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Energy Conference 2010

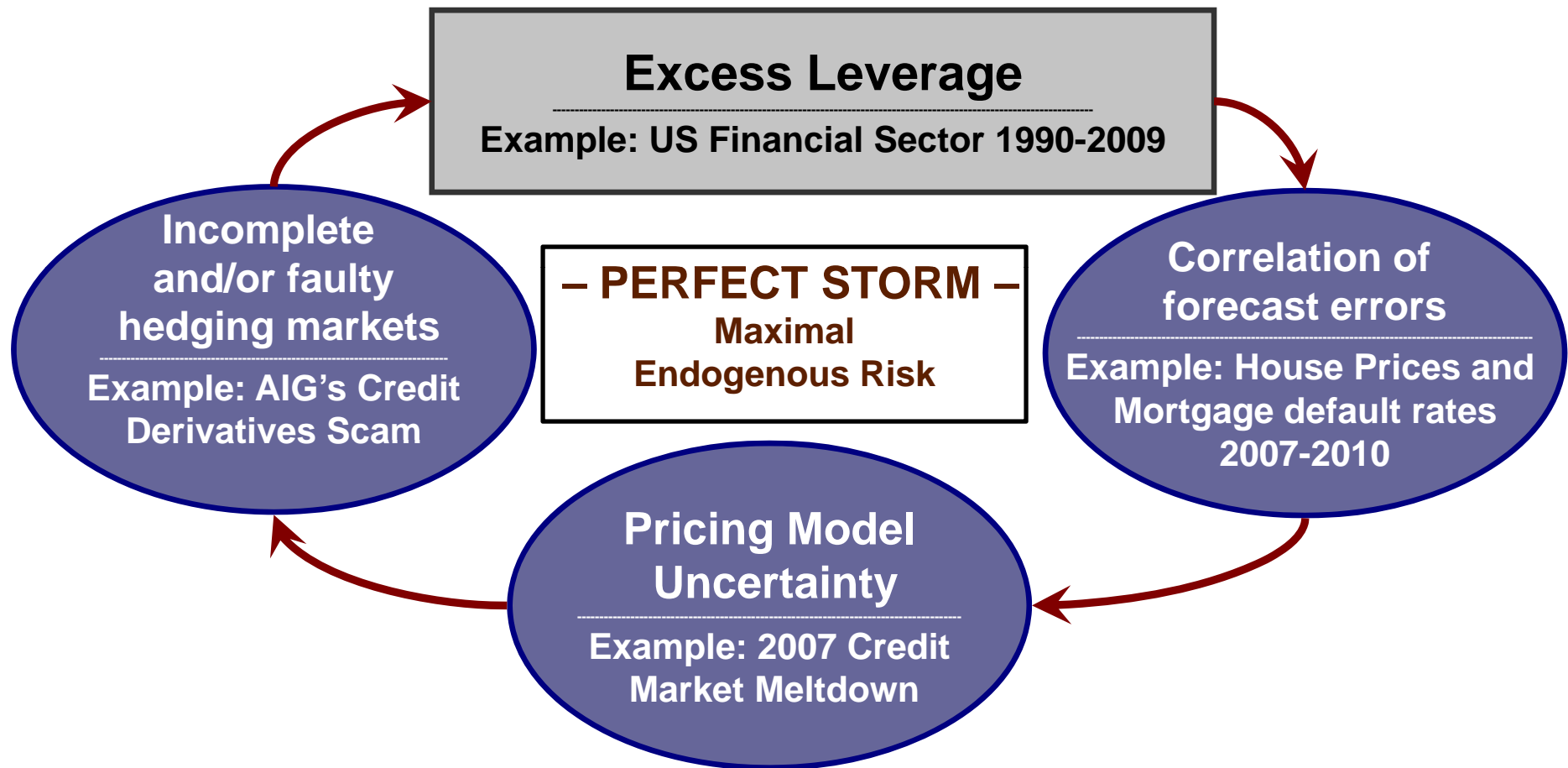
H. “Woody” Brock, Ph.D., President

Strategic Economic Decisions, Inc.

