

# The Telegraph

## Plateau Oil meets 125m Chinese cars

Oil spikes usually metastasize once energy costs reach 9pc of global GDP. The longer they stay there, the greater the damage.



Rush hour in Beijing: the battle for oil will intensify as China alone adds 125m cars to its roads over the next five years. Photo: EPA



By [Ambrose Evans-Pritchard](#)

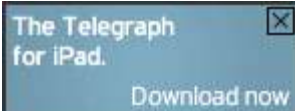
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That proved to be the pain barrier in the 1970s and again in 2008, and we are just shy of that level right now. "Oil is already capturing a higher level of European GDP than in 2008," said Francisco Blanch from Bank of America.



The rule of thumb is that a 10pc rise in crude cuts US growth by 0.2pc four quarters later, but the science is flabbily soft and nobody knows where the inflexion point lies. The effect is famously “non-linear”. Nothing much seems to happen until confidence suddenly snaps.

What is deeply troubling is that Brent crude should have reached fresh records in sterling (£79) and euros (€94) - with a knock-on effect on US petrol prices, mostly tracking Brent - even though the International Monetary Fund has sharply downgraded its world growth forecast to 3.25pc this year from 4pc in September, and even though International Energy Agency (IEA) has cut its oil use forecast for this year by 750,000 barrels per day (bpd).

Oil is not supposed to ratchet defiantly upwards in a downturn, which is what we have with the Euro zone facing a year of contraction in 2012, and much of the Latin bloc sliding into full depression. Japan's economy shrank in the fourth quarter.

Asia's emerging powers of Asia - the key force driving the commodity boom of the last decade - are in various stages of “soft-landings” after hitting the monetary brakes last year to check property bubbles and curb inflation. China's manufacturing has been bouncing along near contraction levels through the winter. So what happens when it recovers?

[Putin's investment pull \(http://www.telegraph.co.uk/finance/financevideo/businessbullet/9123096/China-Debt-defaults-Glencore-and-Russia-investments.html\)](http://www.telegraph.co.uk/finance/financevideo/businessbullet/9123096/China-Debt-defaults-Glencore-and-Russia-investments.html)

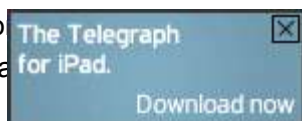
[China claims world's biggest shale gas reserves \(http://www.telegraph.co.uk/finance/china-business/9117072/China-claims-worlds-biggest-shale-gas-reserves.html\)](http://www.telegraph.co.uk/finance/china-business/9117072/China-claims-worlds-biggest-shale-gas-reserves.html)

[China and the 'middle income trap' mystery \(http://blogs.telegraph.co.uk/finance/ambroseevans-pritchard/100015284/china-argentina-and-the-mystery-of-the-middle-income-trap/\)](http://blogs.telegraph.co.uk/finance/ambroseevans-pritchard/100015284/china-argentina-and-the-mystery-of-the-middle-income-trap/)

[China eases credit as property prices slide \(http://www.telegraph.co.uk/finance/economics/9091883/China-eases-credit-as-property-prices-slide.html\)](http://www.telegraph.co.uk/finance/economics/9091883/China-eases-credit-as-property-prices-slide.html)

The unpleasant fact we must all face is that the relentless supply crunch - call it `Peak Oil' if you want, or `Plateau Oil' - was briefly disguised during the Great Recession and is already back with a vengeance before the West has fully recovered.

The IEA said no net increase in oil production occurred in 2010 and 2011. There was no net increase. While there was a boost from Canada and the US shale-oil, and Brazil's offshore rigs, this was offset by the



relentless erosion of the North Sea fields and Mexico's operations, a collapse in the Sudan, and Libya's woes.

Meanwhile OPEC spare capacity has fallen to 2.5m barrels a day (bpd), compared to 3.7m this time last year during the Arab Spring, the event that caused a comparable spike in crude prices and arguably triggered the sharp global slowdown a few months later.

