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Center for Research on Globalization

Plummeting Oil Prices

By Stephen Lendman
Theme: Global Economy, Oil and Energy
Global Research, December 17, 2014

As this is written, West Texas Intermediate (WTI) crude down to below $56 a barrel. Brent at $61. From a high of $115 in January.

Heading for $40 or lower, some analysts believe. Shaking market stability. Reflecting global economic weakness.

Market manipulation. Saudi overproduction a big contributor. Protecting its market share. Targeting US shale oil production.

Hitting Russia hard. Per secret agreement between John Kerry and Saudi King Abdullah.

Washington wanting Moscow's economy to scream. Urging other nations cut economic ties.

Abdullah likely angry about Putin declining a major 2013 arms purchase. Worth around $15 billion. Other generous investments.

Plus a pledge not to challenge Russian gas sales. In return for scaling back support for Assad. At the time, an unnamed Arab diplomat said Putin listened politely.

Expressed no interest. Said Moscow geopolitics remain unchanged. More on Russia below.

America now the world's largest oil and liquid natural gas producer. Around 11 million barrels daily. Overtaking Saudi Arabia and Russia.

Low oil prices hit shale producers hard. According to Zero Hedge, at current prices, only four of 18 shale regions remain economically viable. Maybe none if prices keep falling. As many expect.

Compounded by reduced shale oil well output. Forcing producers to drill deeper. At higher cost. For diminishing returns.

Unless more wells are tapped to maintain output. Affecting an industry producing over half of US oil.

Struggling to keep production up. Increasingly tough with less or unavailable financing. Because of falling prices.

Junk bonds financed America's shale boom. Producing a $550 billion mania, according to Zero Hedge.

Expecting this one to end badly. All bubbles pop. "Anything that becomes a mania ends badly," warned a bond manager.

Bloomberg warned about the danger of stimulus-induced bubbles. Playing out in energy company debt. High-yield spreads near 1,000bps.

An investment boom created by artificially sustained rock-bottom interest rates. Plunging oil prices may cause massive high-yield defaults.

CreditSights predicts around 8% in 2015. Double this year's rate. Moody's Investors Service found corporate debt investor protections at an all-time low.

With average junk bond yields lower than investment-grade bonds before credit crisis conditions hit. Since mid-year, energy companies' borrowing costs skyrocketed.

Compared to the past five years. Companies rated B or lower are "virtually shut out of the market," according to CreditSights oil and gas analyst Brian Gibbons.

They're forced to "rely on a combination of asset sales" to raise cash. Moody's Analytics economist Chris Lafakis called multiple Fed bond buying rounds "a gift to small companies in the capital-intensive energy industry that needed cheap borrowing costs to thrive."

Quantitative easing "has been one of the keys to the fast, breakneck pace of the growth in US oil production which requires abundant capital."

Blowback is here. Distortions affect multiple markets. Center for Financial Stability president Lawrence Goodman says conditions are "like a Whac-A-Mole game."

"You don't know where (trouble will) pop up next."

Magnum Hunter Resources CEO Gary Evans says "(o)il companies that have high funding costs in the Eagle Ford and the Bakken shale plays are the ones that are most exposed right now due to lower crude prices."

He expects other at-risk energy borrowers to be squeezed next March or April.

"(W)hen banks re-calculate how much they may borrow under their credit lines based on the value of their oil reserves."

Deutsche Bank analysts estimate around a third of companies rated B or CCC may be unable to meet their debt obligations.

If oil prices drop to $55 or lower. In other words, bottom line reality is much uglier than deceptive claims about economically beneficial low oil prices.

WTI below $60 a barrel sustained long enough risks pushing the entire high-yield sector into trouble.

A possible widespread default rate, according to Deutsche Bank analysts. A shock this great could trigger broader high-yield defaults.

High-yield JP Morgan Chase analyst Tarek Hamid thinks up to 40% of energy junk bonds will default at $65 a barrel oil sustained for around three years.

Energy companies currently comprise the fastest-growing high-yield bond market segment.

In recent years, around 18%. Double their 2009 market share. Even if at-risk companies cut costs. Sell assets to raise cash. Up to 25% of HY energy bonds could default. A scenario Hamid calls "very dire."

The Financial Times reported investors fleeing US junk bond debt. "(A) sell-off that started in low-rated energy bonds last month has now spread to the broad corporate debt market amid fears of a spike in default rates."

Plunging oil prices hit Russia hard. On December 16, RT International reported record low ruble prices. Falling 20% in a day.

Facing intense selling pressure. Tuesday afternoon trading at 72 per dollar. Modestly better than 78.5 per dollar hours earlier. About 100 per euro.

The ruble down over 60% from January valuations. Tuesday's slide came despite Russia's central bank hiking rates from 10.5 – 17%.

An astonishing same-day increase. Trying to aid ruble valuations positively. By higher returns. Compared to virtually nothing holding dollars.

Russia's stock market "went haywire," said RT. Down 15% at 2:30PM Moscow time. Down 11% Monday.

Russia's central bank chairwoman Elvira Nabiullin said:

"We must learn to live in a new reality, to focus more on our own resources to finance projects and give import substitution a chance."

Citing weak oil prices. Less access to Western capital markets. Because of sanctions.

Nabiullina said Russia's central bank has special tools. Able to aid internal development.

Finance investment projects. Including small and medium-sized business and commodity exporters.

Her worst case scenario: Negative 4.5% Q I growth. Recession.

According to Sberbank CIB analyst Vladimir Pantyushin:

"If anything there will be support, not stimulus for banks. It is a priority of the Central Bank to maintain and stabilize this sector."

He doesn't see Russia defaulting. Like 2008. Its robust budget can withstand hard times.

Russia's currency reserves stand at $415 billion. Compared to $15 billion in 1998.

In 2014, Moscow spent $80 billion defending the ruble. Before announcing it would float freely.

Oil drives things. A combination of oversupply. Market manipulation. Global economic weakness. Especially commodity prices. Key industrial activity indicators.

According to RBC Capital Markets analyst Robert Sluymer:

"Oil is a hugely traded financial asset. It links through the financial system and as it breaks down it becomes a huge tipping point."

It's hard knowing for sure what's next. Doing so isn't simple. Hindsight the best foresight.

Proving only Cassandra was good at calling market tops and bottoms. Mere mortals often try and fail.

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