www.SEDinc.com

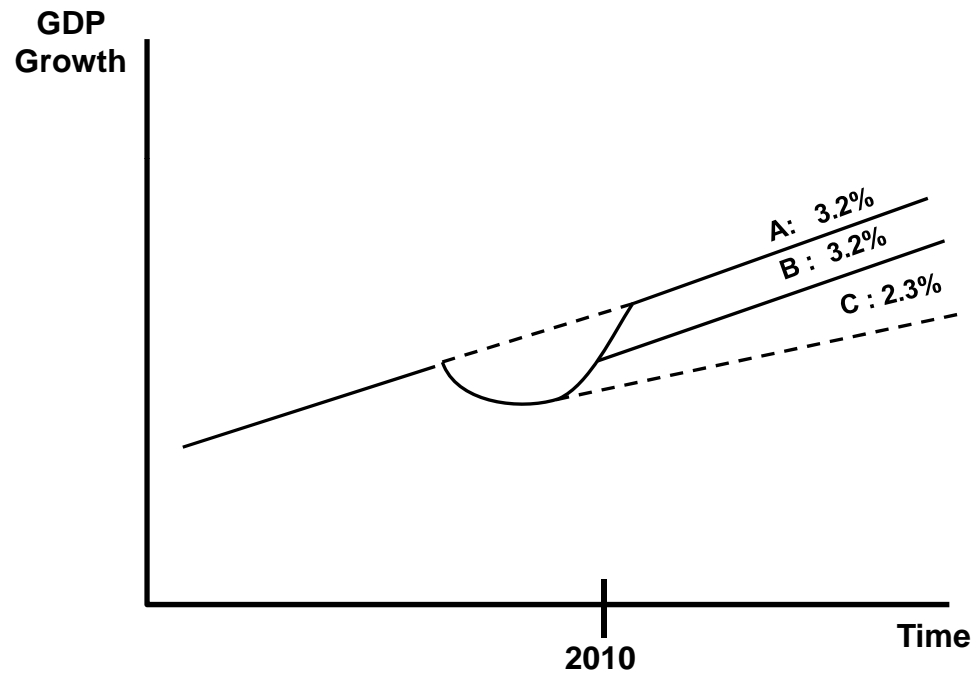


Today's Perfect Financial Storm



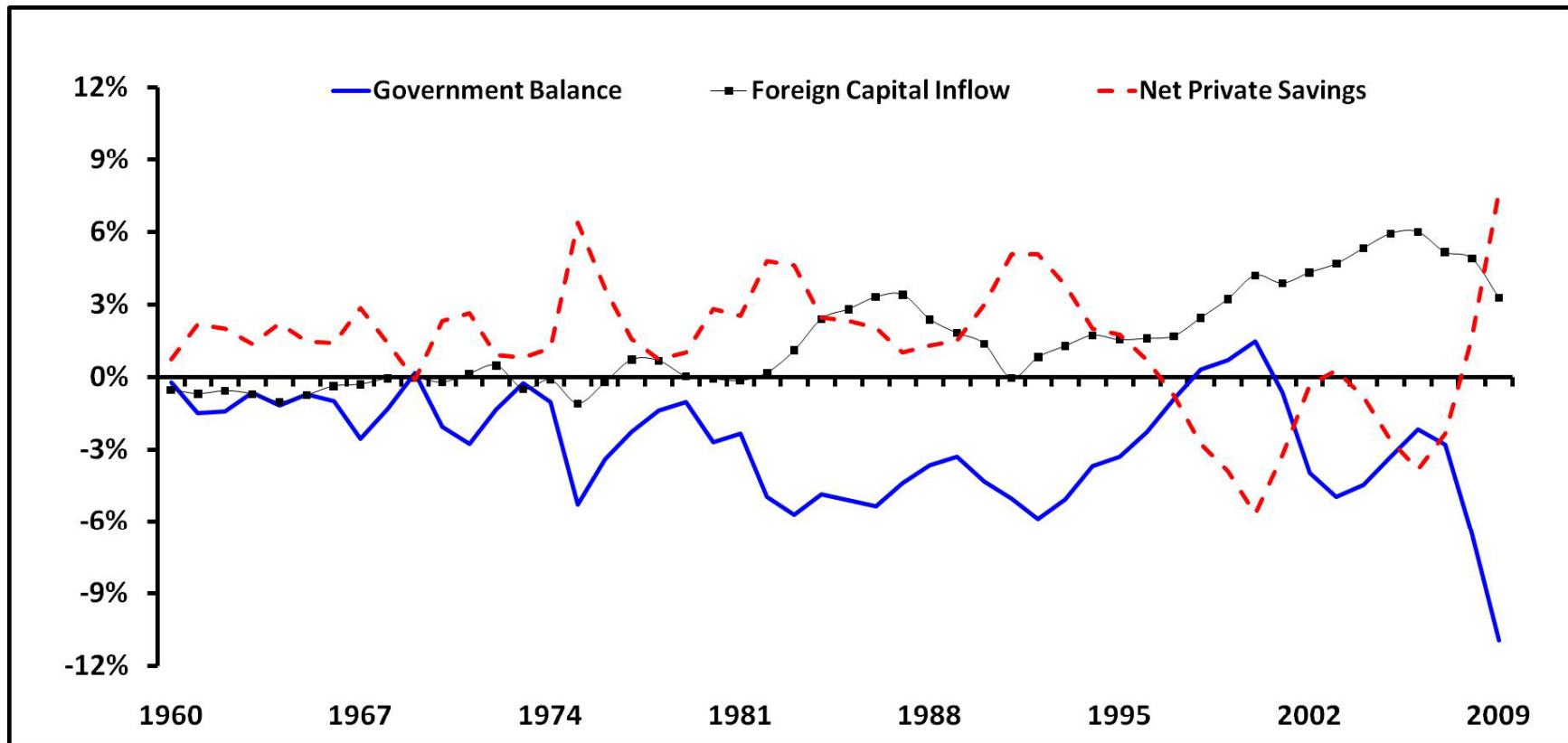
NOTE: In the figure above, leverage is in a rectangular box as opposed to an oval to emphasize that it is a *policy* variable that can be changed and not a *state* variable.

