



OIL PRICE MANIPULATION IN TROUBLED SEAS:

----A NECESSARY EVIL?

PART 1: THE LANDSCAPE---WHY OIL PRICES NEED TO BE MANIPULATED

If we accept that Wisdom is the sum of books read and years lived, we understand why there has never been an “economic prodigy” like Fermi in physics, Mozart in music and Capa Blanca in Chess. All of the major works in the dismal science were written by older mature persons, in their 50’s, the ripe age when the abilities to recognize and decipher tendencies and fix them in economic theory and praxis is at its peak.

The Economic theory so well propagandized by capitalistic countries teaches, for mostly good reasons that the price of everything should be free and subject to the unrestricted laws of supply and demand. The prices of commodities, like oil, should be marked at the margin, meaning that it should reflect the cost mark up of the most expensive barrel you need for market clearing. The accounting of this cost should contain everything: investment in E&P-refining-sea and inland transport-royalties in country of origin-taxes in country of use-plus an acceptable overhead profit margin to cover re-investment, debts, R&D technology, and dividend payments to investors. Sounds complicated but 150 years of experience teaches something.

That is the supply story in a nutshell; but demand also plays a role. *“The historical truth is that ever since petroleum entered the World stage its population six-folded; the size of the World economy has grown by a factor of 20 and its use of energy has grown by a factor of 40”¹*

Meanwhile the dependency of industrial countries in this depleting and thermodynamic source transformed into such a formidable addiction that is impossible to imagine a modern world without oil, still the most important and used energy source for its abundance, versatility, management, cost and use. The link between the run off of oil prices to over \$140 in the summer of 2008 and the World wide recession in 2009 has been established and the fact that oil prices stayed at triple digits from 2009 until 2H14 (when Saudi Arabia engineered its altruism to reduce them by over 50%) was a major cause that the

¹ See Carlos A. Rossi, [The Energy within Economics](#), Nova Science Publishers, New York, USA pp 33





recession lasted that long. True, the over-exposure of major investment banks to toxic loans and “derivatives” contributed too as did their bailouts, but when their ability to grow out of their debt was compromised because of the high oil prices its economic fundamentals ran into a thermodynamic ceiling that needed to be accounted for and managed. This facet showed its face mightily when the International Energy Agency admitted in 2010 that an oil zenith had been reached in the production of its conventional and most common variety in 2006, contributing in no small way to the brutal financial/economic crisis in the industrial countries most addicted (Europe/Asia/USA) that has affected its most recent political elections (Great Britain, USA, Greece) and close calls in others (France, South Korea, Holland, Spain and Italy).

Much like a snake that winds and twists towards a precise target the oil price cause and effect pattern meanders with a fixed purpose: High oil prices » Lower economic growth » Lower prosperity indexes » Lower life aspiration and goals » higher debts» Higher levels of frustrations » Growing anger with political establishment » Higher mistakes in political decisions » Possible international conflicts². It also leads to higher oil investments and in other energy renewable sources. Inequality also increases for this and other reasons that will not be explained here, but it does fuel heat to this already hot stove.

And here is where the price economic theory of capitalism in the oil factor runs into trouble. Because this theory assumes 3 conditions all without scientific fundamentals (economics is more a romantic philosophy than it is science): 1) Oil supply is perfectly substitutable with other similar energy sources; 2) with enough money we can always find more oil; 3) we can always import oil. If these were perfectly true, as it was in the 20th century, then it is easily understood why capitalists prefer that market laws alone decide oil prices thereby impeding head-on coalitions between industries that have dramatically opposing interest, like airlines and power. But nothing like that is true anymore.

Given the strategic importance of oil now exacerbated by the formidable addiction that it entails in the rich industrialized nations and “motors of the world economy” in all of its economic structure (production, consumption,

²“These countries may be, if not already are, flying in an asteroids like collision course towards each other from opposite directions; except that in this case their economies are highly dependent on each other: the United States and China”... from Carlos A. Rossi, El Epilogo del Petr leo, Panapo, Caracas, Venezuela, 2007.