The chain of causality is hotly disputed. A young professor Ben Bernanke no less wrote the definitive paper in 1997 - "Systematic Monetary Policy and the Effects of Oil Price Shocks" - arguing that policy-makers themselves are the villains because they over-react.

"The majority of the impact of an oil price shock on the real economy is attributable to the central bank's response to the inflationary pressures engendered by the shock", he wrote, though he forgot the lesson himself in 2008 when Fed rhetoric turned hawkish just as the M3 money supply was crashing.

Oil spikes act as a tax and are deflationary. You should "look through" the meaningless jump in headline inflation. Yet the European Central Bank rose to the bait in 2008 and again in 2011, lifting rates into the teeth of the crisis, with sadly predicable results. "The ECB is likely to be less trigger happy under Mario Draghi," said Bank of America.

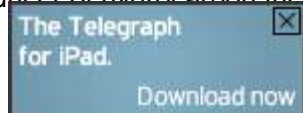
Be that as it may, Saudi Arabia has reportedly cranked up output to 11.5m barrels a day. If so, it may be near its feasible limits. No other country can step in. Which leaves us very naked as brinkmanship with Iran nears its denouement.

The issue is not whether Iran has the military kit to close the Straits of Hormuz and cut off 18pc of global oil shipments for more than a few days (probably not), but whether an Israeli/US attack on the regime's nuclear facilities would later set off an uncontrollable chain of events in the Middle East.

There is clearly danger of a spill-over into Bahrain and the eastern province of Saudi Arabia, home to the Kingdom's aggrieved Shia and most of its oil. Even so, the Iran risk premium in global crude prices is only \$10 to \$15. We must still face the overwhelming fact that global energy supply is on a knife-edge regardless of events in the Gulf - with no relief in sight.

The IEA warned in its annual report that energy demand will rise 40pc by 2035. The world must invest \$1.5 trillion just to avoid a lethal crunch. Even then prices are likely to rise "viciously" unless nuclear power and the renewable family of hydro, wind, and solar can come to the rescue. Fukushima has killed nuclear expansion in Japan, Germany, and beyond. The green drive has faltered, oddly vilified in this country by conservatives who should be its natural defenders.

Yes, the shale-gas revolution has revived America's fortunes. The US may overtake Russia to become to the biggest producer of hydrocarbon fuels in the world within eight years, according to PFC Energy.



But that is chiefly a North American story for now. Exploration in Poland, Hungary, and Sweden has yielded less than hoped. While China claims the world's largest shale-gas reserves - and implicit shale-oil as well - but development has barely begun and China may lack the water needed for hydraulic fracturing.

So we have a remarkable situation. China alone will be adding 125m cars to its roads over the next five years, with auto production targets of 30m annually by 2016. India is spending \$1 trillion on infrastructure projects over the next five years.

Variants of this are happening across Asia and Latin America. The picture is by now well-known to Telegraph readers. Two billion people in the emerging world are joining the global economy and competing toe-to-toe for scarce resources with the West. Their rising demand - not our declining demand - will set oil prices.

"Between 2008 and 2011 we saw a decrease in demand from mature economies of 2m bpd, while the China increased by 2m bpd in the same period. As an oil exporting country, we are watching very closely," said Mohammed Al Sabban from the Saudi petroleum ministry, at the Jeddah Economic Forum over the weekend.

The West has the disquieting experience of watching crude soar even as we languish in stagnation. This never used to happen. If we faltered, energy costs would fall too, acting as a stabilizer. This harsh new reality is going to become uncomfortable when the emerging world enters a new cycle of growth, leaving us behind. Rising utility costs have already raised the numbers of UK households in poverty from a fifth to a quarter.

We should not be defeatist. Engineers and scientists are forever at work. A quantum-leap is possible in solar technology. The Chinese may crack cheap and safe nuclear power from thorium, abdicated by the British. But we should not be complacent either. Windmills anybody?

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