

Global Financial Crisis & The Crude Oil Connection - Part 1

An Interim Perspective of Transition One....

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Global financial crisis in brief

The global financial crisis is largely recognised as having its origins in the United States and was indirectly caused by a progressive increase in sub-prime mortgage delinquencies or foreclosures from 2006 to 2009. The true destructive potential of the crisis became apparent when United States property values began declining and mortgage delinquencies increased dramatically. This crisis has ultimately resulted in the collapse of many banks and financial institutions world wide which has since destabilised the global economy. However, while many financial commentators continue to offer projections and analysis which conveniently resides on the surface of what has been dubbed the perfect financial storm, there is in fact much more to the origin of this financial crisis than commentators are alluding to and from a point of awareness, the majority have unwittingly detracted from a deeper and more defined perspective of the primary cause of this financial crisis currently gripping humanity.

Sub-prime mortgages - A complex and confusing lending policy structure....

Sub-prime mortgage contracts are financial products essentially provided to lower income borrowers who maintain a minimum of long term security which lessens their ability to honour mortgage contract repayments. The sub-prime mortgage and lending industry as a whole has been historically managed through inadequate financial industry regulation and as a result, has generally presented a higher risk of loan delinquency or foreclosure in times of income difficulty or economic hardship. When analysed for integrity, the lending structure of many of these so called sub-prime credit contracts is to say the least, extremely confusing and complex. Many have described these credit models to appear as massive interconnected spider-web like structures that became confusing to the most expert of financial opinion after examining the first few pages of a power-point presentation of the same. In fact, several prominent analysts have stated that they were lost after the fifth page, where the structure had become entangled within the numerous financial entities involved and particularly the way in which many of these structures were moved offshore incorporating many lending institutions and fund management providers. In the majority of cases, providers have continually struggled with aspirations of sustaining an uneasy balance of lending criteria in a virtual mountain of legal minefields. To suggest that the average borrower would have comprehended the legality and complexity of these lending policies would be a fallacy and is clearly seen as a hopeless exercise serving no purpose other than to further concrete the borrower within a realm of legal and financial confusion. In any case, it's not difficult to understand why credit markets world wide began to collapse when millions defaulted on their loans and joined the long and exhaustive mortgage delinquency cue. But the other very important fact to consider is that of the specific levels of corporate greed that have

perpetuated many of these lending strategies. Collective issues of neglect from any single government or group of governments not having implemented sufficient control methods in place to monitor ongoing lending policy criteria is an element that holds as much guilt as any other within the entire spectrum of financial regulation.

Financial and economic decline....

With the dawn of a new and uncertain era that will progressively be seen as the period forging a catalyst of permanent change, it remains rather difficult to imagine experiencing the levels of confidence of past within foreseeable financial market structures of the future. As of the last financial quarter of 2008, losses of somewhere in the order of 17 trillion dollars had been recorded. Since the awakening to what has historically become the biggest financial threat since the days of the great depression, the *global primary energy crisis* or more appropriately described as a permanent crisis geologically acknowledged as a unique phenomenon imposed by immutable physics and nature, has forced many peak oil analysts to ponder where their next phase of geological assessment would take them in determining our precarious post global peak oil supply future. But with the obvious pressures of a major *supply-to-demand* problem being experienced prior to the onset of the global financial crisis now being eased through declining global demand for primary energy and all that is generally associated, we now continue to view our precarious future from an unstable observation platform that provides very few assurances of future supply. But there is one element that provides a specific level of clarity and serves as a unique opportunity to deliver a timely but cautious reprieve to OPEC suppliers. When comprehending the full extent of the problem, it becomes much clearer the further we wade through the tangled web of deceit that an obvious lack of government control over lending policy was always doomed to failure in the long term. It also becomes clear that a handful of government economists and financial advisers with their fingers on the pulse of government policy failed to act well ahead of the point of realisation and inevitable financial collapse. The structure and balance of governance in this case should be considered nothing short of a reckless financial act which has supported the manner in which the world's largest economy has perpetuated an unstable philosophy of growth through its ever expanding desire to feed a constant stream of financial credit to a well conditioned but largely unsuspecting consumer society. Policy models of this nature have maintained an awkward balance throughout lending history and have dangerously sustained threadlike opportunities that have built towards what is now generally accepted as an over supply of banks and lending institutions. This excessive level of financial capacity has continued providing credit and loan contracts that could never be honoured to conclusion which has ultimately resulted in a destructive rippling effect throughout the entire global economic infrastructure. When examining economic prudence in this particular case, it shouldn't come as any surprise to discover that stern warnings of the consequences of such policies had been echoed by several prominent United States economists and other economic analysts as far back as the early to mid nineties. But these warnings fell short of their mark and were never taken seriously, being generally considered in the same context as the fabled boy who cried wolf. With economic decline and the lack of sustainable financial confidence now firmly established within the corridors of financial history, banks and lending institutions alike continue to tighten lending policy and the inevitability of economic downturn continues to transform our lives on a daily basis. For the most part, stagnation of credit flow means ongoing industry closure, job losses and shortages of many general social services. These services play a major role in maintaining social development infrastructures world wide but more importantly, when considering the elements that make it possible to achieve everything