Problematic US Economic Growth - 2010 to 2020 -



Source: SED

The Three Financial Balances



Note: For every year, the three data points must, and do, sum to zero

GOV'T DEFICIT = NET FOREIGN INFLOWS + NET PRIVATE SAVINGS

Sources: US Federal Reserve, BEA, SED

Three Financial Balances (As a % of Total GDP)

	Government Balance =	Foreign Capital Inflow +	Net Private Savings
2005	-3.3%	5.9%	-2.6%
2006	-2.2%	6.0%	-3.8%
2007	-2.8%	5.2%	-2.4%
2008	-6.5%	4.9%	1.6%
2009	-10.9%	3.3%	7.7%

Source: BEA

Growth of US Domestic Non-Financial Debt

(Percentage changes; quarterly data are seasonally adjusted annual rates)

	Households	Business
2005	11.1%	8.8%
2006	10.0%	10.5%
2007	6.7%	13.4%
2008	0.3%	5.2%
2009Q1	-1.2%	0.5%
2009Q2	-1.6%	-2.2%
2009Q3	-2.6%	-2.6%

Source: US Federal Reserve

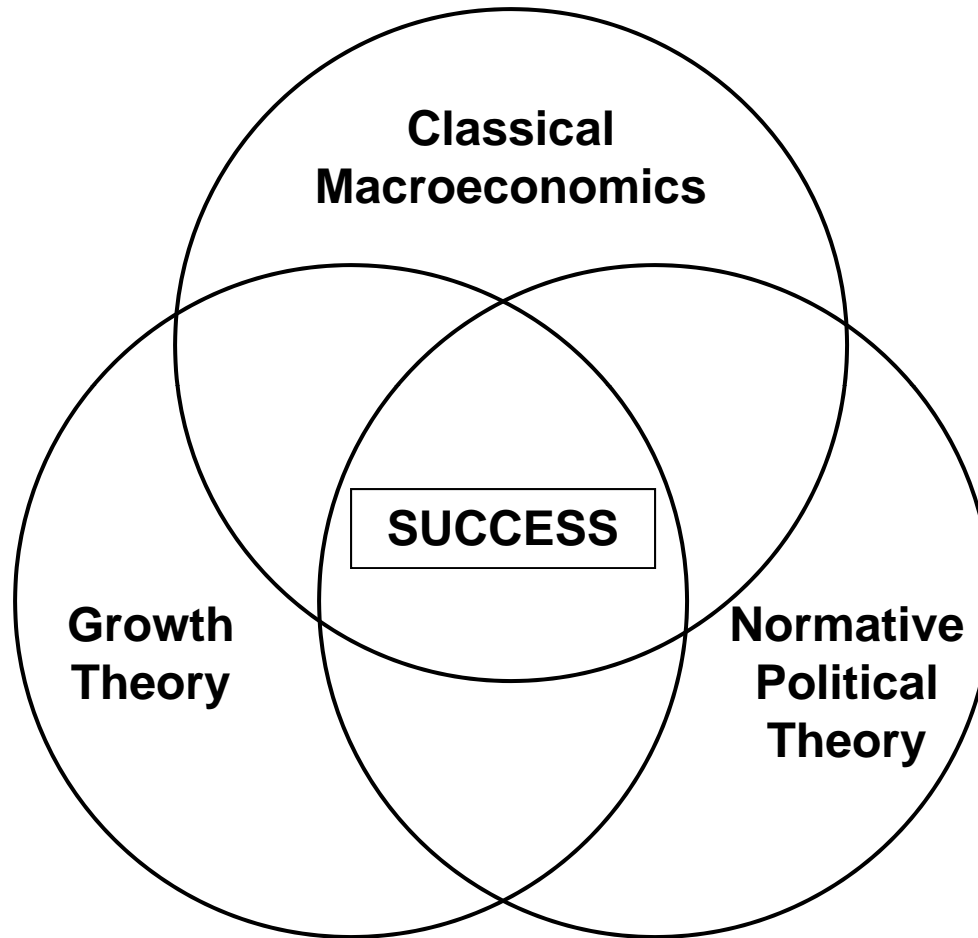
US Residential Investment and Household Savings

