

China's Thirst for Oil Could Come Up Short

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Oil bulls place enormous faith in the Chinese dragon. But don't forget the inkfish.

"Inkfish" are smoke-spewing, single-cylinder engine contraptions driven by many poorer Chinese. They symbolize why China's vehicle market—now the world's largest—mightn't necessarily be a source of rapidly growing oil consumption ad infinitum. What's more, China may also be an unexpectedly bearish force for commodities on the supply side, an issue discussed in a separate column Tuesday.

This year, China is expected to consume 11% of global oil production, says the International Energy Agency. However, it has accounted for 45% of the growth in global oil demand over the past decade.

As China's vast population grows richer, so the thinking goes, so will its appetite for more of everything. Yet, as Deutsche Bank's Paul Sankey points out, Chinese passenger-vehicle sales surged 77% year-on-year in the first quarter. Yet apparent gasoline demand rose by just 3%. Indeed, consultancy JBC Energy reckons Chinese demand for gasoline has been flat since last July.

Why the disconnect? Jack Perkowski, founder of Chinese auto-parts maker Asimco Technologies and now head of advisory firm JFP Holdings, points to underlying shifts in the Chinese vehicle market.

About 50 million engines are manufactured in China every year, says Mr. Perkowski. So while 13.6 million cars, trucks and buses were sold in China last year, another 36 million or so other, low-technology vehicles were sold, including those inkfish. A big reason for the apparent surge in sales, therefore, is the switch from nonconventional vehicles to conventional vehicles, says Mr. Perkowski.

This helps explain the disconnect between Chinese vehicle and oil markets, especially as new cars are more fuel-efficient than inkfish. Still, with per capita car ownership one-twentieth that of the U.S., surely the sheer weight of numbers portends dizzying growth in oil demand?

That view assumes, however, that Chinese drivers emulate Americans and load up on big SUVs and trucks. There is good reason to think they won't. Even with rising incomes, price is the big factor in Chinese car-buying decisions. Smaller cars, perfectly suited for the urban environment of the richer coastal cities, are cheaper than big ones.

In addition, never forget the role of the government. Beijing has little strategic interest in

emulating America's addiction to foreign oil. Accordingly, it has pushed consumers toward smaller engines via tax breaks. This is easier to do in an embryonic market where, unlike America, drivers don't feel like they are trading down to less powerful models.

In June, the government is expected to unveil subsidies for alternative-fuel cars like plug-in hybrids, worth perhaps a third of the sticker price. Besides energy security and environmental concerns, Beijing knows its domestic car makers have a better chance of leap-frogging Western rivals in the development of new electric-car technology than in long-established combustion engines.

The upshot is that China's thirst for oil mightn't grow as rapidly as many expect. Mr. Sankey sees oil demand there starting to flatten out at between 13 million and 14 million barrels of oil per day by 2025. That is more than this year's 9.1 million bpd, but implies an annual growth rate over the next 15 years of just 2.6%, about a third that of the "super-cycle" decade just gone.

A less thirsty Dragon would coincide with nascent, but determined, efforts to suppress oil consumption in the industrialized world.