sustainable within social infrastructures, it means that demand for *primary energy* declines. In short, people are forced to take steps to reduce spending on general commodity items and conserve energy expenditure. These and many other aspects of economic downturn have touched our lives in one way or another and it seems that no geographical quarter has escaped the impact in the wake of this devastating primary energy driven global financial crisis. One of the most significant losses during the crisis has been the gradual destruction of earning potential for retirement funds which are predominantly invested in International Share Portfolios. This has resulted in millions having to apply for government funded pension allocations as their retirement funds no longer sustain the potential to carry them into retirement and beyond. Self funded retirement policies are only a small example of the destruction this crisis has produced to date. Manufacturing and associated supply industries have also suffered with closures and mass redundancies due to the lack of available credit to provide wages, salaries and operating costs. But even as the global economy continues its historic path of rapid decline with the United States leading the way, it would appear that lessons have still not been learned from the specifically related impact of excessive and overwhelming corporate greed that has plagued the United States economy for decades. As we are all forced to come to grips with economic devastation, *Wall Street* corporate bonuses for period 2008 exceeded 30 billions dollars. During the same period, the United States economy had declined by more than 4 % percent and projected percentages of decline that would follow will set new records of economic devastation.

United States debt projection provides a catalyst for devastation....

When we comprehend the scope of detail and look even deeper into government policy and the specific levels of future debt projection in a desperate attempt to make sense of it all for the purpose of creating positive preparation for any potential of economic inevitability in our precarious future, we find that accumulated United States debt to date totalling approximately US\$11.27 Trillion Dollars is considered a dot on the horizon when we comprehend the levels of projected debt expected to become reality by 2018. Despite the stream of positive rhetoric from the United States administration in talking up economic growth long into the future, the level of projected debt by 2018 is expected to be approximately US\$23.1 Trillion Dollars. If this wasn't enough to strike fear into the minds of many, several analysts have offered their synopsis concerning future debt accumulation and have concluded that it would be impossible for any government to survive at debt levels above US\$18.0 Trillion Dollars. Based on these calculations, analysts have drafted gloomy scenarios that would force the closure of many government departments including social welfare, infrastructure and many other vitally important facilities and government services. At this point, we must remind ourselves that the luxury of maintaining economies intact is only made possible by the availability and affordability of abundant supplies of primary energy. Understanding the fundamentals of any specifically grouped or indirect causes of the global credit and financial crisis may readily provide a means of acknowledging what must be achieved to quell the damage, but when we seek to comprehend the *primary energy or crude oil connection*, we clearly understand that financial losses to date can only be viewed and measured as a prelude to what we can expect in the coming months and years ahead.

United States debt as at May 16, 2009 = US\$11.27 Trillion Dollars
Projected debt to 2018 = US\$23.1 Trillion Dollars

The crude oil connection

An Interim Perspective of Transition One....

When considering economic management and the manner in which transient economies are progressively developed and sustained, it goes without saying that any suggestion of economies being powered by financial wealth or capital is not actually stating fact. This element tends to misrepresent economic development reality and would only benefit those who seek to build the extraordinary wealth that many in the financial world speak of with selfish abandon.

Fact....

The global economy and for that matter, all economies are actually powered by (primary energy), which makes it possible to achieve everything we do within social infrastructures such as industry, engineering, manufacturing, financial, health care, medical, agriculture and all aspects of social demographic management.

Quite simply, no primary energy means no social or economic infrastructure, and crude oil is at the very top of the primary energy chain. In other words, the availability and pricing dynamic of crude oil governs everything we do....

References concerning economic structural management including Transient Economies or Transient Phenomenon and Steady State Economies can be found at the Author's web site and in the Author's publication.

THE ENERGY OF OIL

A peak oil awareness and resource publication

<http://www.hydrocarbonuniverse.com/>

Global conventional peak oil production plateau....

To understand the close correlation between crude oil production and the current global financial crisis, we have to go back to the months and years leading up to the crisis. From this period we can follow an uneasy transitional phase within global energy markets which was primarily based on a rapidly maturing fear of global *supply-to-demand*. While collective industry acknowledgment of a major crude oil supply problem remained evident with the resulting high cost of the same which topped US\$149 per barrel in July 2008, a range of production and supply strategies were being thrashed out within the confines of OPEC member board rooms and the same of many other global suppliers. The period 2005 through to 2006 was largely seen as the commencement of the transitional period of the long awaited global conventional peak oil production plateau. More specifically, this was now the period where the global supply of regular or conventional crude oil was approaching dangerously close to its expected decline, which is a permanent phenomenon naturally imposed by nature.

