Our View: The CERA Silo

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S&P Global's annual CERAWeek begins today, March 18, in Houston. The talks will cover everything from the impact of artificial intelligence on energy to zeroing out global emissions. One thing is assured, however: the discussions, while wide-ranging, will be entirely about energy, especially fossil fuels. Most of those attending will dismiss the energy transition. The prospects for continued global economic growth will reassure the majority that natural gas and oil have a strong future.

The good news for oil and gas emanating from Houston will result from what Gillian Tett describes in her book as *The Silo Effect*. The effect relates to how key participants in various economic sectors fail to think or communicate outside of "their little specialist departments, social groups, teams or pockets of knowledge." Thus, in 2007, the world's leading central bankers had never heard of the "shadow banking" system that had accrued more than $1 trillion in debt. A year later, these shadow banks brought down Lehman Brothers and caused the Great Recession.

Today, those in the energy sector are similarly oblivious to at least one major threat to the global economy and fossil fuel demand, which originates in China. Setser, Weilandt, and Baur put this issue into stark focus in their Council of Foreign Relations paper describing China's record-high manufacturing surplus. They note how China's post-pandemic exports now exceed two percent of world GDP.

Indeed, the Chinese surplus is far greater than the record Japanese one noted in 1985. At the time, the United States and European nations, who were experiencing substantial trade deficits, responded by forcing changes in global exchange rates. Their actions drove the dollar's value down by forty percent. Many assert that this so-called "Plaza Accord" was a principal cause of Japan's two-decade-long stagnation.

A new adjustment is coming as the United States and European nations, the countries with the largest deficit in manufacturing exports, take action to reduce the Chinese trade advantage. Spurred on by public anger at the country, their governments will strengthen or add trade barriers to reduce China's surplus and help ease their deficits.

This shock could rock those comfortably ensconced in their CERA silo, just as bankers asleep in theirs in 2008 were jolted awake when the US housing market and Lehman Brothers collapsed.

Policymakers, company officials, and those following the energy sector, as well as investors, would be wise to emerge from their shelters and look to the growing risks.