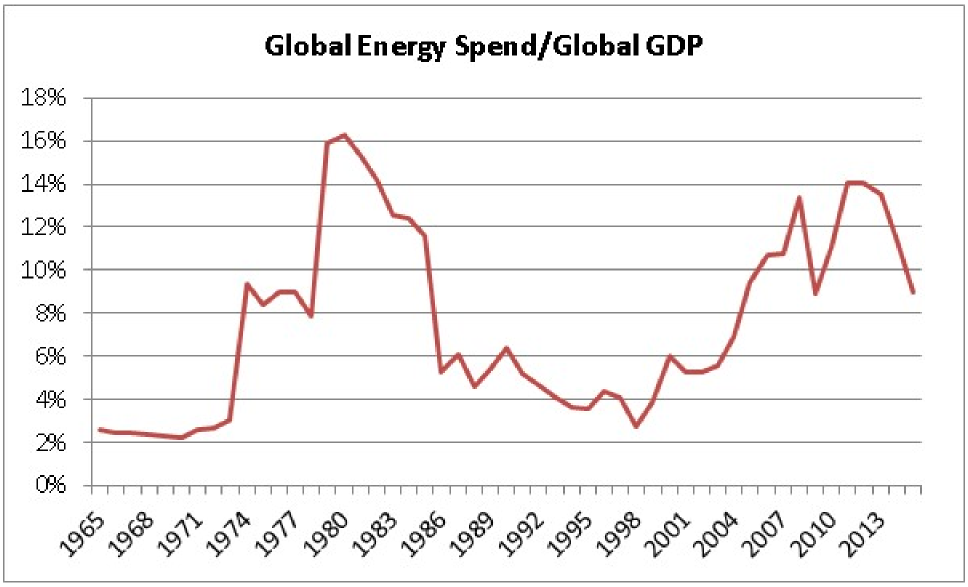
PEAK OIL PRICE – AN UPDATE

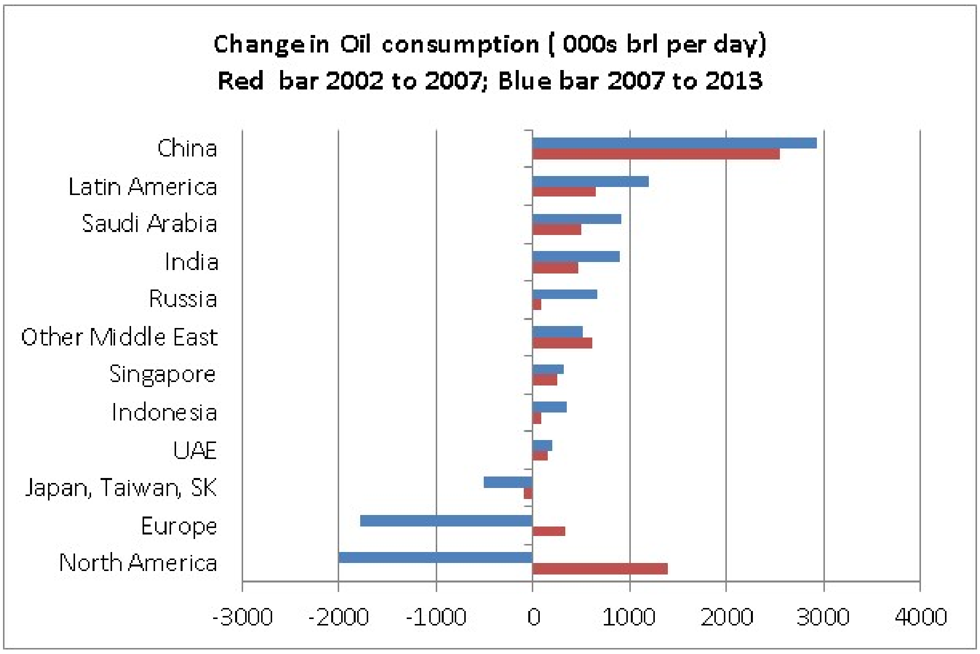
I published a note called Peak Oil Price ([click here to access]) – in February 2013. The argument was that we could look at how much was being spent on energy as a percentage of global GDP over time. I found that it rose from 2% in the 1960s to a peak at 16% in late 70s before falling back to a 2% in the late 90s. The rally in oil prices had again pushed energy spend to 14% of GDP. In my view this made it likely that energy spend would drop down again to a lower level.

Given the recent move in oil prices I present an updated version of the graphs from that note. Data taken from BP Statistical Review of World Energy June 2014.

