An explanation of the volatility of oil prices II

Classical models

Demand-driven

Supply-driven

Petroleum model

A. Industry with few rigs working and small exploration staff is slow to respond to small increase in demand; price increases greatly.

B. After long period with little exploration, supply falls and price increases.

C. With price falling, companies continue or increase production to maintain revenue, increasing glut and causing further drop in price. Companies cut exploration staff.

D. After long period with little exploration, supply falls and price increases.

A. Industry with few rigs working and small exploration staff is slow to respond to increase in price.

B. After increase in exploration and drilling, supply increases and price decreases.

Demand decreases little in response to increase in price because infrastructural change in transportation is slow.

Supply and demand respond quickly to change in price, buffering change in price.

The ideas presented here are largely from an article titled “How low can oil go?” by economist James Surowiecki in the issue of The New Yorker for December 22 and 29, 2014.