most of each form will be coming from the faster-moving BRIC economies and Asian “tigers.” But those are starting to look more like the developed economies of the five biggest euro zone countries, Japan, and the U.S., Lee asserts: “The composition of growth in China is changing from industrial productivity to less oil-intensive areas of the economy.”

If Lee is right, the new “peak oil” may not be supply-side as some were predicting a decade ago, but instead a peak in demand. Per capita demand, in fact, has hardly budged in 30 years.

The one factor that could spoil the Boston Company’s and Citigroup’s forecasts would be a big drop in price. If fracking and other recently developed extraction methods bring more oil to market, that could push prices lower—and thereby help revers some of the very demand trends they cite.

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