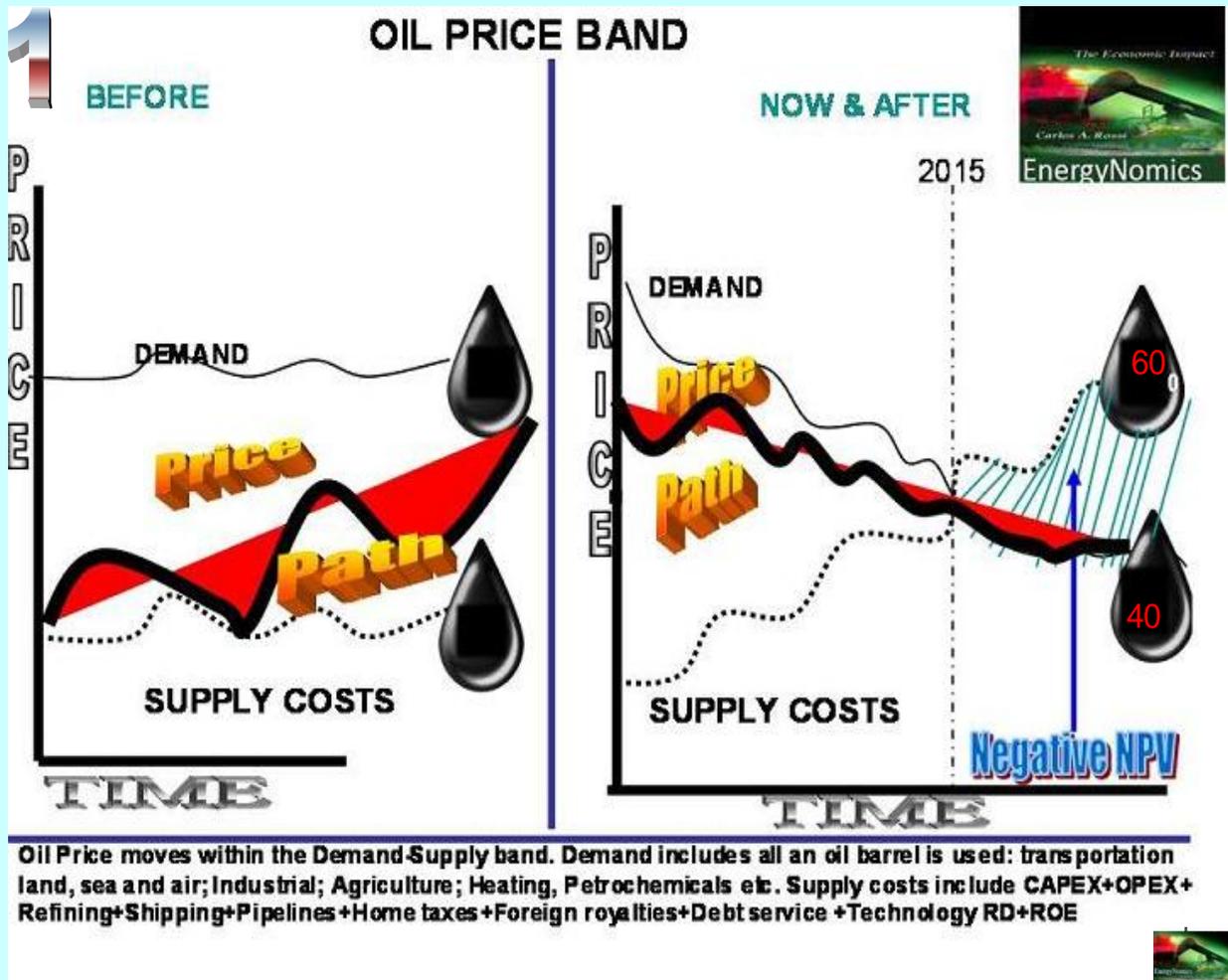


transport, industry, agriculture, and in the creation of money itself), affecting its political structure as well, it BECOMES CRITICAL, the need to manipulate its price so it satisfies the twin-valid but contradictory goals of supply and demand in different moments (same moments is impossible). Killing two birds with the same stone is difficult, but when both birds are flying in opposite directions the only way to do it is to pick different moments over and over again which is what the price manipulators have been doing since Copenhagen 2009. Under the circumstances it must be said that they haven't faired badly at all.

