

Will capacity problems push commodity prices higher?

Key points

- Although global demand for oil and minerals has been strong in recent years, driven by buoyant emerging markets such as China and India, supply constraints have become an increasingly important factor behind the rise in oil prices to record levels of almost US\$150 per barrel (pb). And it is the lack of supply response, in contrast to previous periods of high prices, that has caught the markets by surprise.
- With some OPEC members such as Nigeria and Venezuela experiencing production setbacks due to political and/or technical problems, and political concerns surrounding Iran, there has been little appetite among other members of the cartel to lift output significantly in order to stem the rise in world oil prices. Saudi Arabia has opted to raise its output from June, but it is unclear whether it has the spare capacity to implement this quickly. Indeed, OPEC overall appears to have little spare capacity at present.
- And production among important non-OPEC countries such as Norway, the UK and Mexico has started to decline, while output in Russia and other FSU countries has fallen short of expectations. Although demand in the developed economies has now started to decline, overall global demand remains high, boosted by an element of speculative demand and the impact of the weaker US\$. As such, the supply/demand balance remains very tight at present, with the IEA lowering its estimates of supply over the next few years, while global stocks are still at historically low levels.
- There have again been fears of “peak oil”, which in turn could lead to higher oil prices as conventional supplies of oil dwindle. But with world oil reserves still rising and supplies of unconventional hydrocarbons largely untapped, there seems little danger of the oil running out. But the long period of very low real oil prices through the 1990s discouraged the necessary investment to ensure continued rising supply, and recent investment will take some years to come to full fruition.
- Similar arguments apply to some metals prices, with the pick-up in global demand led by China resulting in a lack of capacity following a long period of under-investment in metals such as copper and aluminium. Substantial Chinese investment underway in some countries, such as Peru and Zambia, should help to alleviate the tight supply position in the copper market in the coming years. Precious metal prices have also risen steeply, although there will have been larger investment demand driving these metals.
- The rise in base metal and other mineral prices in recent years has been in response to a steep decline in stocks, which have only started to recover since mid-2007 and are still at historically low levels.
- Even though world growth is slowing in response to the credit crunch and surging oil prices, commodity prices appear likely to remain high for some time. The supply response will take time to feed through and unless the world economy slides into recession, which seems unlikely at present, oil prices are forecast to head even higher in the near term before starting to subside from mid-2009. As such, the world faces a lengthy period of high commodity prices – but it is not inconceivable that this could be followed by a period of much lower prices as recent investment in additional capacity and technology comes to fruition.

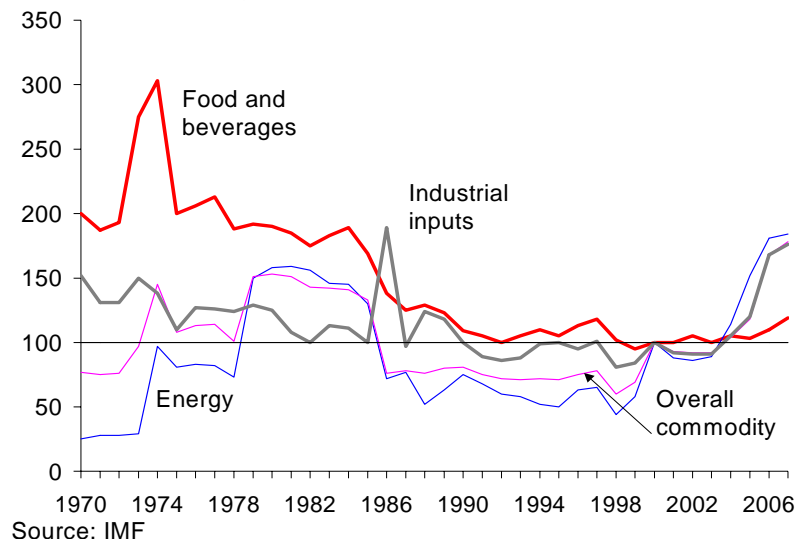
1. Introduction

World commodity prices have risen strongly in the last five years, led by the surge in oil prices to record highs of over US\$140 pb but with prices of metals and industrial materials also climbing steeply. And food prices have joined in the boom in the last two years, with wheat and rice prices more than doubling over this period. In real terms, commodity prices are still below their highs set in the late-1970s and early-1980s, but it is quite possible that the upward trend will continue. Although there are some supply issues that have played a part in this price surge, the key driver initially was the strength of global demand, with rapidly-growing economies such as China and India accounting for a large chunk of the increase in demand in recent years - in particular for energy and metals. World GDP growth (on a purchasing power parity basis) has been around 5% in each of the last five years, the strongest period of expansion since just prior to the first oil price shock in the early-1970s, so perhaps it should be no surprise that commodity prices have surged.

