March 6, 2009 - Thank you, Dick for sharing your thoughts concerning what will drive today's economic growth. I know you're pointing me in the right direction with regard to traditional economics, but I am coming from a completely different angle and I'll explain below.

Here's how I see the World fundamentally ... 1) Diminishing availability of essential natural resources (combined with declining oil production) and increasing consumption rates due to westernization of emerging markets combined with 2) monetary stimulus globally to counteract credit contraction and finally 3) economic assumptions built on ever increasing growth in consumption.

My point is that I believe that global oil production is undergoing a production plateau that is soon to be followed by an irreversible decline. If you have the time you can take a look at theoildrum.com, as they point to the evidence and lack of viable alternatives. There have been several posts there that take a look at the issue related to the current decline in liquid fuels production. This was apparent before the crisis hit and there were some that argued this was to be the trigger of the global crisis back in 2005. For example, the Cantrell Field in Mexico started a dramatic irreversible decline last year: http://www.theoildrum.com/story/2006/7/12/10421/4972.

Saudi Oil decline forecasts: http://www.theoildrum.com/node/5154
Overall global declines: http://www.theoildrum.com/node/4820

I see energy as the a major part of this equation and some evidence posted on theoildrum.com points to a serious risk to Keynesian assumptions: http://www.theoildrum.com/node/5160

The Keynesian models do not take into account energy availability (not that we would expect them to), and that's how I see inflation that the Fed can do nothing to control. They have no choice but to push the crisis back to future generations by increasing inflation (and inflation expectations) to avoid widespread government defaults. The alternative would be an unmitigated global financial system default, and lower commodity prices through demand destruction, which at this point is clearly not the chosen path. Certainly one could argue that I'm looking too far out, but the disconnect between forecast oil production and oil demand needs a severe adjustment to resolve. Any form of stimulus will do nothing other than exacerbate the situation in the future. So if the stimulus is successful doesn't that drive commodity prices higher (more money chasing fewer resources)?

I don't expect a recovery since I don't see the "energy" being available for it going forward 5-10 years or so. In fact I see quite the contrary, until the system and all of its assumptions change dramatically. I think any fiscal stimulus would make things worse.

Here's one more source if you're interested in this subject of Peak Oil. This is from Matt Simmons, president of Simmons & Company, and he makes available to the public some of his presentations on this subject:
http://www.simmonsco-intl.com/research.aspx?Type=msspeeches

Bottom line is I think we'll either need to see a permanent state of high unemployment globally (to lower energy consumption), and if we don't work towards that we'll stimulate the wrong things (energy prices) and create a vicious cycle of increasing inflation with decreasing "real" activity.

ANSWER - A couple of comments (maybe more than a couple) in response to all of your thoughtful points:

1. Peak oil and the Export Land Model are viable theories - I subscribe to the concepts and think they are correct.

2. Monetary policy: Old economics predicts inflation following monetary stimulus. Specifically, there is a high correlation between inflation and the Adjusted Monetary Base. This can be predictive except in the current economic, political and monetary management environment. The issue today is deflation. Adding reserves to the banking system is not creating excess money supply today for a number of reasons: increased savings, lower consumption, falling personal net worth balance sheets, corporate failures, huge unemployment, illiquid financial markets, and the collapse of the shadow banking system. All work

together to cause deflation.

Beyond the obvious (above) there are the more subtle management techniques designed to manage inflation. Managing money supply - domestic and global - controls inflation. Global political cooperation generates economic cooperation to stimulate growth and to manage and limit inflation. Historical academic analysis has provided the tools for controlling inflation and economic growth.

3. The problem today is that we do not have a set of tools, or knowledge base, which will help when the economy deflates. The risk of economic collapse is clearly a function of the current deflationary process that is trying to take hold of the global economy today.

4. How does Energy fit into this picture? I see it differently than you. You see an energy funnel that is an oil funnel. Squeeze the funnel smaller, and economic growth slows; open the funnel and economic growth increases. If oil is the primary source of energy, this is an oil funnel and controlled by the supply of oil. Today, oil is not the sole energy source. Tomorrow, it will not be the <u>primary</u> source of energy.

The longer this depression lasts, the lower the energy usage, the better the opportunity to develop alternative sources of energy: gas, LNG, solar, wind, coal, nuclear, hydro, conservation, managed energy distribution systems. The bottom line is that there will be a change in the oil demand curve.

5. Inflation is a function of too much money chasing too few goods. Reduce the demand for goods or reduce the supply of money and you are able to control inflation ? simplistic but true, nevertheless. Today, demand has fallen off a cliff and the supply of money is not reaching the system.

6. Deflation - how do you define deflation? I can describe it; I am not sure if I can define it: falling demand, excess inventories, falling personal and corporate income, higher savings, falling prices, large numbers of people out of work, lower standard of living, debt reduction- personal and corporate, dramatically reduced debt creation, bankruptcies.

7. With regard to remedial options available, the Fed and other global regulator equivalents will not have to force the issue as you suggest (inflating in order to prevent global financial collapse). There will not be a growth curve that brings on inflation. There will be no shadow banking system that creates money outside of the regulators' managed growth system, for several years to come. Consumer behavior is changed and mortgage equity withdrawals are no longer available to feed ongoing consumption. It will take years before those sources of money supply can be reconstructed. You project a rapid re-inflation of the economy. In the past this would be a reasonable prediction. In today's environment, it is way too early to predict that this same scenario will play out once again, as it has over the past 60+ years. Today's problem is an economic failure that has not been experienced in our lifetimes, and there are few useful, academically derived, tools available to deal with this type of crisis.

8. I think, however, that we can say with certainty, that this economy will not be repaired quickly, there will be no "V" bottom in the stock market, and any projected recovery will extend far beyond 2010.