When oil prices are manipulated to increase its for investors to have the incentive to invest and produce obtaining positive returns ($NPV > 0$), just above the direct and indirect subsidies that they receive; when they are manipulated south is because consumers and "motors of the world economy" need to grow just above a tolerable limit of prosperity. A price band is formed between \$40 and \$60 as graph 1 indicates below, which is not the result of any "invisible hand" but of visible hands that reconcile all of these interests and watch out for prosperity of the planets inhabitants in different moments.

The price band has a Demand ceiling and a Supply floor. If the price goes up and breaks the demand ceiling it risks world wide recession starting with the countries more vulnerable to it, which are the most dependent on oil imports for their industrial structure and are already highly indebted. If the price goes down through the Supply floor we risk lack of meaningful investment and that entails an oil shortage in the future that no one wants. Notice that since 2015 the costs of investments and maintains (CAPEX/OPEX) in high cost projects (like pre-salt in ultra deep waters and oil sands) has increased over and above the demand tolerance level, which results in negative NPV values that are not sustainable.





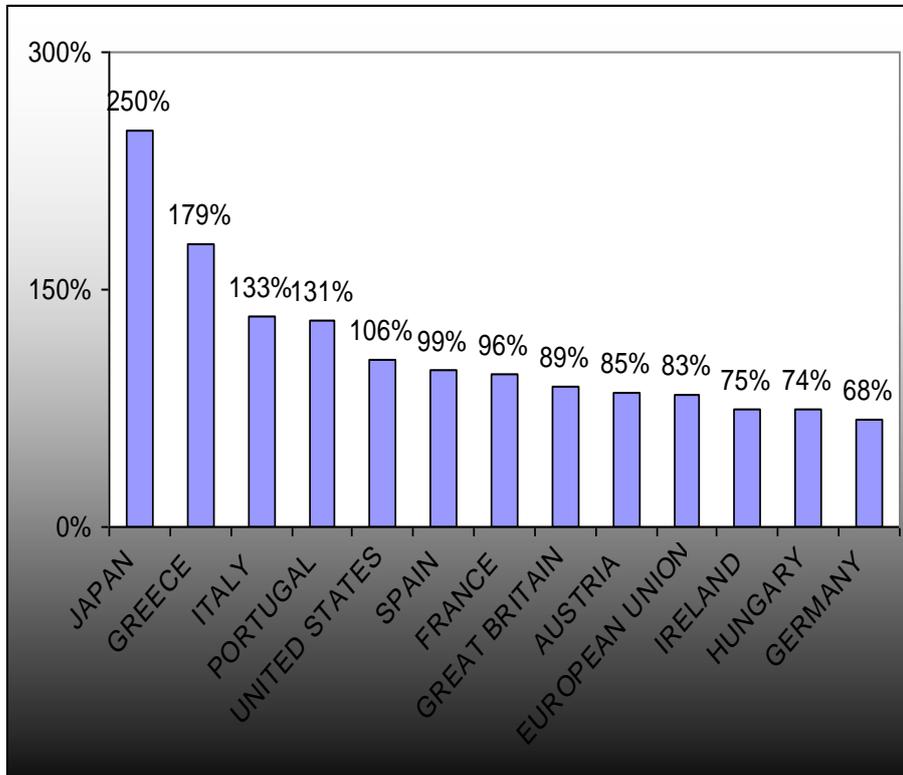
Graph 2 shows the very high indebted ratios of most of the highly industrialized oil dependent nations with negligible oil reserves of their own. The importance of this is to show the small manoeuvring room these countries have regarding growth economic policy to get out of debt, which would need additional credit. But since we all want them to grow and their citizens to prosper, plus oil companies to invest, oil prices need to be handled with outmost care³

³ When I studied economics, I was taught that a country begins to have problems whenever the Debt/GDP ratio crossed the 50% threshold.





Debt/GDP Ratio 12-31-2016



When is this all over?

When the oil stops being a formidable addictive production input partially replaced in its entire value chain by other energy sources that satisfy the following characteristics: renewable; cheap; massive; versatile (petrochemicals); accessible to 7.5 billion people in this planet; secure, safe, and environmentally sound⁴.

I am sorry to say industrialized countries will never recuperate completely from their prosperity slump until its addiction to oil is not at least partially cured and that is only resolved in both sides of the supply-demand equation. In supply with renewable energy, and in demand by curving the appetite for fossil fuels and by taking informed mental account of the need to rationalizing oil consumption to the minimum necessary for tolerable growth and prosperity.