A. Residential Investment (% change from previous year)	
2005	13.9%
2006	-1.7%
2007	-17.4%
2008	-24.1%
2009	-24.6%

B. Household Savings (as a % of disposable income)	
2005	1.4%
2006	2.4%
2007	1.7%
2008	2.7%
2009	4.6%

Source: BEA

The Crisis of “Macroeconomics”



The area of intersection of the 3 circles represents the success in solving the nation’s long-run macroeconomic crisis

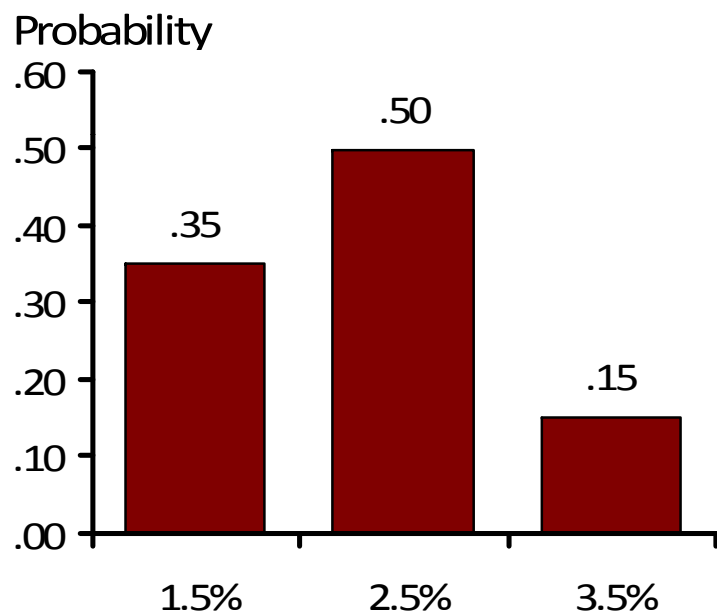
When Will China Surpass the US?

– Comparing GDP Growth Rates
Under Nominal Conditions –

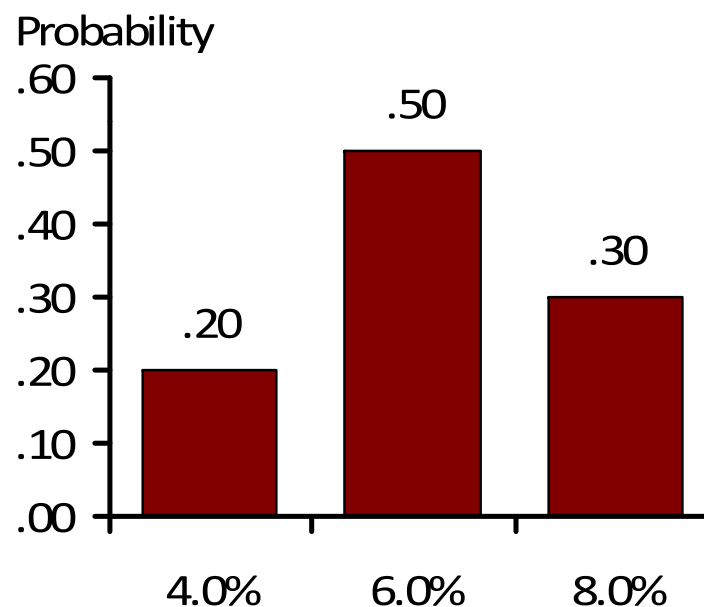
		US		
		1.5%	2.5%	3.5%
China	4.0%	2058	2091	2256
	6.0%	2036	2044	2059
	8.0%	2028	2031	2037