The late **Dr Ali Morteza Samsam Bakhtiari**, a former senior advisor to the Iranian National Oil Company and global oil supply expert who had published some of the most accurate predictions concerning a global conventional crude oil production peak and the ensuing consequences resulting from the same, aptly named this transitional period of post global

peak oil production as (*Transition One*), or the first of several stages that commences the period following a global peak oil production plateau and the continuation of a long train of economic events that follow shortly thereafter. But even during 2006 when the barrel price began its historic rise and was collectively acknowledged by the majority of leading Petroleum geologists and oil supply analysts as a monumental moment indelibly embedded into primary energy production and oil supply history, the United States economy was already reeling from a surplus of housing and rapidly declining property values coupled with a struggling employment sector and jobs market. From a geological or primary energy perspective, it should be considered without any doubt whatsoever that the aforementioned decline of these and many other elements of socioeconomic continuity were uniquely and inherently linked to increasing energy costs directly associated to having achieved a global conventional peak oil production plateau. Equally threatening was the fact that United States oil imports had been progressively increasing over several decades due to the lack of locally produced oil which is an association to the well documented fact that United States oil production had peaked in 1970 and had been in rapid decline since. The inexorable rise in the barrel price prior to the lead-up to a more pronounced global economic crisis was a natural market reaction to what was now considered as the newly acknowledged value of crude oil based on nothing more than fear and negative market speculation concerned with future primary energy supplies and the fact that regular or light crude oil was fast becoming a dangerously rare commodity. In the light of conventional Petroleum geology wisdom, common logic tells us that the more rare the commodity becomes, the higher the price until supply is no longer available. Supply in this case is permanently threatened once peak oil production has been achieved and production decline sets in at around 3 % percent or possibly greater per annum. The other point of concern to reiterate with respect to having already achieved a global conventional peak oil production plateau is the fact that global oil supply is no longer plentiful, which is now unfortunately a permanent feature in the entire spectrum of global energy supply.

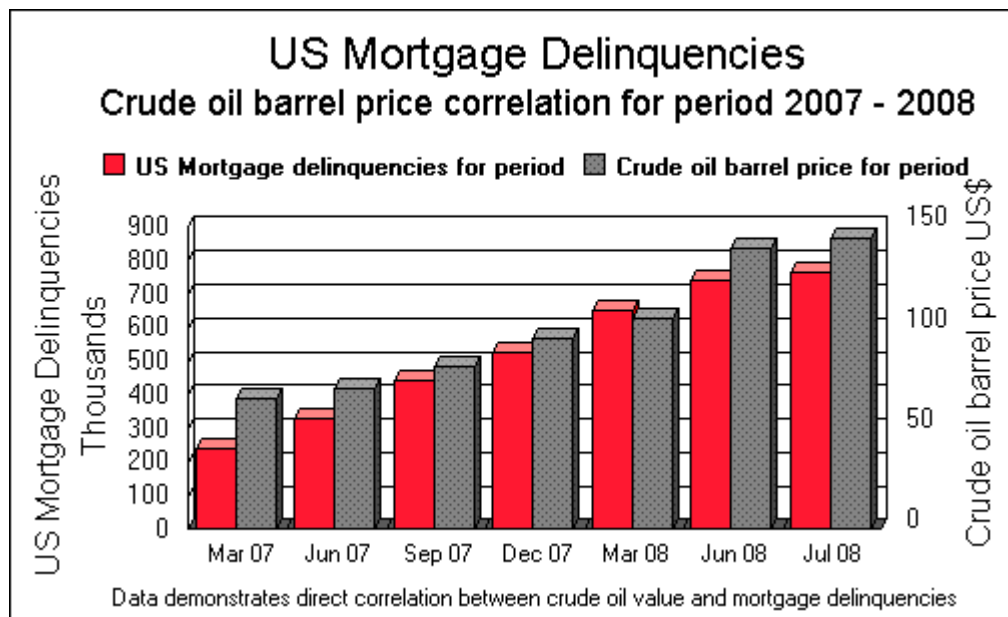
These and other facts serve as a perfect platform to promote the philosophy that crude oil must increase in value until the threads that bind economic stability give way. With economic hindsight firmly established, it remains clear that the global economy with its vast trading network cannot sustain the social and industry pressures endured when crude oil value increases to within US\$150 or higher per barrel. We have now physically achieved the point in economic history where a non sustainable peak in primary energy value casts its permanent shadow over humanity and offers yet another opportunity of understanding that perpetual economic growth is not sustainable and was never going to be.

Economic destabilisation....

