The Oil Drum
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

Losing our Balance? Some Predictions...

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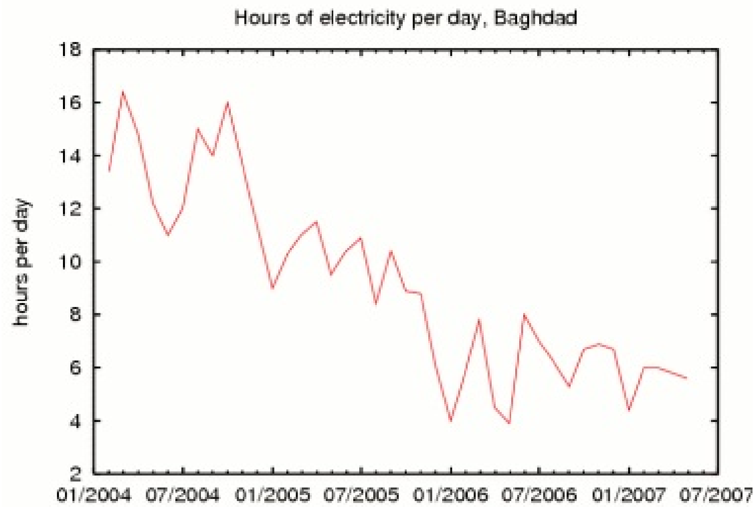
Interesting times, indeed. Oil (NYMEX WTI front month future) closed at record intraday trading high of $78.77 per barrel on August 1st, but has since fallen back to near $70. The markets are clearly shaken, and suddenly people are realizing that the recent explosion of derivatives has created as much hidden rigidity as resiliency in our financial markets (as I wrote about here). Is this the beginning of economic collapse, or just another minor perturbation?

There are several stories worth following at the moment:

Mexico continues to reveal how deep its problems run. After my article on the looming collapse of Mexico sparked a lively conversation, the meme of Mexico collapse spread quickly (though I don't take credit for that--the situation speaks for itself). One little gem was PEMEX's announcement late last Friday that they will probably be out of oil in seven years--out of oil, not just beginning to decline. Notice how this came out on Friday afternoon. That's when you issue a press release when you want to bury a story. In theory, an oil producing field or region is never actually "out of oil." Instead, production continues nearly indefinitely at increasingly low levels. However, when geopolitical disruptions and positive feedback loops are accounted for, such as are increasingly impacting Mexico, the absolute cessation of oil production is a very real possibility. At the very least, it looks likely that Mexico will soon cease to export oil in any significant quantity.

And electricity seems to be a growing problem, at least in the third world (and those areas that the US military has transformed into the same). It is interesting to note that Jay Hanson (of dieoff.org notoriety) popularized Richard Duncan's Olduvai Theory along just these lines--that it would be electricity, not oil, that would be the actual cause of collapse. This seems quite plausible to me, though I still think that it will be fundamentally driven by declining oil production, with the resulting electricity-grid problems being best understood as an above ground factor stemming from oil. Oil is driving metal theft to new highs, which impacts the viability of electrical grids everywhere. Oil and natural gas prices makes it more difficult to maintain fuels for peak-generating capacity. Oil prices breathe life into infrastructure insurgencies everywhere, which repeatedly target electrical grids for their high return on investment.

Take a look, for example, at what has happened to the electrical supply situation in Baghdad, despite the impending success (sarcasm) of the current "surge" by US military forces there:



Ryan Crocker, the U.S. ambassador to Iraq, told the Senate Foreign Relations Committee last week that Baghdad residents could count on only "an hour or two a day" of electricity.

Interestingly, John Robb has picked up on this crisis in electrical grids around the world (especially in Iraq) as a possible point of development for Africa--their grids are becoming so unreliable that African communities have the opportunity to lead the world in innovating a mode of modern civilization without grid electricity, and possibly export any success that they may have to the rest of the world. While I don't see Africa finding a profitable export market for their brand of grid-free living (admittedly, that isn't actually what Robb was suggesting), I do agree with Robb's assessment that we need to learn to build resilient communities--I've written about that, as well.

Meanwhile, despite Jim Cramer's meltdown to the contrary, the Main Stream Media is doing an admirable job of proselytizing the approved message that everything will be OK. It's not quite time for bargain hunting among the financial stocks, but everything else is still a good long-term investment. CNN has been leading the pack, explaining that we shouldn't freak out about recent drops in the Dow, and that oil won't hit $100. CNN cites Paul Beutel, an oil analyst for Cameron Hanover. Beutel explains that we are about to see significantly increased spare capacity in the oil markets because Saudi Arabia will increase capacity by 2 million barrels per day by 2010, and we'll see an additional 3 million barrels per day of ethanol and oil shale by 2010. Meanwhile, CNN explains that the EIA sees demand growth over to 2010 at *only* 1.3% per year because of economic slowdown. Even at 1.3% growth, the world will need an increase of 3.4 million barrels per day within 3 years. While, admittedly, peak production can only be identified with regards to a historical period, the latest EIA data (.xls file) shows continued *decline*, rather than increase. There are several serious flaws with CNN and Beutel's rosy prediction. First, they fail to account for the export land effect, where oil revenues to exporting nations drive domestic consumption, and decrease exports. Second, their assumption that Saudi production will increase significantly over the next three years is contradicted by the evidence. And third, while subsidy-driven ethanol production may well increase by a few million barrels per day by 2010, this increase may represent a much smaller net gain after accounting for the net energy of ethanol. If anything, the media's performance over the past week has validated Jeffrey Brown's Iron Triangle model. So, while fund managers are currently pulling money out of speculation in oil, resulting in the recent retreat in prices, the fundamentals are bullish. $100 oil by 2010 seems like one of the best bets available (though I'm *slightly* less confident if you account for inflation and the falling dollar).

So that's a brief, annotated wrap-up of a few key stories . . . but what does it all mean? Are we about to permanently plunge into the civilizational abyss and return to a hunter-gatherer existence? While civilization seems to be stumbling on its balance beam at the moment, predictions of total doom *may* be premature--and this comes from someone who continues to predict general economic collapse. I tend to think that Bernanke's resistance to giving in to public calls for the Fed to lower rates and "fix" this problem stand a decent chance of inflicting more short-term pain but buying a temporary reprieve from outright collapse. If, however, the Fed decides to "refinance" this bubble with rate cuts, they *may* achieve temporary victory, but will worsen and quicken much greater problems down the road.

I called 2006 the year of the balance beam--meaning that everything would be fine as long as nothing "significant" happened. I called 2007 the year ofTrends, as I predicted that it would be the period where trends like Peak Oil become clear--and, keeping with the metaphor, where the balance beam grows steadily narrower. We are drawing precariously close to losing our balance--arms are flailing and we're collectively making those funny gyrations as we try to stay up. That said, we will likely find a way to regain our balance in '08, and in '09, and '10. Robert Anton Wilson's concept of "Maybe Logic" seems well suited: anyone who says that they KNOW that (or when) the economy will collapse, or that they KNOW that human ingenuity will provide a solution is speaking from faith, not reason. That said, it certainly *seems to me, at the moment* that we're getting steadily closer to the edge. At the new year, I predicted that we wouldn't "fall off" our balance beam until 2008. Maybe that's too early. But, if current trends continue, I have a hard time seeing how we haven't hit the mat by 2012. What does "hitting the mat" look like for our global economy? I don't pretend to know, but I'm guessing it will make the troubles of the past few weeks look like a walk in the park. I don't put much stake in Mayan prophecies, but in my grand notebook of semi-accurate predictions 2012 is shaping up to be a very interesting year...