⁴ Energy scientists of all sorts, it must be said, are labouring hard to make great leap forwards in renewable technology both at the producer end-solar panels and consumer-E-Cars. Much more is needed. If people knew the gravity of their oil dependency they would contribute more.

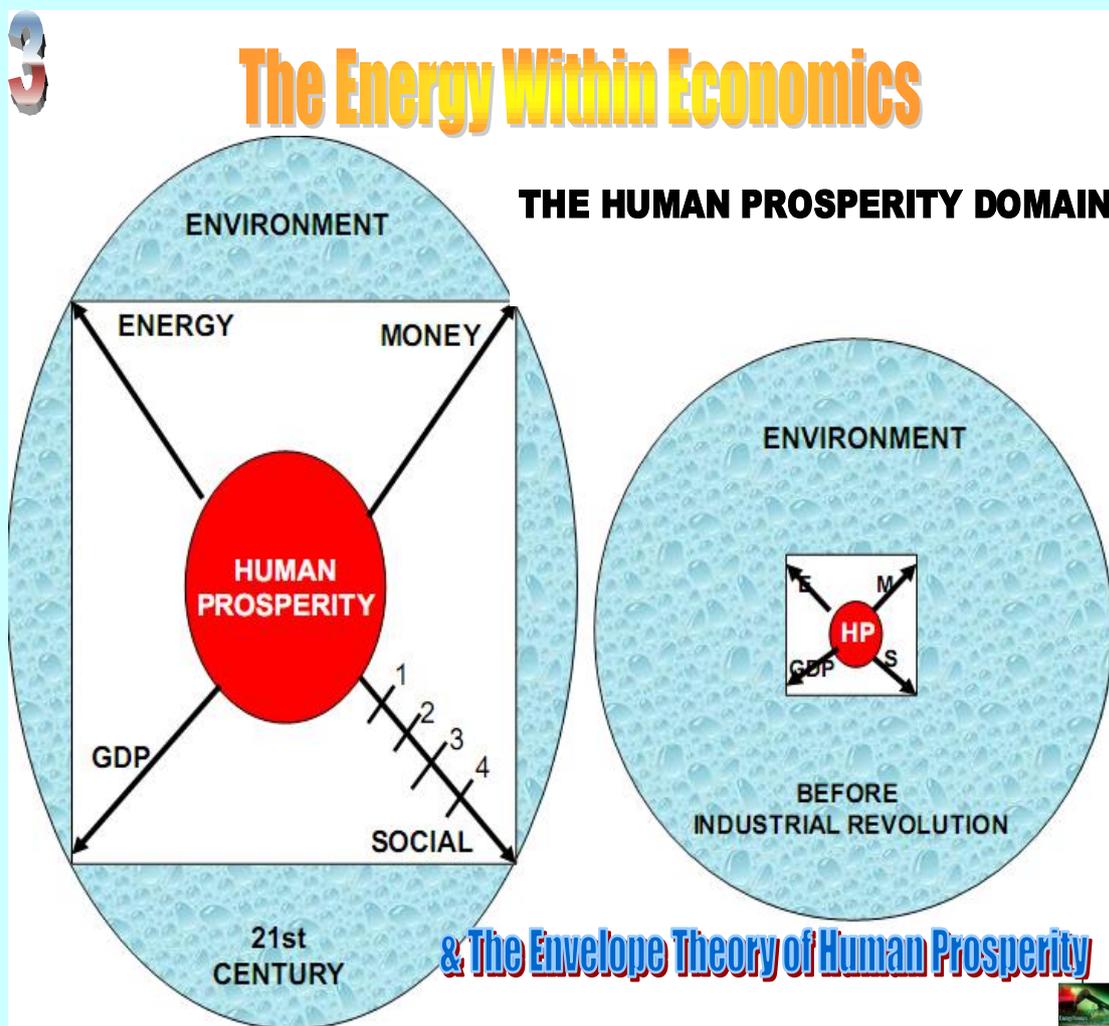




The shale oil revolution in the United States is a temporary not a permanent solution.