The upward spiral of commodity value against the associated threat of the long projected natural decline of crude oil supply after having achieved a global conventional production plateau, automatically brings about the destabilisation of economic threads that bind all social infrastructures together. Essentially, the rising cost of crude oil becomes unaffordable in so many ways, seriously affecting industry, manufacturing, agriculture, transportation, employment and all that is inherently associated. This primary economic variable had already been realised by many within the industry when crude oil value increased to a record price of US\$149 per barrel in July 2008 during what was geologically recognised as the final stages of a global conventional peak oil production plateau. However, the more definitive point to make with respect to the aforementioned and the connection we can now draw toward

economic destabilisation is the fact that crude oil value was increasing on a progressive scale over time before it had reached its record highs. In fact, the value of this primary energy commodity was on an upward climb prior to 2005 and considered in many circles as the dominating factor concerning industry closure and job losses, long before the financial crisis had peaked to the point where major banks and institutions had collapsed. Although many countries including the United States continued reporting quite attractive percentages of economic growth, this period was clearly documented as the period of gradual change within industry and associated employment. Many small businesses, manufacturers and transportation companies were struggling to make ends meet, with dwindling profit margins forcing many against the wall. The accumulated stresses of a rapidly increasing primary energy value began to tare at the heart of the employment industry and the ability for many to maintain personal financial budgets, mortgage payments and all that is generally associated with the benefits of sustaining permanent or long term employment. As industry continued to suffer the onslaught of energy commodity price increases, the percentage of mortgage delinquencies or foreclosures also continued to climb proportionately. As clearly demonstrated in the graph below for period 2007 to 2008, we can definitely draw a correlation between higher primary energy prices and sub-prime mortgage delinquencies.

US Mortgage Delinquencies / Crude Oil Barrel Price Correlation Graph....



Although OPEC member countries such as Saudi Arabia have continuously boasted having plentiful supplies offering adequate spare production capacity to cope with western economic growth long into the future, and with this rhetoric being constantly offered without evidence of the same and also being provided in the light of reports from world leading Petroleum geologists that have proven otherwise beyond doubt, the price rises from 2005 to 2008 were clearly indicative of a worrying supply scenario deeply entrenched in concern for western economic stability. Conversely, stable crude oil prices during the above mentioned period would have been indicative of strong and sustainable confidence within energy markets,

confirming a more reliable and stable supply of crude oil. It is considered that the latter of economic scenarios would definitely not have promoted the need for industry closures and employment redundancies of which were definitely documented as having increased on a steady scale along with the price of crude oil. But economic decline presents a new set of rules that invokes continuous decline in demand for primary energy and in this case, oil production decline automatically follows.

Secondary or more extreme supply-to-demand scenario example....

Commodity value continues its upward spiral as regular supply is dangerously threatened with exhaustion due to a rapid decline in production potential post global peak oil production plateau.

This circumstance when viewed with the inclusion of any existing financial crisis would no doubt promote the need for collective and strategic government and military intervention on a massive scale to draft a completely new order of control governing the secure and safe proportionate distribution and delivery of remaining global crude oil supplies. Considering the dramatic long-term end result of this supply scenario, the increasing value of the commodity in this case would eventually achieve what has become evident within the structure of the primary scenario and cause the progressive collapse of the global economy long before such extreme measures could be drafted and implemented into long term action. Either way, the economy declines which reduces demand on primary energy or crude oil by significant percentages and thus, reducing production output and commodity value considerably for an undetermined period that would be governed by the supply chain of events.

Production barometer....

With global production hindsight providing the perfect barometer for the path that lies ahead, it would appear that US\$150 per barrel was always going to be the point where the economic and financial bubble had to burst. Although many had believed that crude oil would go to several hundred dollars per barrel, it would seem that after viewing specific events as they happened which provided the ultimate realisation of an actual ceiling from which increasing primary energy value would begin to effectively destabilise the global economy, the outcome could actually now be viewed as being almost impossible to predict until the event occurred. However, with this in mind, it is impossible to discount primary energy value increasing beyond that of the high values achieved during 2008, as future economic scenarios will always be governed by primary energy and that of the ensuing effects of protracted military campaigns in many strategic regions. The dawning of this reality has since become a true measure of the affects of high primary energy commodity values on what can only be described as dangerously dependent economies and population centres. When countries that host rapidly dwindling super giant fields such as Saudi Arabia begin to permanently cut supply to the west because they too will have reached the point where they can no longer afford to export crude oil in preference of safeguarding their own economic survival, crude oil value will skyrocket and will no doubt accelerate way past the values achieved during 2008, and this period destined to be indelibly marked in human history is not too far away.

Author

“There is no escaping the fact that humanity will always remain dependent on primary energy, but only until the point where conventional exploitable primary energy has been exhausted, and this will be the point in history where humanity will have once again been returned to the dark ages....”