Long-Term Growth Rate Scenarios

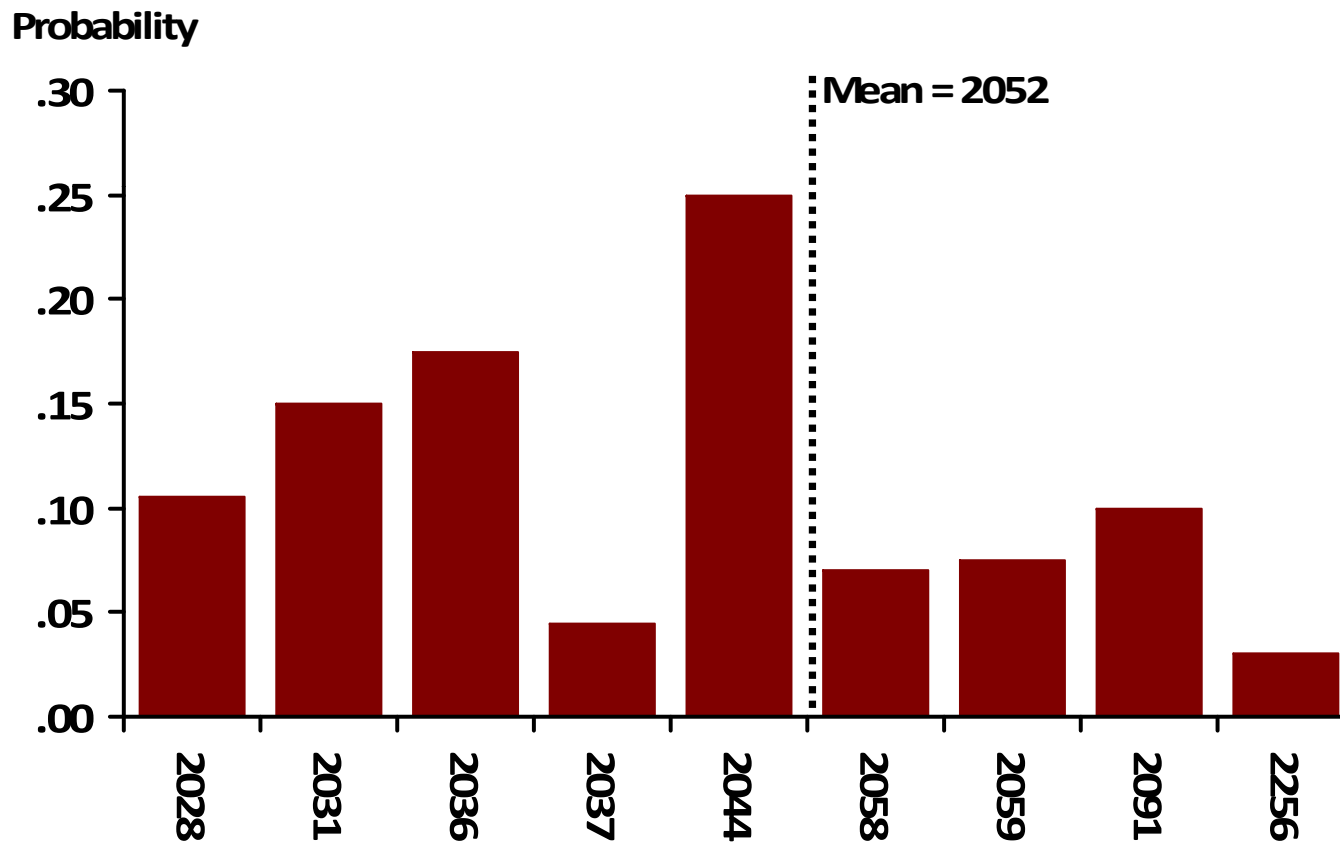
US Long-Term Growth Rate
(Mean = 2.3%)



China Long-Term Growth Rate
(Mean = 6.2%)