Energy is, as I proved in my book **The Energy Within Economics** (2012) one of the four factors that drive human prosperity, the other 3 being: GDP; Money; and Social Attitude⁵. Whenever any of these 4 factors decreases the rest also diminish proportionally. Like the rest of the factors, Energy can be harnessed and controlled, but energy is the only one of these that we humans can't create.

Graph 3 illustrates this from my book.



⁵ Tolerance for religion, democracy, women empowerment, education, health etc





PART 2 RECENT PRICE TRENDS



Demand analysis of oil prices in the energy industry necessarily shifts the conversation to economic growth; if nothing else because correlation coefficients between energy consumption and GDP growth has shown to be as high as 0,81⁶.

In recent quarters the global economy has not fared badly at all. Excluding EU and riding the momentum of 3.2% GDP growth in late 2016 Global GDP is expected to strengthen to 3.7% in 2017 and 3.9% in 2018, led by the resilient Chinese and Indian behemoths and by strong commodity prices that help out emerging markets. In the USA the picture is almost as rosy, growing a full 3% in 2Q17, its strongest since 1Q15 and sparked by surges in durable goods consumption, fixed investment and services. Since the Saudi altruism policies of low prices in 2H14, specifically July14-July17, the USA average GDP growth was 2.23% well above President Barack Obama’s 8 year average 1.5%. (to be fair, oil prices during his presidency averaged \$76,7 per barrel).

In Europe the percentages are not as rosy but they show positive upward recovery of 4 years going into the 5th (see graph 4), with a spring forecast (by the European Commission) of 1.7% in 2017 and 1.8% in 2018 YTY. Low to mid \$40s Brent oil prices throughout (left-top side graph 4), a product of the reported Saudi- Altruism (http://www.energynomics.com.ve/wp-content/uploads/2013/04/Abstract_OilScenery.pdf) doubtless fuelled on these

⁶ See Carlos A. Rossi, El Epilogo del Petróleo, Panapo, Caracas, 2007





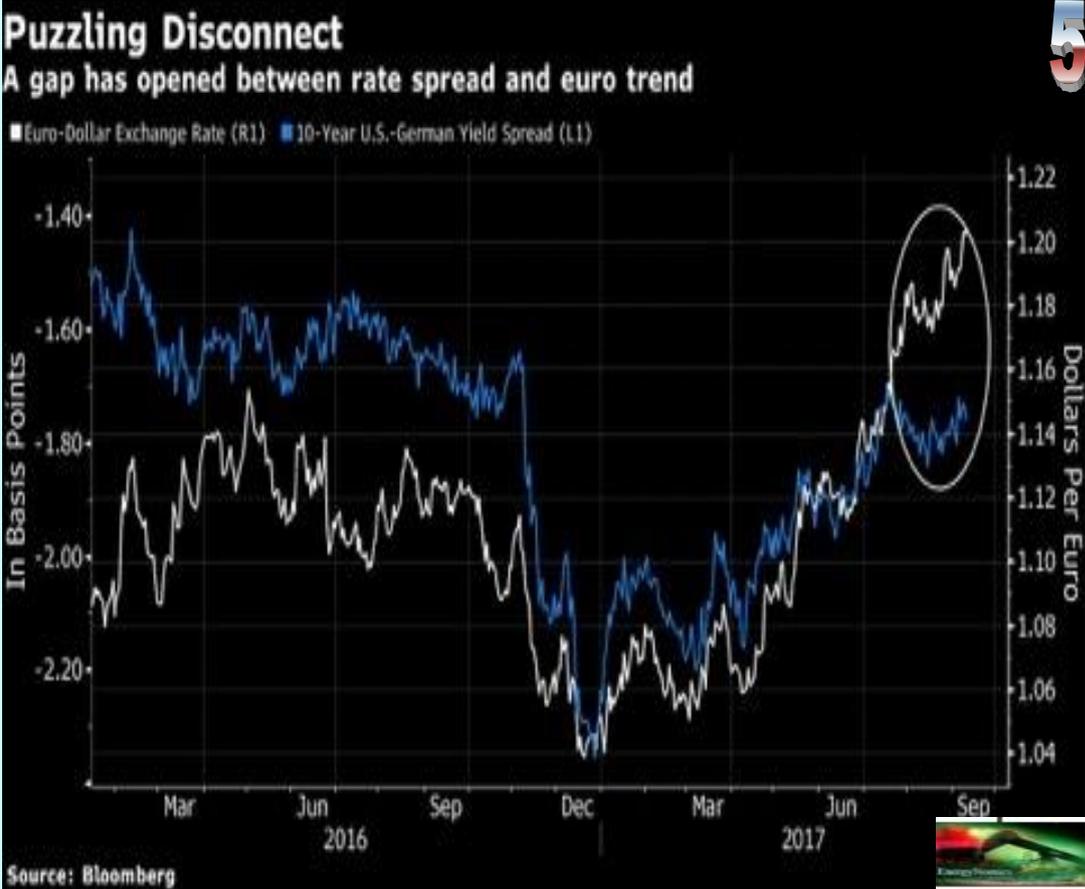
recovery of the European Union and possibly also saved them from a disastrous break-up from French and Dutch political opportunists⁷. The International Energy Agency has already increased its estimate of oil demand growth in 2017 by 100,000 barrels to 1.6 Billion or 1.7% in Europe; causing a reduction in oil inventories from “oversupply mode” down to their 5 year averages.