But whereas in the 1970s and 1980s there was a response from both supply and demand, with oil output rising and demand for oil falling, this does not appear to have been the case so far this time around. This has once again given rise to the “peak oil” theory, which suggests that world oil reserves have reached a maximum and are now dwindling, leading to shortages and ever-rising world energy prices. Despite the strong period of demand growth, expansion of capacity for hydrocarbons and metals supply has certainly been slow to respond - this article looks at the supply side and concludes that prices of these commodities are likely to stay relatively high for the next few years despite the slowdown in demand now underway in the US and Europe.

World commodity price aggregates

2000=100 deflated by manufacturers unit value



2. Global oil supplies tight in 2007

World energy prices remain key in determining the course of commodity prices more generally, and at this stage there seems little sign of any end to the period of high and rising oil and gas prices. The initial phase of higher oil prices was clearly demand-led – with prices rising steeply despite OPEC raising its production from 25 million barrels a day (b/d) in 2002 to 32 million b/d in 2006. But supply factors have come to the fore, with OPEC collectively now content to flex its new-found muscle after a long period of low real and nominal oil prices, and there seems little prospect of any significant increase in world oil output for some time. According

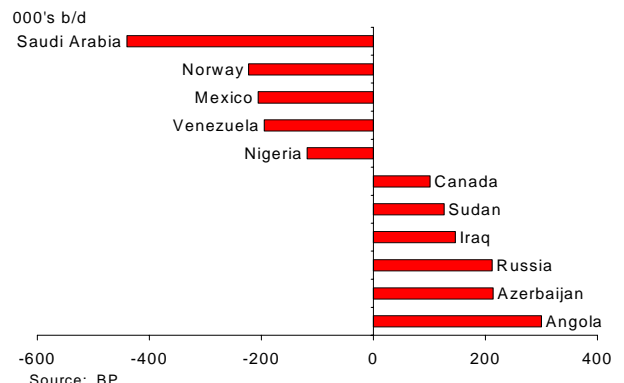
to figures produced by BP, total world oil production in 2007 fell to 81.5 million b/d with the decline largely due to the net effect of output cuts by OPEC and lower production in the OECD (despite the first rise in US output since 1991). The main weakness in non-OPEC output was in Mexico and Norway (while output in the UK was flat after seven years of decline). These declines more than offset a 520,000 b/d increase in output in the rest of the world, primarily coming from Russia and former Soviet Union (FSU) countries, in particular Azerbaijan, as well as Angola (which became an OPEC member in January 2008).

World oil production

	2006	2007	Change 07/06	% of world total
Total	81569	81533	-0.2%	100.0%
EU	2422	2394	-0.9%	2.9%
OECD	19458	19170	-1.4%	23.0%
OPEC	35560	35204	-1.2%	43.0%
Non-OPEC	33780	33524	-0.7%	41.0%
FSU	12318	12804	3.9%	16.0%

Source: BP

Main changes in oil output in 2007



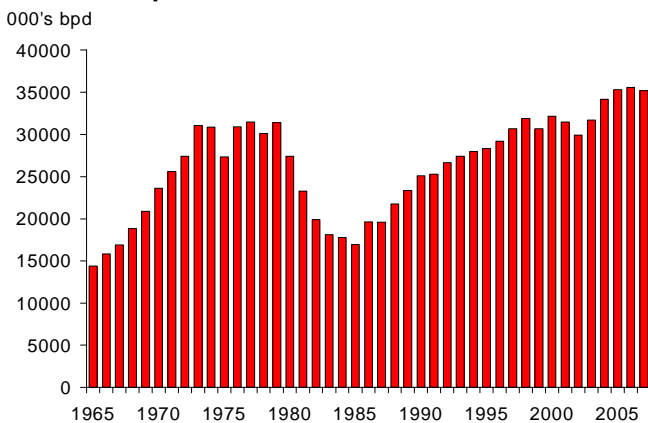
Source: BP

3. OPEC still reluctant to boost output

The tight supply position has continued in 2008, although there has been a modest rise in output by some OPEC countries, partly due to continued gains in Angola but also a rise in Saudi production. But, despite pressure from western economies, there seems little appetite among oil producers to boost output more significantly. OPEC members currently see supply and demand conditions very much in their favour, especially the more hawkish countries such as Iran and Venezuela, and the modest increases in output by some members seen so far this year just highlight the reluctance of the cartel overall to meet the needs of the global economy. The news that Saudi Arabia is boosting its production by 300,000 b/d from June will help the supply/demand position, but it remains unclear whether this will actually raise global output or merely help to cover production shortfalls being seen elsewhere, such as in Russia and Nigeria.

