Oil prices increasingly disconnected from demand

This article originally appeared in April's edition of *EEnergy Informer*, a newsletter produced by Perry Sioshansi of Menlo Energy Economics and editor of *Behind and Beyond the Meter: Digitalisation, Aggregation, Optimisation, Monetisation*.

While irrelevant may be a bit exaggerated, it is probably fair to say that the historic relationship between the price of oil and demand are no longer as strong or binding as they used to be. Historically, when price of oil dropped, for whatever reason, the demand would spike, with the reverse when prices jumped. The world had an insatiable appetite for the stuff. Like an addict always craving for more of the "fix," oil consuming countries would only buy less when it became pricey.

While the fundamentals of supply and demand have not been radically altered, there are long-term trends that suggest that the demand for oil may not be as strong as it was nor could we expect it to resume its historical growth patterns. For example, future economic growth in several global markets need not necessarily be accompanied by rising demand for oil – a familiar feature of oil markets in the past.

How can this be possible? The answer is that, as economies and major companies begin to move towards achieving their net zero targets (prior article), they will increasingly substitute energy efficiency and renewable energy for oil – and all carbon-loaded fuels. Will this substitution effect, currently in its nascent state, make an impact on demand for oil, and if so, when is anybody's guess?

The other reason to expect a gradual departure from historical trends is the expected electrification of the transport sector followed by household heating and industrial demand away from fossil fuels. Once the entire bus fleet in Los Angeles is electrified, for example, that demand for diesel will not come back, no matter how fast the rate of economic recovery or growth. Ditto if the US Postal Service or Amazon electrifies its delivery fleet.

Additionally, there is the gradual effect of investments moving away from fossil fuels and into other sectors. This trend, which was the subject of the lead article in the March 2020 issue of *EEnergy Informer*, is just beginning to gain traction as younger and more environmentally aware investors begin to ask awkward questions from fund and pension managers and/or demand that their savings not be invested in companies they do not consider environmentally sensitive.

Fossil fuel companies may find that a growing percentage of investors may rather not put their money in their sector. Many of the same may also be willing to switch to electric vehicles or take public transport to work. The pressure on fossil fuels is likely to intensify.

While no one is predicting the immediate demise of oil any time soon, some oil companies are indicating that they too know that the good times may not last forever.

Among the obvious signs was a recent announcement by Shell that it was developing a 10GW offshore wind to hydrogen project. Oil companies have the resources and the know-how to shift away from offshore oil to offshore wind platforms. They also know more about hydrogen, transport and logistical issues than anyone else and have enormous financial resources.

Not to be left out of the game, ENI, the Italian oil major, announced that it was investing in 55GW of renewables. That is more than the total installed capacity of many countries. Likewise, Total said it is investing in France's biggest battery storage project.

While the size of these investments are minuscule compared to their overall investments, by all indications nearly all European oil majors are aggressively moving into renewable electricity, offshore wind, hydrogen, energy storage as well as electric vehicle charging infrastructure. It takes time for the big players to shift gears. Perhaps the current low oil prices and weak demand will propel them to do even more.

The most extreme, of course, are BP and Repsol's decision to go net zero carbon – hard to believe. The former has said it will provide further details by September. No doubt many engineers and economists are working hard to develop a workable blueprint to deliver what the CEO has already announced. We suspect it would be awkward to say in September, sorry, we thought we could, but we cannot deliver.