OPEC has effectively been divided into two competing camps that I label the “good OPEC” led by the Gulf Cooperating Council GCC of which Saudi Arabia is the leading member and which goal is to watch out for their client’s welfare over and above their own, and the “bad OPEC” which is only interested in looking out for their own internal revenues to keep in power corrupt plutocracies, of which Venezuela is the leader. The good OPEC has the upper hand due to their spare capacity power; they are the ones that, together with Non-OPEC help from Russia and Norway, can influence price levels within the price band noted above. By contrast the bad OPEC are just on-lookers. In November 30th 2016 OPEC reached a production cut deal to be effective from January 2017 that would cut production to 32.5MBD to prop up oil prices and the compliance rate has ranged between 80-85%, which is good by historical standards, except that they exempted 2 countries explicitly, Libya and Nigeria, both of which have increased production significantly, and two countries implicitly, Iran and Iraq. Russia has been responsible for over half the production cut from Non-OPEC members. Venezuela has complied too, but more because incompetent model that thwarts oil investment in its aging oil fields than because of deliberate policy.

Important to note, the needs of OPEC are akin to producers but not completely in contrast to the necessities of the consuming rich countries because it does not behoove them to be directly blamed for their clients depression and demise, and this was the the principal reason of the Saudi altruism policies during the hot summer of 2014.

⁷ Remember none of these nations have a currency of their own, like Britain.





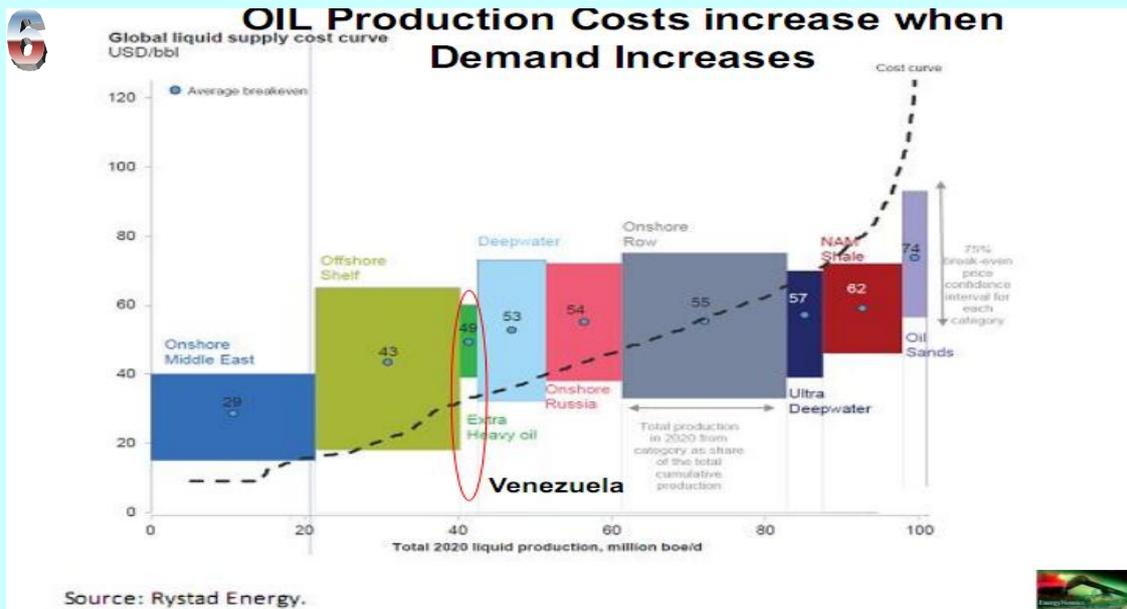
In Graph 5 we see plotted two separate relationships against each other. The Euro-Dollar ratio on the one hand and the 10 year US-German security yield on the other. Strong and sustained EU growth activity pulls up the Euro/US\$ exchange rate (white line), adding upward pressure to oil prices that are paid in dollars. The 10 year yield spread in US-German securities show a recent flatter behaviour (blue line) but up from the 9 months before where its activity was high. This suggests even confidence of long term US-German activity by investors. The widening gap in the spread between the 2 highly correlated lines could be an indicator that the yield line will drag down the exchange rate line and close the gap in the near future, an omen for lower economic activity in Europe and of higher oil prices, especially if OPEC cuts start to kick in on tightening supplies within the structure of Europe’s industries. Once we know, as we do, the oil price threshold by which GNP growth start their inflexion point upwards or downwards, and the threshold by which oil investors are motivated to dig deep into their pockets, then oil price manipulation begin to be fairly predictable.