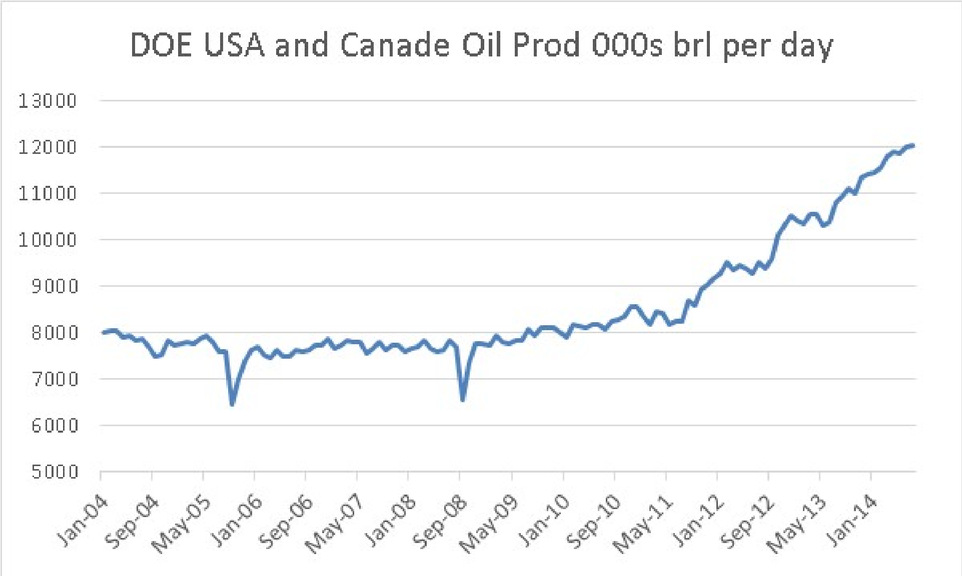


For 2014 I have used the average oil price, but for 2015 I have used 70 USD a barrel. I also assume that global GDP increases at the same rates as the last two years.

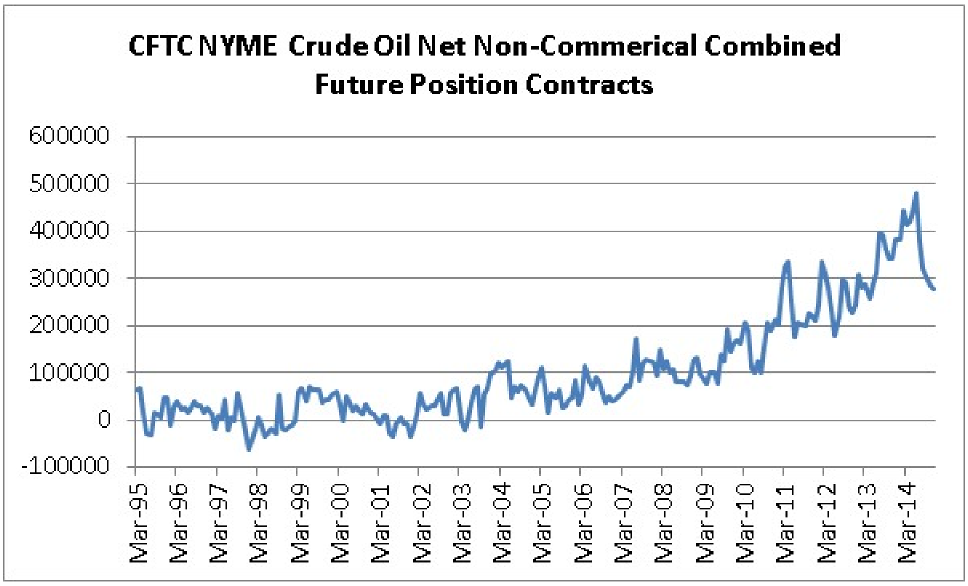
The previous note also pointed out that while China and India are responsible for a large amount of consumption growth of oil, the economies of Latin America, Middle East and Russia were also driving consumption growth. This implies to me that a falling oil price could lead to collapsing consumption in the oil producing nations, which would result in surplus supply, further forcing prices lower. Data taken from BP Statistical Review of World Energy June 2014.



