

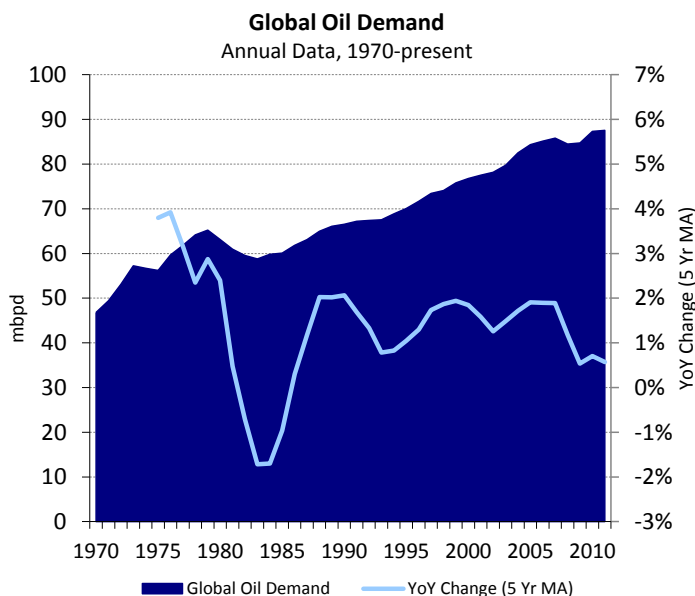
## Consequences of the Confluence of “Peak Demand” and an Expanding Production Boom

“Peak oil” giving way to  
“peak demand”

Conservationists and industry have been at odds over the ability of crude oil to continue to serve as a primary conduit for meeting the energy needs of an ever-expanding population and associated economic output almost since the inception of commercial-scale crude oil production. Although preceded by other doomsayers, the theory of “peak oil” is most frequently associated with “Hubbert’s peak,” which argues that oil production rates generally follow a bell-shaped curve, tapering off once infrastructure investment reaches a point of diminishing returns and the resource begins to be depleted. While production has struggled in some regions (notably in the North Sea), a common argument among commodity analysts of late has been that we are approaching not “peak oil” in a supply sense, but rather “peak demand.”

“Peak demand” is the notion that, between fuel switching brought on by shale gas production and declining per capita energy consumption growth spurred by economic and industrial maturation (see 22 March 2013 [Opinion](#)), the world’s demand for crude oil will actually level off and decline in the relatively near term. Various estimates of this peak range from 95-110 mbpd, which is not much higher than the current IEA assessment of global demand of 90.6 mbpd.

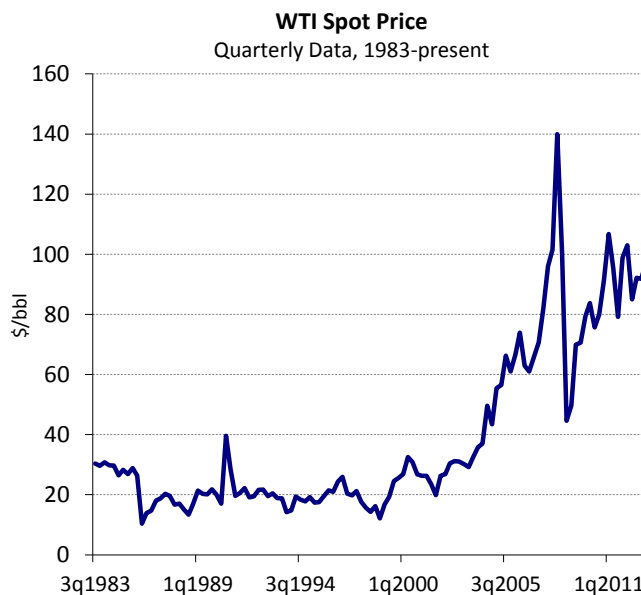
Consumption growth  
showing slowing trend  
over longer-term



Source: Bloomberg, US DOE, Poten

The supply of oil, though finite at some point, is in fact a function of price: oil recoverable at \$100/bbl may not be recoverable at \$50/bbl. Indeed, the sustained period of higher oil prices over the last decade is credited as a factor enabling the commercialization of unconventional crude oil extraction practices that have led many to argue that the United States is on the precipice of so-called “energy independence.”

