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## Speculating About Bubbles

From time to time we like to write about the oil market, not because it directly affects what is going on in uranium, but because it can provide some useful parallels with the situation in uranium. Robert Samuelson's recent op-ed, "Is There an Oil Bubble?" which appeared last week in *The Washington Post* <http://www.washingtonpost.com/wp-dyn/content/article/2006/07/25/AR2006072501301.html>, provides another such opportunity. While Samuelson does not answer the question posed by the title of his op-ed directly, and seems to argue against such a bubble, he makes some useful observations about how oil prices got from \$20 to \$75 a barrel, many of which are relevant to uranium.

Samuelson tips his hand on the bubble question early in his opinion piece when he notes that a characteristic of financial bubbles is that prices become "unhinged" from fundamentals. He goes on to state that this isn't the case in oil, by arguing the current oil price is such that Americans only spend 4% of their disposable income on it and that the \$2.2 trillion annual sales of oil based on a \$70 a barrel price is only a "tiny" share of the \$50 trillion worldwide economy. By this same logic, one could argue that since uranium costs represent only a small fraction of the cost of nuclear power, uranium prices have not become unhinged from their fundamentals. However, this line of argument is not terribly convincing, and makes Samuelson seem like some sort of apologist for the oil companies.

In explaining the rapid rise of oil prices, Samuelson emphasizes the fundamental nature of oil demand: "Indeed, it is precisely because people and companies need oil so desperately – it's essential for almost everything they do – that any possible scarcity raises prices sharply. In economics jargon, prices are 'inelastic.' A big jump dampens demand only slightly. Similarly, a big decline increases it only slightly." However, this observation by Samuelson, while true, also seems to suggest that oil is a prime market for speculation. In this respect, it would seem that speculation and inelastic demand would go hand in hand, as bigger price moves are possible with inelastic demand, both to the up and down side.

Uranium probably represents the mother of inelastic demands, as there are essentially no substitutes, save enrichment, and enrichment does not represent much of a substitute today because of the tight supply situation in that market. At least when it comes to oil, you can take public transportation, telecommute, and take other actions that will reduce demand. For uranium, all you can do is shut down or coast down your reactor. Again, speculators realize this, and to the extent they can bet on uranium – they do this by taking physical positions as opposed to cash positions in oil – they do.

Just as applicable for uranium is the following statement that Samuelson makes about the recovery in oil prices: "Low prices and miscalculation explain the turnaround. From 1985 to 1999, crude prices averaged \$18 a barrel. Investment in expensive oil fields and new refineries became unprofitable. Companies cut budgets. They fired petroleum engineers and merged. ... Meanwhile, almost everyone underestimated oil demand. Driven by China, it grew much faster after 2000 than before."

Sound familiar? Uranium has experienced a similar underestimation of demand. In August 2001, we wrote an editorial that talked about the stealth nature of demand, where demand increases were associated with the move to higher capacity factors and not the introduction of new reactors. Later in 2001, we noted the changing nature of demand with growth in China and Russia and that this decade would be different than the 1990s, when supply dominated. However, the market was slow to pick up on this change, given that the spot price was under \$10 at the end of 2001 and did not begin to move with any significance until 2003.

Near the end of his opinion piece, Samuelson cautions about jumping to "the easy conclusion that speculators have artificially increased oil prices," noting that speculators are addressing real risks – production, political, and otherwise – and all of this is reflected in the high prices that currently exist. Except for the fact that its market is less developed, uranium is really not much different than oil. Uranium is essential, has risks associated with it, and its demand has grown more quickly than suppliers imagined, resulting in rather strong fundamentals. Speculators realize this and have acted upon it. These actions have affected price formation, but undoubtedly less so than in oil.

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