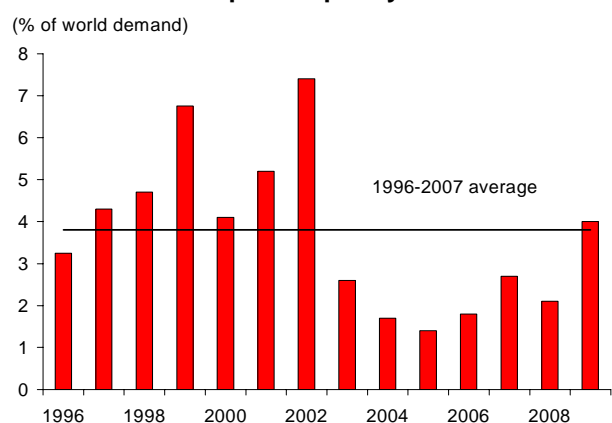
And despite increased capacity in a number of OPEC countries, including most notably Saudi Arabia, other countries, such as Nigeria and Venezuela, have seen lower output and capacity levels in the last few years because of internal difficulties and lack of adequate maintenance and investment. As a result, OPEC's spare capacity measured as a percentage of world demand has been relatively low since 2003, a trend that is only now beginning to be reversed.

OPEC: Oil production



Source: BP Statistical Review of World Energy

OPEC effective spare capacity



Source: IMF

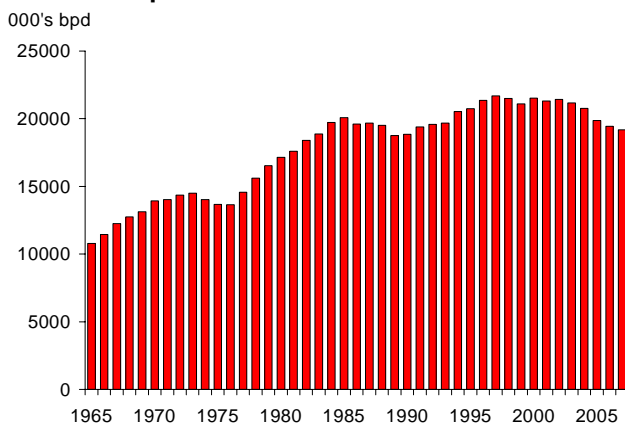
4. Non-OPEC output is levelling out

And there is little relief in prospect on the non-OPEC front. The main OECD producers, such as Norway, Mexico and the UK, seem almost certain to be facing a further decline in output in 2008 and probably in the years ahead because of their ageing oilfields. Mexico is the exception, but in order to raise its output it needs fresh foreign investment, a decision that still seems politically unacceptable. Other smaller producers are continuing to raise output, including some in Africa such as Sudan – with the backing of Chinese investment – and Libya. But with the exception of Angola - which is now producing close to 2 million b/d and has overtaken Nigeria (albeit perhaps only temporarily as a result of the latter's internal problems) - Africa is still a small producer in the global context. Excluding OPEC members Nigeria and Angola, Africa's output in 2007 accounted for only about 7.5% of world output in 2007.

As well as declining OECD production, the other area of disappointment has been FSU. Despite the surge in energy prices, it is clear that new supplies of oil and gas are proving slower to come on stream than expected from many of these countries, with the notable exception of Azerbaijan (which is still a minor producer) where output climbed some 32% in 2007 to 868,000 b/d. Russian production rose by just over 2% in 2007 to almost 10 million b/d, but it has been in year-on-year decline since January this year, more than offsetting the continued rise in Azerbaijan. Kazakhstan is the other big producer in the FSU region, with its output rising 4% last year to 1.5 million b/d, but the problem here is transporting the crude abroad through the various pipelines that are being constructed to Western Europe.

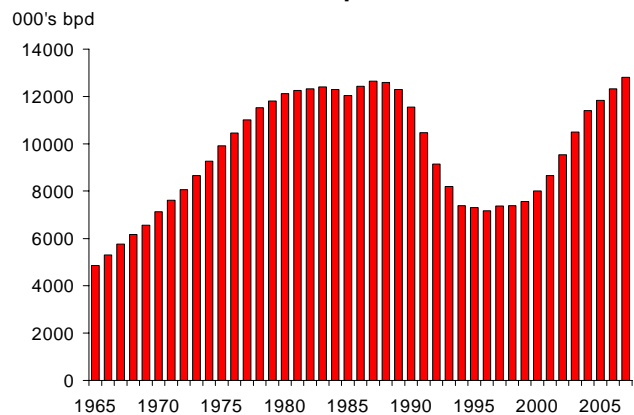
Despite the modest 3.9% rise in FSU output last year, overall non-OPEC fell short of expectations and posted an increase of just 0.5%. At a time of still rising demand and OPEC reluctance to supply more oil, this is well short of what might be needed to allay concerns about tight supplies.