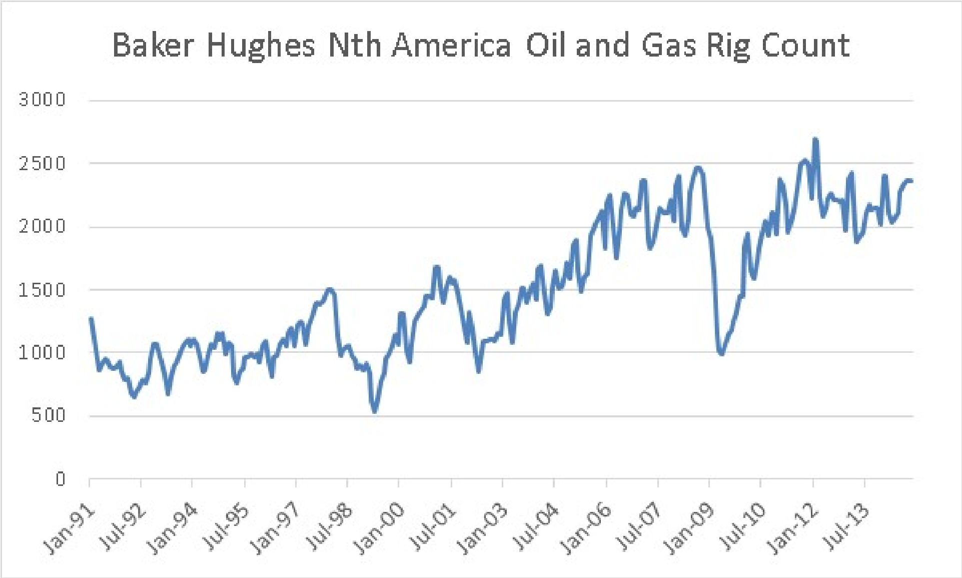
What is also interesting is that Americans have cut demand for oil as they have been producing ever more oil. Below is combined US and Canadian oil production.



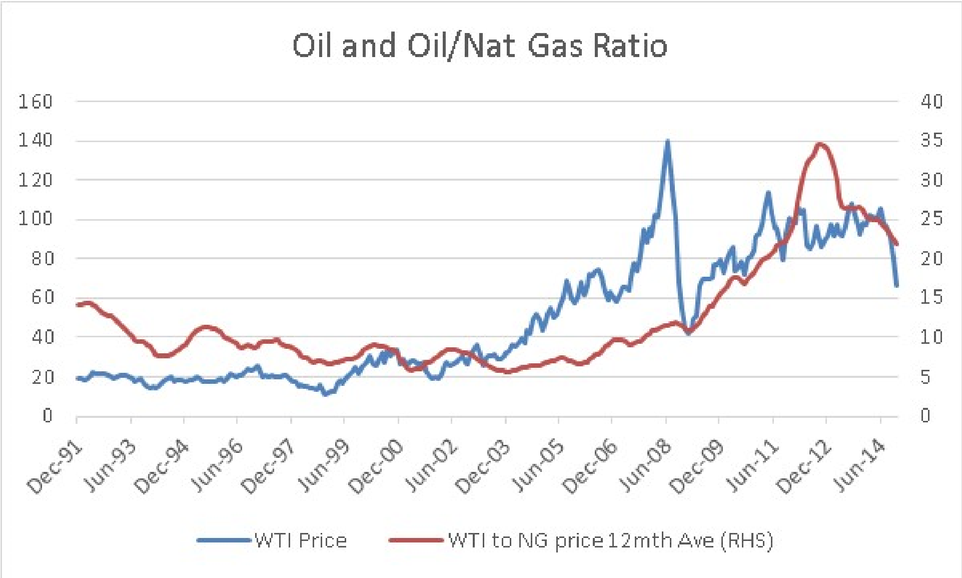
Despite weakness in the oil market, recent data still shows that the market is still long physical oil.



North American oil producers tend to be the most price responsive oil operators. Recent Baker Hughes rig data has yet to show any meaningful response to lower oil prices.



So how far can oil fall? If we look at US natural gas markets which were the first to suffer from oversupply we can get an idea of where pricing can fall. Prior to the collapse of US natural gas prices in 2008, oil and gas prices traded in ratio that ranged from seven to ten. After 2008, the ratio moved out dramatically, but it is now correcting. Natural Gas in the US has traded around 4 USD for the last two years. If the old ratio reasserts itself that would give a target for oil price around USD 28 to USD 40.



We can also refer to the first graph of this note that showed energy spend fell to somewhere between four and six percent of GDP gives a price target of between USD30 and USD 50 a barrel on very rough numbers. It seems to me that the oil price has further to fall.

INFORMATION

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