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IENE Comment

The Importance of Realistic Expectations

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The CERAWeek energy conference, which took place on March 18-24, served few surprises, with industry executives and analysts alike rather upbeat about the prospects of oil and gas demand.

What appeared to have been surprising, however, was the fact that oil demand has held up better than most expected. It should have been the least surprising thing but it turned out to be a shocker. The reason? Too many people bought into wishful thinking predictions at the expense of actual facts.

Last year, forecasts for oil demand overwhelmingly pointed to things like booming EV sales and poor economic growth as factors determining a weakening trend. Instead, oil demand broke yet another record. Bafflement and confusion ensued.

While seemingly difficult to understand how this was possible, the explanation is quite simple if not exactly flattering. Most analysts were surprised by the strength of oil demand growth because they forgot two things: first, the fact that oil demand is extremely inelastic, and, second, the fact that those forecasts about an EV boom do not necessarily reflect reality.

Indeed, sales of electric cars reached a record high last year. But even in China, which is the largest EV market in the world, oil demand continued growing strongly. This might have given analysts and observers a hint about the difference between forecasts and reality but apparently it didn't.

As regards inelasticity, most bleak oil demand predictions last year were based on signs of weak global economic growth, most notably in large markets such as the United States and the European Union. Indeed, growth was weak—but that did not affect oil demand as much as it should have, per expectations. And that is because of that inelasticity that has been a mark of oil markets for as long as they have been around.

It is one of the simplest concepts in economic theory and practice, and yet it appears to have slipped a lot of minds. Perhaps now that we have the data about 2023, the slip can be corrected—as it has been in the oil industry itself.

Oil executives, CERAWeek revealed, have become more upbeat about their core business. This has in turn made them bolder in their calls for letting go a bit of the transition pedal.

While just a year ago these executives would have only dared suggest a slowdown in the transition push quietly, not they are calling for it openly. Because they now have proof the transition is not moving either as smoothly or as quickly as expected.

All of this could have been foreseen. Indeed, it was, by analysts who were shunned as climate deniers by the mainstream. These analysts repeatedly warned that willful ignorance of the realities of the transition such as raw material scarcity and technological challenges would end up boomeranging.

They warned that oil demand is going to continue growing for quite some time yet because it does not have a comparable alternative among the transition technologies. They were repeatedly ignored. Now, everyone's surprised.

There are two ways out of this situation. The first, and smartest, would be an acknowledgment of the challenges that transition industries are facing. This has been happening, reluctantly, but inevitably, as the truth of rising costs for wind and solar becomes too obvious to ignore.

Following this acknowledgment, an adjustment in plans must come and this does not seem to be happening. Instead, governments in Europe and the U.S. are only doubling down on already unrealistic targets. They have opted for the second way out of the current situation.

The second way is essentially a continuation on the same path that brought us here. This is the path of unfounded optimism, wishful thinking in the disguise of energy trend forecasting, and, ultimately, shock when things don't pan out as predicted—because they never could pan out as predicted when those predictions disregarded fundamental—and natural—market laws.

Oil demand growth is not going to peak by 2030. Neither is gas demand growth or, likely, coal demand growth. The reason is that these three provide the kind of energy that the developing world needs. And they also provide the kind of energy that the developed world needs, for all its effort to shake off its hydrocarbon habit.

Trying to ignore the reliability of hydrocarbons does not make it disappear. It only makes alternatives even more expensive because the more wind and solar you build, the more hydrocarbon backup you need to ensure reliability of supply—as Germany and the UK recently realised.

Yet they have learned the wrong lesson from this realisation and are going for the backup instead of reconsidering their wind and solar targets, which, it bears repeating, are as

unrealistic as the EU's total and U.S. targets. These are targets that will never be hit because there is no physical way installations can grow so quickly, as evidenced by both the EU and the U.S. already falling behind on their targets. The CERAWeek provided a much needed reality check on energy demand and supply. Hopefully, someone will draw the correct conclusions.

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