OECD: Oil production



Source: BP Statistical Review of World Energy

Former Soviet Union: Oil production



Source: BP Statistical Review of World Energy

5. OPEC discipline keeping supplies tight

Latest International Energy Agency (IEA) figures do not suggest there will be any early relief on the prices front either. The IEA sees an increase in global oil demand of about 920,000 b/d this year, led by non-OECD demand, while non-OPEC output is seen rising 680,000 b/d. As noted above, OPEC's ability/readiness to cover the excess of demand growth over supply growth appears limited in the short term. Saudi Arabia has promised to raise its production capacity to 12.5 million b/d by mid-2009, which if realised would be its highest level in decades, but doubts persist about its ability to deliver on actual output. Saudi production in 2008 H1 was running at 9.2 million b/d, but it has not produced above 10 million b/d in any month since mid-1981 and its highest-ever annual output was 9.9 million b/d in 1980 according to US Energy Information Administration data. In the short term, Saudi's plans to increase output and ramp up capacity will help to keep prices in

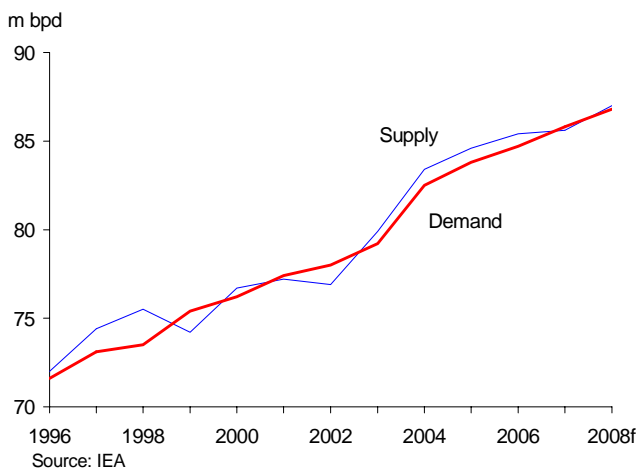
check but may do little to alter the fundamental problem, which still appears to be a lack of readily available capacity. In the past, OPEC has taken up the slack (albeit with some delay), but there are increasing concerns that this may not be the case this time around. Indeed, one of the defining characteristics of the current bull phase in oil markets has been the ability of OPEC to control its cumulative output – following a fall in oil prices in late-2006 and early-2007, the two OPEC quota reductions were instrumental in triggering the sustained surge in oil prices since then. The quota-busting (by countries such as Nigeria and Venezuela) that undermined previous OPEC efforts to bolster prices has been avoided on this occasion.

6. IEA cuts its supply projections

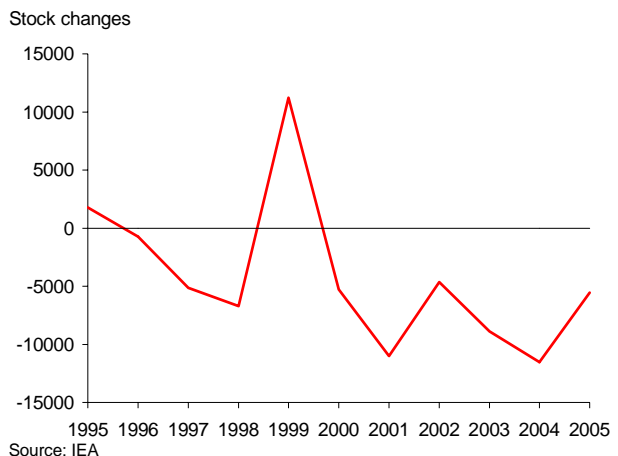
As well as seeing tight oil supplies through 2008, the IEA has also lowered its medium-term projection of world oil supply. The agency now sees oil output at 95.3 million b/d in 2013, some 2.7 million b/d below its previous estimates, and it also believes that spare capacity in the oil industry will fall to “minimal levels” by 2013 despite rising over the next two years as global demand weakens. In the last year, the IEA has made significant downward revisions to its projections for both non-OPEC supplies and OPEC capacity. As a result, it believes that over 3.5 million b/d of new production will be needed each year just to hold global production steady, which underlines the view that increased investment in both the upstream and downstream oil industry is required to keep the market adequately supplied. The main message of the IEA medium-term prognosis is that demand growth in developing countries and ongoing supply constraints mean that the oil market will remain tight over the next five years.

As a result of the tight supply/demand balance, world oil stocks have been declining in recent years. According to IEA data, stocks fell in each of the years from 2000 to 2005 even though output has been running close to demand over the period. However, the position may now be in the process of changing – rising fuel prices in the US are curbing demand and inventories there are now rising, and a similar story may well be emerging in Europe as well.