China Catch-Up Date Scenario

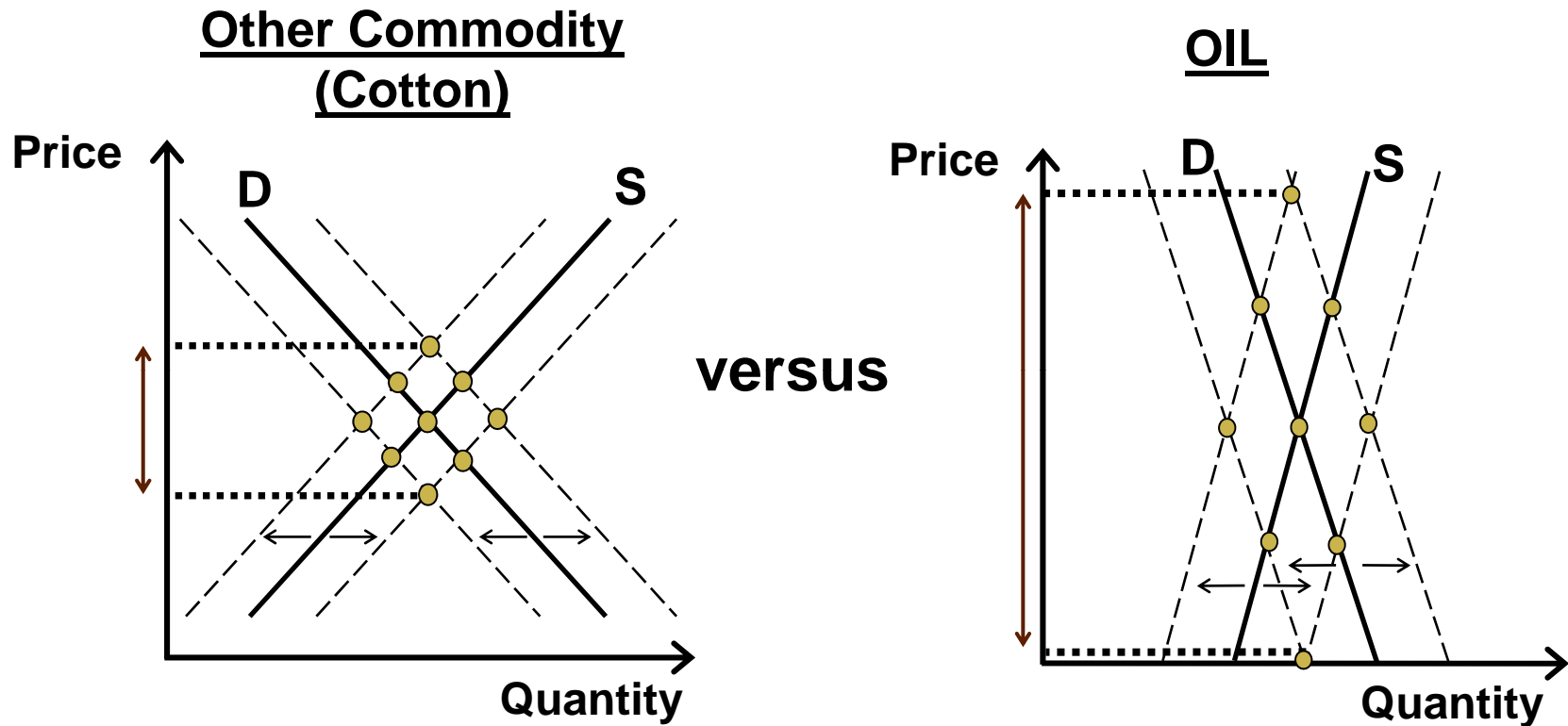


The Oil Market Crisis

– A Review of Our Predictions –

- **The Three Structural Changes:** Our prognosis of much higher oil prices was predicated upon the intersection of three developments that would generate a “perfect storm” of much higher prices and much greater price volatility:
 1. Accelerating demand for oil, principally (but nowise exclusively) from Asia;
 2. The advent of the “peaking” of production from the great old oil fields; and
 3. The advent of a pathological “incentive structure” that would discourage the exploration and development of large new oil fields in ways not previously experienced.

The Truth About Commodity Price Volatility



- The volatility of price increases non-linearly as a function of the steepness of *both* the supply *and* the demand functions
- Most everyone understands why demand is price inelastic, but few can explain why the *supply* curve can also be very steep

Relevance to Today's Oil Crisis

Virtually all aspects of our forecasts seem to have materialized.

Supply

- Output of old oil did peak about two years ago and is declining—and by more than pessimists expected
- Additionally, the rise of thugocracy and the death of an oil “market” in any meaningful sense of that word has been even worse than we expected

Demand

- Despite an increase in prices from \$10 in 1999 to \$140 in 2008, the demand for oil increased. [Technically, this is a “backward-bending” demand curve.]
- US consumption is finally falling a bit, but consumption elsewhere is rising.

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