PART 3: AND THE DAY GOES TO:

So Who does this day belong to? Producers or Consumers? Graphs 6-7 below provide unequivocal clues





You got it!! This day belongs to the Producers. Beginning in late 2016 the World needed low oil prices to spark GDP growth and prosperity in the highly oil depended industrialized nations; especially if you note that these people have not seen prolonged hardship in at least 4 generations dating back to the onset of WW2. But today we need higher oil prices to crop up investment for future oil production. Consumers need to bite the bullet now, as producers did since 2H14 with Saudi Altruism. This is a task that would be much easier, **EnergyNomics** believes, if politicians came clean and informed these people in layman's terms of the physical properties of oil and its direct connection with the prosperity levels of industrial civilization. Trust me, they will understand. But politicians are what they are.

CONCLUSIONS:

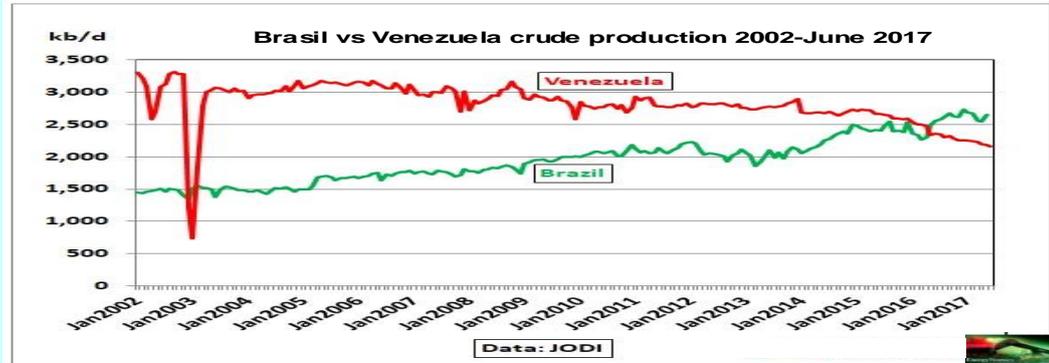
- 1) Oil prices are of critical strategic importance to both producers and consumers but for opposite reasons; both of which are valid.
- 2) Consumers need oil prices to be relatively low to fuel consumption demand, investment, and GDP growth and prosperity levels.
- 3) Producers need oil prices to be relatively high to motivate investment in oil and in non-fossil renewable energy thus providing future oil and energy that is critical for long term prosperity.
- 4) Since both sides cannot be reconciled at the same time but only in different moments, oil prices need to be deliberately manipulated. You can say that *"Oil is too important to be left to the market forces"*

If you need to know how the producers won and its consequences become a client of our firm, **Consultora EnergyNomics de Venezuela...**
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