World oil supply and demand



Change in world oil stocks



7. Oil prices look set to remain high

But supply factors on their own are not keeping oil prices high. As noted above, the almost unprecedented period of strength in the world economy in recent years has played a role and, despite the slowdown now underway in the developed economies, growth is still likely to remain quite strong this year. This is in part due to the continued buoyancy of the emerging markets - China and India, in particular - which to a large extent have remained decoupled from the main OECD economies. There will obviously be an impact on the pace of growth in the emerging markets resulting from the slowdown in the west, but at this stage at least the signs

are reasonably hopeful. Emerging Asia, for example, is expected to post GDP growth of around 8% in 2008, down only a little from about 9% in 2007, whereas the US is seen slowing to 1.6% from 2.2% and the Eurozone is expected to slow to 1.5% from 2.6%. So, despite the forecast slowdown in world GDP growth (on a PPP basis) to just over 4% this year, the emerging economies should continue to perform robustly, notwithstanding the current emphasis in many on tightening monetary and/or fiscal policy in an attempt to curb the recent pick-up in inflation.

Another factor that is clearly influencing the price of oil is concern about the mounting tension between the US (and Israel) and Iran over the latter's nuclear intentions. Although the risk of military action should be small, the confrontational stance of the Bush administration is worrying and some military strike cannot be excluded. The very real worry here is not only that Iran's 2.4 million b/d of oil exports could be halted, which on its own would be a major blow to world supplies as it is the world's fourth largest oil exporter (after Saudi Arabia, Russia and Norway), but also that a large chunk of Middle East oil exports are at risk. Given its geographical location, Iran can control the passage of shipping in the strategically vital Strait of Hormuz, through which some 40% of the world's oil supply passes.

In addition, many emerging economies are still applying subsidies to prevent the full feed-through of rising fuel and food prices to domestic consumers. IMF research suggests that, of a sample of 43 emerging and developing economies, fewer than half allowed full pass-through of the increase in international prices in 2007 compared with three-quarters in 2006. As a result, the pricing mechanism has not been allowed to have its full impact on demand in these countries, which in turn has had the beneficial effect of supporting growth. Some countries, such as India, Indonesia, Malaysia and, most significantly, China (where petrol prices have been raised 16% recently), are now in the process of reducing fuel subsidies, but even so it is likely that consumers in these and other countries will remain sheltered from the full impact of current high world prices. But the latest evidence of demand in the US is informative – with gasoline and diesel prices up by over a third so far this year, consumer demand is now beginning to fall. As a result, latest figures show refinery consumption of crude oil in the US falling to its lowest level in more than five years and inventories starting to climb.

But with energy supplies from the FSU and Asia proving to be less reliable and slower to come on stream than initially expected, and some OPEC members experiencing ongoing production problems, prices are likely to remain firm in the near term before responding to the slowdown in demand. In addition, there appears to be a shortage of refining capacity in the world, which in turn may add to the upward pressure on petrol prices even if crude supplies begin to improve. The Oxford Economics forecast is now for oil prices (Brent crude) to end this year at around US\$150 pb, for an average for the year of US\$130, double the 2007 level. Given the slowdown in the global economy that is now well under way and may well get worse next year, it seems likely that prices will level out in 2009 H1 and then start to head modestly lower, ending the year at around US\$120-125 pb but with an average a little higher than this year at around US\$135 pb.

8. Why hasn't supply responded more rapidly?

With markets and oil analysts in recent years increasingly seeing oil prices staying high on the back of falling forecasts of non-OPEC supplies, the sluggish supply response is surprising. IMF data show that during 2004-06 nominal oil industry investment actually rose by about 70%. But real investment has risen much more slowly, as much of the higher nominal costs reflected a global scarcity, and hence higher prices, of equipment and skilled personnel as well as much higher average exploration and development costs of technologically more complex oil resources, such as deep-water offshore drilling, oil sands projects and other unconventional oil sources (which in total are estimated to be several times larger than conventional oil reserves).

Furthermore, recent oil finds have tended to be smaller (the really big fields were discovered in the 1950s and 1960s) and more difficult to exploit. And other regions where oil is thought to be in plentiful supply, such as parts of Africa, the Arctic and Antarctic, will take many years to exploit and the costs will be very high.

In addition, international oil companies have faced numerous obstacles to extending operations in some countries, ranging from the threat of nationalisation in countries such as Venezuela and Bolivia to regional unrest in Nigeria and very challenging regulatory environments or disadvantageous tax regimes such as in the FSU. And some countries, such as Iran and Sudan (and also Libya until a few years ago), are considered “out of bounds” by the oil majors because of western sanctions.

9. Lack of investment in last 20 years

But it is also certainly the case that the global oil industry is unable to respond more quickly to the tight supply conditions because of the lack of investment in new oil fields over the past 20-25 years. The long period of low oil prices has lulled countries and companies into a false sense of energy security, deterring them from investing more heavily. The situation is now changing, but it may take up to 10 years before current investment and technological advances show through in terms of more sustained increases in output.