High oil prices have incentivized technological innovation



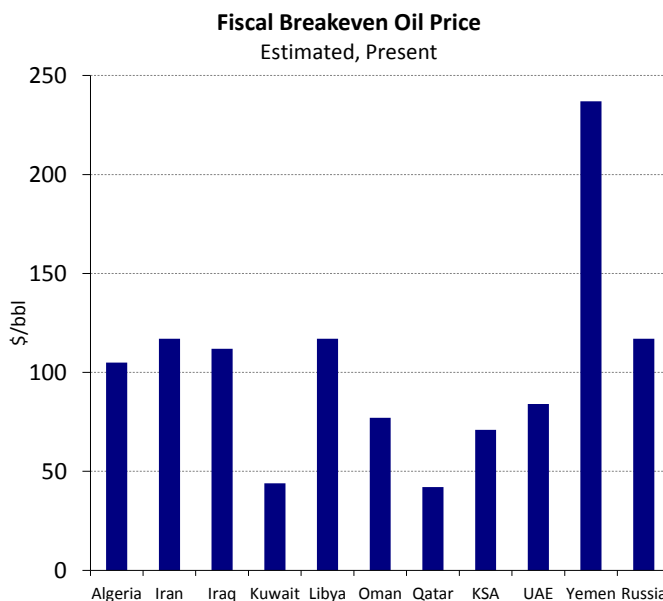
Source: Bloomberg, CME Group

OPEC's cartel status, combined with spare capacity, has meant that global oil supply has generally been reactive to oil demand, and has allowed it to influence prices in a manner beneficial to domestic leadership. Rapid production expansions in North America have the potential, however, to undercut this arrangement. Bank of America Merrill Lynch suggested earlier this year that US crude oil futures could fall to \$50/bbl in the next two years, while Citi has suggested a similar temporary drop with a more stable price range of \$65-90/bbl.

Will lower oil prices actually lead to geopolitical issues?

Politicians on both sides of the aisle in the United States have made a habit of coupling aforementioned “energy independence” with national security. As if crude oil markets could simply be domesticated, they argue that less reliance on crude oil produced outside the US would serve as some sort of panacea for its foreign policy missteps in a region that has proven bewildering. On the contrary, Benjamin Alter and Edward Fishman pointed out in an opinion piece in last Sunday's *New York Times* that increased North American production “will drive down global energy prices, undercutting the foundations of petrostates everywhere.” They go on to argue that “lower energy prices will undermine the stability of the Persian Gulf monarchies, whose hefty oil revenues have allowed them to win their populations' loyalties through patronage and a lack of taxation.” In a possible precursor to making more barrels available for export in an attempt to offset revenue reductions caused by falling prices, a policy disagreement has

emerged in Saudi Arabia this week over the necessity of a possible expansion of production capacity of 20% by 2020.



Source: Citi Research

**Lower prices could paradoxically spur both increased consumption and production**

Barring any unforeseen supply shocks, the notion that oil prices are heading lower is currently in vogue, and lower prices may actually beget even lower prices as production could be boosted in some countries in an attempt to solve budgetary woes. Such a move would be supportive of tanker demand to a certain extent: a 2010 IMF working paper – *Peaks, Spikes, and Barrels: Modeling Sharp Movements in Oil Prices* – suggests an oil price elasticity of demand of -0.32 for OECD consumption and -0.14 for emerging markets, meaning lower prices should increase demand for the commodity.

Markets are in a constant state of iteration and self-correction, though, and such downward price movements may prompt political unrest in more volatile areas of the world. This could provide an either real or perceived threat to supply that would be bullish for both oil prices and tanker rates.

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