

Financial Crisis and Energy Markets: What Impact on Energy Investment?

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Financial crisis and energy markets

- No simple linear relationships finance – energy or energy – finance but complex interdependence with multiple feedback loops
- On finance – energy:
 - (a) Excess liquidity (interest rates too low and inadequate recycling), (b) financial market deregulation and (c) new financial engineering (CDOs, CDS...) spawned unsustainable expansion of world economy by means of excess leverage (“money too cheap”) causing
 - Rapid growth in energy demand hitting capacity limits and fast rising prices (especially, but not only, oil);
 - Increase in investment (not enough to alleviate capacity constraints);
 - Market expectations of ever rising prices due to resource constraints (“speculation”);

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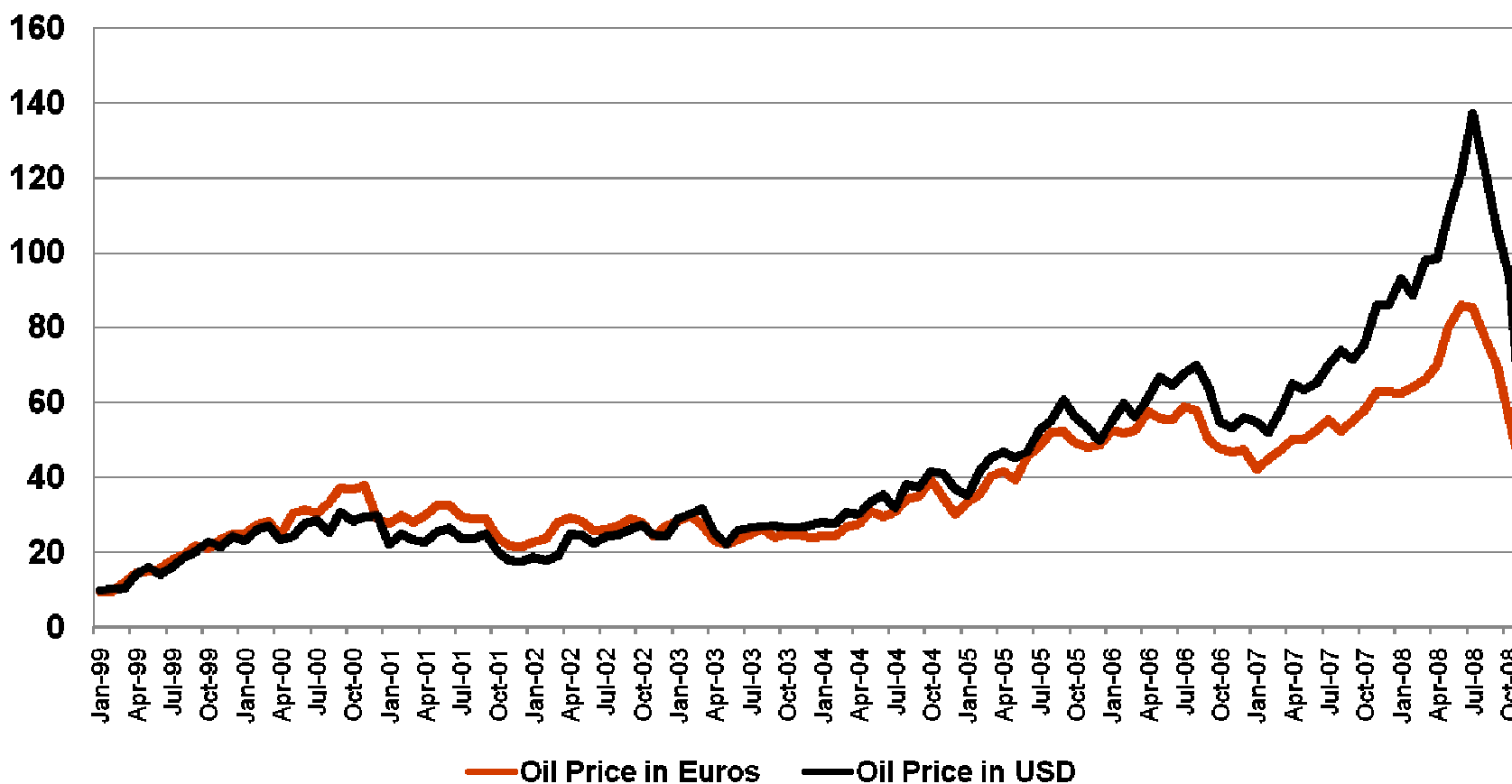
- On finance – energy (continued):
 - De-leveraging and the sudden turnabout in risk perceptions lead to harsher credit conditions and to a limited effectiveness of monetary policy (interest rates). Energy sector is better placed than others due to:
 - Energy sector traditionally secure access to financing due to (a) large size, (b) professional management, (c) stable cash flow (energy remains basic necessity with income elasticity below one), (d) long timeframes (which means short-lived slump less important).
 - Risks for energy investment come from two different areas:
 - “Self-defeating expectations” (D. Babusiaux): long delays between project decision and operation, as well as uncertainty, lead to hog-cycle phenomenon); memories of overcapacity in the 1990s linger; recession re-enforces short-term focus.
 - Lack of governance in energy investments: (a) resource nationalism and unpredictability, (b) NIMBY and lack of priorities, (c) increased uncertainty about transport.

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- On energy – finance:
 - Lack of sufficient investment and increasing marginal costs (more difficult access, qualified labour, regulations...) contributed to high prices and increasing surplus for low-cost producers:
 - Transfers from consumers to producers \$ 1 – 2 trillion per year (M-C. Aoun); in comparison: world economy \$ 60 trillion, global trade flows \$ 20 trillion (IMF est., 2008); US mortgage market \$ 12 trillion.
 - Key question for world economy: what is the efficiency of *recycling* of commercial surplus by exporters of resources and manufactured goods (China) in order to avoid excess liquidity;
 - Issues to watch: professionalization of sovereign wealth funds, Abu Dhabi, active rather than passive investment;
 - Historical comparison: the Latin-American debt crisis after the second oil choc with very imperfect recycling of surplus; crisis ended only when Brady bonds set new price floor.

Oil Price Variations: A Financial Phenomenon?

The Oil Price in US Dollars and in Euros
(Barrels of oil from January 1999 to November 2008)



Gas, Coal, Electricity, CO2 still Expensive