As such, however, although talk of “peak oil” appears premature and there is little danger of global oil supplies running out, geological and technological factors mean that supply rigidities will persist for some time and may not improve until oil prices have stayed above US\$100 pb for even longer. But the lack of progress in tapping unconventional supplies is still surprising – 15 years ago, it was asserted by industry experts that oil reserves such as tar sands would become economically viable when oil reached some US\$40-50 a barrel. It is, of course, possible that the oil majors do not yet see any need for more serious exploitation of unconventional reserves – notwithstanding the increase in demand in recent years, proven oil reserves have continued to climb. According to BP data, proven reserves at end-2007 were 1.24 trillion barrels, up from 1.07 trillion barrels ten years earlier.

And, although the US and the EU are frantically searching for alternative sources of energy, both unconventional hydrocarbon and alternative renewable sources of fuel are proving very expensive notwithstanding the current high level of oil prices. Exploitation of huge reserves of tar sands, such as in Canada for example, is now viable but progress is slower than expected. And the impact on oil prices of the drive to boost output of biofuels via the production of maize and sugar is marginal – indeed, the main impact has probably been to drive up the cost of cereal prices as more land is diverted away from food crops (a finding that appears to be confirmed by as yet unpublished World Bank research). The IEA projects that biofuel production will rise from 1.35 million b/d in 2008 to close to 2 million b/d by 2013 – effectively having little or no impact on the supply/demand equation. Other renewable energy sources will also play a peripheral role, unless government policies towards investment in these new technologies change. Solar energy could be the major source of renewable energy, but as yet there is little sign of the shift in policy in developed countries to enable this to happen.

10. Speculative demand a factor

In addition to buoyant demand from both developed and developing countries in recent years, another factor that has contributed to the run-up in commodity prices has been speculative, or investment demand, with the introduction of exchange-traded funds making it as easy to invest in commodity futures as in stocks and bonds. With commodities offering an opportunity for returns that are not directly linked with economic performance in the major economies, investors are using commodities as a means of spreading risk – indeed, it is likely that some of the recent surge in commodity prices is due to investors anticipating stagflation in the major industrialised economies.

Some estimates suggest that the value of commodity index investments has grown by about a third since the start of 2008, to more than US\$250 billion. Much of this is speculative, but in turn it is almost certainly based on a rational expectation of future supply constraints and continued robust demand. Hence, this form of demand exaggerates the trend rather than driving it in the first place. And, in any event, purchasing

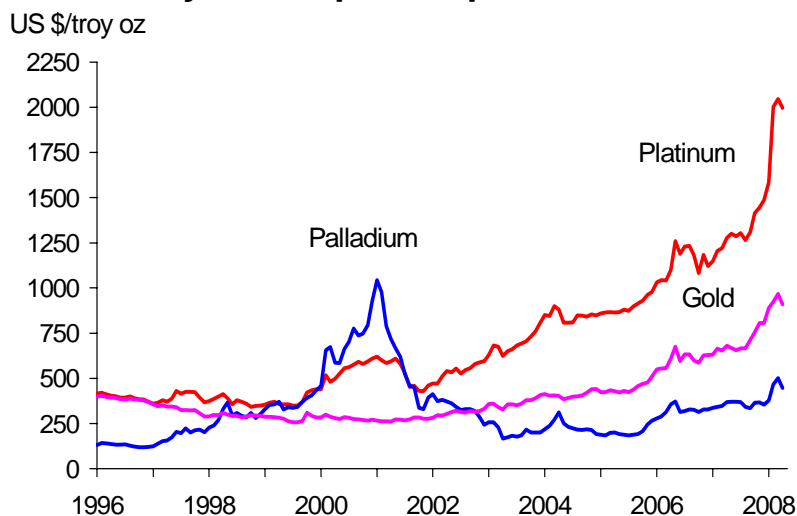
commodity futures does not reduce physical quantity arriving on the market – if it did, one would expect to see inventories rising, which has certainly not been the case over the last year. Reinforcing this view is the fact that the prices of thinly traded metals such as cobalt have also risen sharply, a trend that cannot be attributed to speculation.

11. Significant impact from weaker US\$

One imponderable in the equation about commodity prices is the impact of the weaker US\$. Whereas the prices of oil, metals and grains measured in US\$ terms have soared over the course of this decade, they have been more stable when measured in terms of gold or euros, both of which have been a better store of value in the last five years. IMF analysis suggests that 40-50% of the climb in oil and gold prices since 2002 has been the result of US\$ weakness, while some 25% of non-fuel commodity price moves have been US\$-related. The weaker US\$ has increased the purchasing power of commodity consumers in non-US\$ areas and has also led to a rise in demand for real assets as an inflation/currency hedge.

But this factor is likely to go into reverse at some stage, when the US\$ begins to recover. This in turn would reinforce any downward adjustment in commodity prices that may occur in the next few years in response to much slower growth of world demand and increased supplies. Gold and other precious metals would obviously face the biggest hit from a US\$ rebound, but oil and other metals would probably suffer as well.

