The Oil Drum
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

Energy/Credit/Currency Crisis Open Thread

Posted by Nate Hagens on October 6, 2008 - 9:50am
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In what feels like the middle of a multi-round heavyweight bout, the world financial markets continue to be buffeted tonight, following the recent trend of lower equities, stronger dollar (vs Euro, SF and Sterling), sinking energy and commodities prices and considerably less confidence in the overall system than in weeks prior. Theoildrum.com has historically focused on the biophysical aspects of a world economy based on energy (and occasionally the human aspects that impact energy demand). Most research here attempts to predict what world oil and gas production might look like in a future where depletion inexorably overtakes technology, and the costs of procuring large amounts of quality fuels continue to increase. However, the spiralling of recent events make it likely that, at least for a time, be it a week - or several years - oil and gas depletion might be more than offset by the reduction in demand due to the manifold implications of the reduction in global financial leverage and resulting credit contractions and dislocations in the real economy. The linkages between finance and energy are becoming more direct, but I'm quite certain there are many under the surface we are yet unaware of.

Below are a few article links followed by some open ended questions. Please deposit data, charts and links of relevance.

From Nouriel Roubini's article in Forbes:

> In a solvency and credit crisis that goes well beyond illiquidity, no one is lending to counter-parties as no one trusts any counter-party (even the safest ones), and everyone is hoarding the liquidity that is injected by central banks. And since this liquidity goes only to banks and major broker-dealers, the rest of the shadow banking system has no access to this liquidity as the credit transmission mechanisms are blocked.

From Bloomberg, on European Union Leaders Stop Short of Regional Plan on Bailouts:

> Sarkozy said that ``all actors" must be supervised, including rating firms and hedge funds. Executive-pay systems must also be reviewed, he said.
>
> ``We want a new world to come out of this," Sarkozy said. ``We want to set up the basis for a capitalism of entrepreneurs, not speculators."

> Anticipating increased spending, declining tax revenue, and government bank takeovers, they called for ``greater flexibility'' in the application of European Union competition and budget rules.

And in addition to an earlier announcement that Germany would guarantee all bank depositors (much like Ireland announced last week), HYPO did get a 50 billion Euro government led bailout. This on the heels of BNP Paribas buying out Fortis earlier today.

Tonight the Euro continues to weaken, and is now at levels not seen since late 2004. It is difficult to keep tabs on all that is happening, both globally, nationally, and locally. My personal view of our future continues to be a probabilistic distribution of many possible outcomes, the odds and timing of each, periodically adjusted based on the actions and feedbacks of important world actors. The 'public' is likely to become as important an actor as any.

The odds that peak oil is now behind us are now (in my opinion) nearly 100%. The odds of global economic expansion (and growth) now being over are also high (this has been oft-analyzed but here is a good overview of the reasoning). Whether we will have inflation or deflation of 'money' (as opposed to the four real capitals: natural, built, social and human), is still an open question and depends on what path world central banks choose. History suggest that the news has been so bad for so long that we are due some respite from concerted central bank intervention that props up confidence and the markets for a time. But history has been based on growing energy surplus, and ultimate confidence that one will get a return OF capital in addition to a return ON capital. Thus, the current financial/energy landscape may accelerate the popular modern timing of exchanging bank digits for real capital from the end of ones career, to somewhat earlier. Yes, this time it may be different.

Recent events are certainly stirring the pot of possibilities - here are a few questions for general discussion: (no right or wrong answers...;-)

- **If/when the dollar rally ends will the oil sell-off end as well? Or do they have fundamentally different causes?** (Here I would suggest that oil selloff is largely capital flow/hedge fund driven, and dollar rally has been largely flight to quality and repayment of debt denominated in dollars and leverage is mandatorily reduced.) (Note: Dollar rally vs Euro is 82% correlated with rise in 30 Yr Treasury prices

-**What impact would a demise of the Euro have on the future for energy?** (Note: tonights ECB call for 'greater flexibility' does not seem consistent with formal limits on borrowing and fiscal deficits by EU members under the Stabilization Pact)

-**Will the fall out from the credit crisis cement peak 'energy'?** (Presumably, we are headed for a depression and concomitant demand reduction - will the time gap brought about by credit crisis in creating/financing of new energy infrastructure now be overtaken by ongoing depletion in coal, nuclear, and oil industries?)

-**Given what is happening, would a 'fast-crash' scenario be, in many respects, preferred to a long drawn out slow crash?** (In the sense that a fast crash leaves more quality resources in the ground, and creates enough pain and recognition that our current 'ends' are not the best way to spend our remaining fossil energy surplus?)

-**If Peak Oil means the end of growth (I think this likely but not certain), what do people do with IRA's/401ks that aren't due to be redeemed for 10-30 years?**

-Would a concerted 100 basis point global ease this week do anything?

-What other Black Swans could make this situation better, or worse?

It seems (at least one) genie is out of the bottle. The time to ask comfortable questions and get comfortable answers may be passed. But uncomfortable answers probably still have a window.