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Up, up and then??

Overnight, oil is up 3+% and gold is down by about USD30/oz. Sharemarkets are stable and the post New Year stuff in China was not a problem and meantime the Yuan increased in value. So the week started with not a lot of negativity on the economic front although Russia and Turkey are at each other's throats in Syria – so WW3 by proxy still is on...

Buut...

As you know, my emails seem to focus on the economy and oil. I suppose that if electricity supplies were finite then I would talk about it too. But the world is by no means short of energy and much of it can be converted to electricity - even if fungible storage then becomes the limiting factor. Were electrical energy storage not a limitation, the up to 70% of oil used for transport fuels would face an ideal and cost-effective alternative.

Once we get to the point where conventional crude oil (under 45 degrees API) supplies falter and fall as they will do within the next couple of years, the price of that oil will rise to make electrical energy storage powered options more viable. But electrical energy storage using lithium-ion derivatives is not a solution that will allow our industrial society to prosper, because so much oil is still required that it doesn't look like an enduring alternative.

Regardless of finding any suitable, fungible and cost effective electrical energy storage system, society still requires sufficient real capital to replace the built infrastructure, vehicles etc to make the transition away from fossil fuels. That will be an enormous task that human society has never previously been faced with...due mainly to the scale of the job and the need for vastly more fossil fuels to carry it out.

The only electrical energy storage technology that I have yet found that offers the hope for our future is the mythological EESU. The problems with leakage and cracking still need to be addressed but the possibility of developing a solid state capacitor with a longer life than a car still keeps me interested.

On the edge of a precipice

So this is where we are on the edge of a precipice. With too much money, too much debt, too little ability to grow, and demand for goods and services that is waning. So our primary focus is on the economy. Despite the catastrophe of 2008, nothing has been done in real terms to insulate financial institutions and the man-in-the-street from a derivatives melt-down. The BIS loosely monitor this mess by looking in the rear view mirror at six-monthly intervals ....and the cross collateralisation of a mix ranging from substantial institutions to those who may already be insolvent amounts to anywhere between USD620 to 1,200 trillion at any one point in time. This is why governments have enforced bail-ins legislation on their unsuspecting publics. The euphemism is "open bank resolution" and it hangs like a "sword of Damocles" over every person who has any savings in any bank. Institutions that have liabilities of over USD5 billion are almost too big to be allowed to fail because they could cause an unpredictable domino effect that central banks could not prevent – even if all joined hands in an attempt to do so. You may recall that Warren Buffett once referred to derivatives as "Financial Weapons of Mass Destruction".

The pipeline effect

The greyer haired heads of companies have one thing they fear most. It is a phenomenon called "the pipeline effect". This is something that happens after a boom slackens off and increasing capacity meets falling demand. The usual symptom is cancellation of orders, crashing prices for goods and services and massive lay-offs. The global steel industry, the global oil industry and all commodities are in the same boat – right now. The "Baltic Dry shipping Index" shows this clearly with more ships being built and fewer cargoes – even for the existing ships – resulting in the lowest ever index. The fact that Maersk Shipping who are into general freight have lower cargoes means that international trade is also shrinking. That introduces a note of desperation into the advocacy of those folk promoting free trade (i.e. the TPPA). But free trade will not help the problem. "The pipeline effect" is extant and it is ruining businesses and causing ructions in the global derivatives markets as I write this. In the role of CEO of major organisations, I have experienced this phenomenon first hand on three or four occasions. It is not to be taken lightly.

This works like a vicious circle. It drives the economies it hits towards depression. The fact that it is affecting all economies to a greater or lesser degree means that we sit on the verge of the world's first global depression.

What's next?

The way this will play out will be easily predicted....

1. Deflation is extant. To combat this, interest rates are being reduced...even into negative territory and credit expansion is being used by many countries.
2. Some central banks are already warning major financial institutions to not value assets at market prices if it forces them to recognise threats to solvency. Banks are being allowed to hold risky assets and even huge contingent liabilities "off balance sheet".
3. This will endure up to the point where business failures cannot be prevented. Then the crashes will start to flow into the global derivatives system where Credit Default Swaps are impacted and demands on unsuspecting counterparties start to occur at electronic speed.
4. It is probable that central banks will succeed in both impoverishing their populations and creating the situation where hyper-inflation happens...first country by country.
5. Up to this point, you will find a number of "economists" and central bankers who understand the risk. But from this point onwards they are trying to ignore the next events.
6. The first is global currency wars. The central banks manipulate exchange rates downwards in the hope of giving their economy and advantage over the neighbours. This has already been happening and the impacts are worsening things to

the point where soon China must react too. The effect of that happening – likely this year - is incalculable.

7. Regional conflicts are escalating and now we have reached the point where World War three by proxy has already started in the Middle East.
8. The winners of conflicts will be those with the energy supplies and technology to beat their competitors.
9. By the time WW3 is over, the global age of oil will be over because wars always result in dramatically higher usage and waste of oil.
10. The end of the industrial age of oil without suitable alternatives, will collapse international trade and by this time financial assets will have little value by comparison with the ability of real assets to generate wealth. For instance, growing food on a localised basis will be less efficient, but the only future possible. Trades-people will likely demand real assets or gold/silver for their services rather than a debased monetary unit This is the apocalyptic future that doomers write about.
11. If all this comes to pass, cities will not be safe places to live and personal safety may need to come from the weapons one has at one's disposal... and one's wealth from what one is able to protect. Governments will protect themselves and their constituents and the old adage that "a politician who robs Peter to pay Paul can always count on the vote of Paul", means that populist socialism is likely to turn extreme as the years pass. If you have cash or food supplies, it will be expropriated. If you have precious metals, it will become illegal to own them...so they will be stolen by decree.

There are ways to avoid this nasty stuff. But as of today, I am spoiled for choice for attaching links to articles by reputable people who show how this horror story is progressing. So I have to admit that it is progressing and the scenario I describe is becoming more likely as time passes (despite up days).

Few if any of us can change our occupation or buy and operate a lifestyle block, nor would we wish to if we could, unless the writing was more clearly on the wall. I admire those of you who already have productive land and are building knowledge and self-reliance, but I am not yet ready to do that.

Preparation can only be effective before collapse. While I am not saying we should head for the hills packing guns, ammo and beans, I am saying that there are simple precautions to be taken against the possibility of bank runs, bank holidays, runs on supermarkets and loss of financial assets. It is embarrassing to think these extreme events could happen and even more embarrassing to discuss the possibility with sceptical friends and family whose only experience is the affluence of the present. But just remember that if trucks don't arrive daily at your local supermarket, it could be out of stock within three days. Once an event occurs, the public will react by stripping banks of cash, and supermarkets of the necessities of life.

So we should start trying to build ourselves a buffer. With the stuff on our boat and at home, we have done that. But that doesn't mean it is a comfortable thing to do. As deflation takes hold the cost of stuff we hold drops and this will likely continue until hyper-inflation takes its turn to mess with us.

Nothing we can do is ever a sure bet.

We in New Zealand are fortunate to live in such a lovely country and doubtless our long term prospects will be helped by our isolation from world affairs, by the affluence of our resources, and by the resourcefulness of our people.

Just a pity our political masters are so useless ... I don’t think they have a clue....