Commodity market prices - precious metals



Source : Oxford Economics/Haver Analytics

12. Supply problems also facing metals

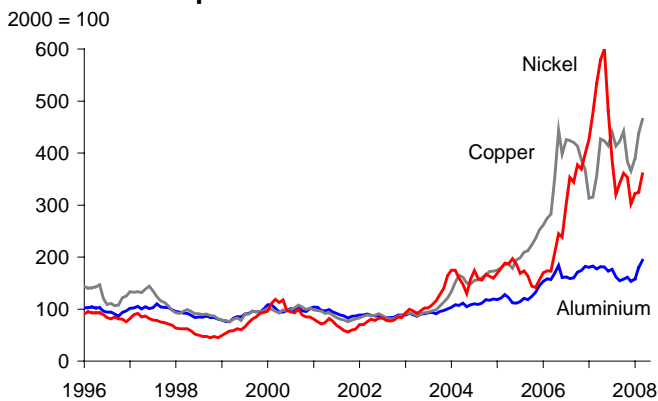
So, despite some impact from investment demand, supply factors are clearly apparent in the rise in most commodity prices as producers struggle to raise output in line with demands. And, on the minerals side, it can take up to 10 years for new mining projects to start to come on stream. In addition, although new iron ore mines are being developed in Western Australia, for example, considerable investment is also needed in related infrastructure, such as power supplies, roads and accommodation and a railway to ship the metal from the mine to the coast. Ports also need to be expanded or new ones built, together with new ships, to transport the ore to China and other destinations. This in turn further complicates the supply response to higher world prices.

Although investors have been turning increasingly to gold (a traditional store of value in uncertain times), prices of base metals - which tend to be more sensitive than other commodities to fluctuations in the business cycle – have also risen strongly. These peaked in May last year and then fell by 20% in 2007 H2 on slowing global manufacturing activity and a recovery in inventories from very low levels, but prices have recovered most of these losses this year because of supply concerns and, to a lesser extent, the weaker US dollar. And, although there has been talk of a bubble in metal prices, price developments of aluminium, copper and iron ore - all key inputs in the industrialisation and urbanisation of emerging economies as well as still in high demand in industrialised countries - can be explained by supply and demand fundamentals rather than any kind of speculative activity. The price of base metals is heavily influenced by the cost and time involved in developing new mines, which can take up to ten years. In the late-1990s and early-2000s, metal prices were broadly static, which deterred mining companies from embarking on new projects. Although rising demand in China and other emerging markets has changed the equation since then, it will take time before new mining capacity can come on stream. In the meantime, of course, prices are being boosted by some natural disasters, power shortages and strike activity in a number of key producing countries.

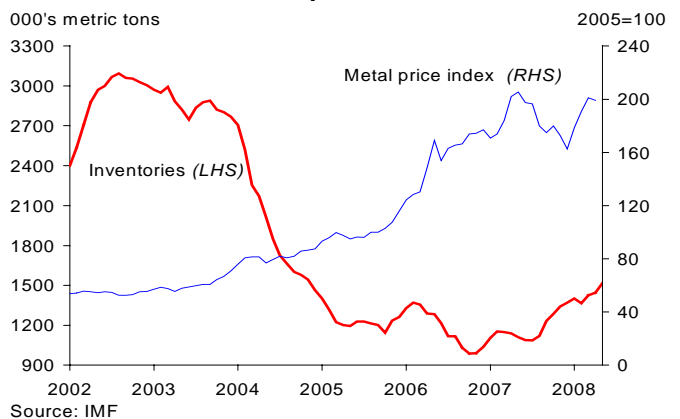
13. Aluminium boosted by China and South Africa

Aluminium prices have doubled since 2003, but in large part this reflects sharply higher energy and other raw material input costs such as bauxite during that period. And, more recently, there has been a slowdown in aluminium output because of mounting power shortages in China and South Africa. China is a major producer (and consumer) of aluminium and the massive earthquake that hit Sichuan province has disrupted electricity supply in the region and is thus impacting on more than half a million tonnes of aluminium that is normally produced in the region. These supply concerns, along with the higher cost of bauxite, may lead to further rises in aluminium prices. And some have suggested that China will be forced to increase imports of fuels such as diesel and naphtha in order to generate power following the earthquake.

Commodities price index - base metals



Metal inventories and prices



14. Copper stocks are very low

As the world's third most widely used metal, copper is a key factor in global industrial development and, as such, is a barometer of economic expansion. Since 2003, the price of copper has increased fivefold in US\$ terms – this remains a supply-side story, with supply continuing to disappoint despite now weakening world demand. According to the International Copper Study Group, world copper production in the first two months of this year was down 3.8% from a year earlier, resulting in a seasonally adjusted 15,000 tonne deficit for the period, implying a further decline in stocks, which have fallen in four out of the last five years. And, with recent events such as cuts in interest rates and strong Asian demand at least partially offsetting the impact of

weaker US and European economies, and physical stocks very low, copper prices are unlikely to ease much in the second half of 2008. Moreover, copper production in Chile, the world's largest producer, fell 8.4% on the year in March as a result of power interruptions – ongoing power shortages and strikes at leading companies have dampened production prospects for Q2 and quite possibly for quite some time. And in Peru, the threat of labour unrest continues to mount, which in turn could jeopardise the inflows of FDI needed to sustain mining operations.

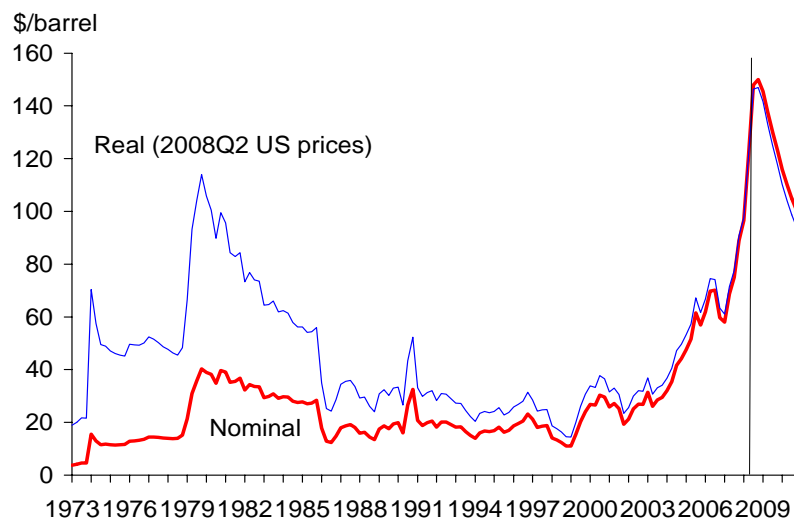
On the positive side, copper production in Zambia is expanding again following fresh investment in mines by China, with Konkola Copper Mines (majority owned by the Indian Vendanta Resources), planning to raise copper output to 500,000 tonnes by 2010 from 200,000 tonnes currently. The company's new Nchanga smelter is expected to be operational in mid-year with an annual finished copper production capacity of 300,000 tonnes. In addition, Australia's Zambezi Resources has several exploration projects underway and Canada's Caledonian Mining is engaged in a feasibility study of producing cobalt in Nama and hopes to start production in 2009. Overall, Zambia's copper production could reach 1 million tonnes by 2010, which could make it the fourth largest producer in the world (it was ninth in 2007), but there are numerous infrastructure and political constraints to be overcome that continue to cast doubt over this target.

As a result of current production problems and the fact that it has been a long time since any major new copper reserves have been discovered, supply is still likely to disappoint in the coming year. Although China is investing heavily in new reserves in Peru (most notably Mount Toromocho) and elsewhere, the global supply/demand balance is unlikely to improve in the next couple of years given the strength of demand from China itself.

15. Conclusion – oil/mineral prices will fall only slowly

In conclusion, it is clear that the era of cheap oil and other commodity prices is over. Given the lengthy period of low oil and metals prices in the 1990s, investment in new productive capacity has been delayed too long for supply to be able to respond quickly to the surge in demand seen in recent years. New oil and metal supplies are coming on stream, but not yet fast enough to meet the burgeoning demand from Asian developing countries.

Oil price



Source : Oxford Economics

Demand in the west is now falling – most notably demand for gasoline and diesel in the US – resulting in lower demand for energy and metals, but demand in the developing world has remained resilient, meaning that there has not yet been a significant slowdown in global demand for oil and other key minerals. Until this happens, oil and metal prices look set to remain high and may go even higher given current political concerns in the Middle East. But, if there is no major interruption to oil supplies in the Middle East or elsewhere, some price weakness seems likely later in 2009 and heading into 2010 as emerging economies start to slow more significantly in the wake of the downturn in the industrial world, although there is unlikely to be a major decline unless the global economy grinds to a halt. Despite the mounting problems and the ongoing impact of the credit crunch, this still seems unlikely.

But looking further ahead, it is quite possible that the current position of tight supply will give way to over-supply as growth in global demand falters and recent investment in new hydrocarbon and mineral resources results in higher production levels. The inevitable increase in the use of nuclear fuel in some developed countries will also tend to erode the demand for oil and gas for electricity generation. So, in another ten years, it is quite conceivable that the world could be facing another period of relatively low oil prices, albeit the US\$10-20 pb price levels seen in the latter part of the 1990s will almost certainly never be repeated given the widely-held concerns about “peak oil”. However, if governments and companies believe that there could be a return to low oil prices, then there is a danger that the required investment in new conventional and alternative energy sources will not take place – and this would certainly lead to even higher oil prices in the years ahead. Official policy towards investment in unconventional and renewable sources of energy will therefore be crucial in determining the future of world oil prices.