The Oil Drum: Europe
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

ODAC Newsletter, Saturday 20 October

Posted by Doug Low on October 22, 2007 - 1:30am in The Oil Drum: Europe
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2a/ UK house market is 'heading for crash' (The Times, Thu 18 Oct)

http://business.timesonline.co.uk/tol/business/economics/article2678215.ece

Comment: A re-current theme in media articles about UK property prices is that one thing that may keep them high is "shortages of supply". What exactly do they mean? Much of the feedback in the Telegraph articles by Ambrose Evans-Pritchard of recent suggest this shortage of housing may by an illusion. If the UK was really short of housing why are rents in general not much higher (so the argument goes)? It may well be that there is enough housing / flats, just not in the places that people want to live? With higher interest rates and the difficulty now of getting astronomical mortgages, we may see that house buyers will have to lower their expectations of what constitutes an affordable dream house, and the "shortages of supply" is not quite as acute as we thought.

> The property boom of the past ten years has left the British housing market in danger of following the slump in American house prices, the International Monetary Fund said yesterday.
>
> In a bleak warning, the IMF found that homes in Britain were overpriced by up to 40 per cent — far more than the overpricing in the US before the current property slump began there. The finding will fuel fears over housing market prospects after growing evidence recently that prices have already begun to fall in some parts of Britain.
>
> The warning came as it emerged yesterday that the Bank of England discussed whether to lower interest rates this month to shore up Britain's growth. But there was substantial reluctance among the Bank's Monetary Policy Committee to rush into lowering borrowing costs, with only one of the nine-strong panel voting for a rate reduction.
>
> The IMF report said: "The extent of house price overvaluation may be considerably larger in some national markets in Europe than in the US. The estimates suggest that a number of advanced economies' housing markets outside the US could be vulnerable to a correction."
>
> House prices in Britain now stand at about nine times average annual earnings — up from about five times in 2001. Average national house prices have risen threefold since the early 1990s, from about £60,000 to about £200,000 now.
>
> ... The IMF, however, did qualify its pessimism, saying that there were "considerable uncertainties" in its model, which did not take in key factors in Britain such as shortages of supply, boosts to prices from immigration and greater affordability due to the availability of mortgages.

2b/ New mortgage approvals plummet by 12% (The Times, Thu 18 Oct)

http://business.timesonline.co.uk/tol/business/economics/article2685153.ece

> The rate of new UK mortgages being granted plunged by 12 per cent during September, adding to growing evidence that the booming housing market is finally running out of steam.
>
> The Council of Mortgage Lenders (CML) said today that the 12 per cent decline in lending, to £30 billion, was above the typical decline expected between August and September when the amount of home loans normally falls by 5 per cent. The figure includes re-mortgaging as well as new home loans.
>
> Although lending in September rose by 2.5 per cent compared to the same month last year, the CML said it was the smallest increase in two years.

> The Building Societies Association concurred with the CML's findings, that mortgage lending had fallen, but said the rate had declined year-on-year, plunging by 10 per cent from £4.8 billion to £4.3 billion...

2c/ Eastern Europe to reap its own subprime crisis (The Telegraph, Thu 18 Oct)

http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2007/10/17/bcnlat...

Comment: Ambrose Evans-Pritchard, International Business Editor of the Telegraph, reviews the economies of central and eastern Europe.

> Soaring inflation across Central and Eastern Europe has begun to derail the region's booming economy, setting off alarms bells at the IMF and raising the risk of a monetary crunch.
>
> Inflation in Bulgaria (12pc), Latvia (11.4pc), Kazakhstan (8.6pc), Russia (9pc), Estonia (7.2pc), Lithuania (7.1pc), and Romania (6pc) has reached levels that will force the authorities to slam on the brakes, endangering banks that have allowed credit growth to mushroom out of control.
>
> ... "This could easily become Europe's subprime crisis," said Lars Christensen, Danske Bank's chief economist for Eastern Europe.
>
> "The macro picture is deteriorating dramatically. On almost all indicators, the extremes are worse than during the East Asia crisis in 1997-1998. We have a story of over-leveraging and asset bubbles with massive excesses that are clearly unsustainable. Look at Latvia, where the current deficit has reached 30pc of GDP, and it is not much better in Bulgaria and Romania," he said.
>
> "They could do this when easy money was on tap but that's not available any more after the global credit crunch. The situation is already turning quite serious. The money markets are basically not functioning in the Baltics," he said.
>
> ... Latvia is in the eye of the storm. Riga house prices – now more expensive than Berlin – have begun to slide. According to international estate agent Knight Frank they rose 61pc in the year to March 2007.
>
> ... But the prime victim so far has been the ex Soviet republic of Kazakhstan, despite holding 3pc of the world's oil reserves and the vast gas fields of the Caspian.
>
> After credit growth of 100pc over the last year, its $40bn lending bubble has suddenly popped. House prices in some quarters of Almaty, the country's largest city, have fallen by nearly 20pc in the last three months, while the banks are suddenly finding that the global capital markets are no longer willing to roll over loans.
>
> "Kazakhstan has a number of problems in the banking sector. There are no critical, dangerous phenomena," said President Nursultan Nazarbayev yesterday. That is a matter of dispute. Foreign debts are now $92bn, against reserves of $18bn – down $5bn already over the last two months.
>
> ... Kazakhstan's economy is not big enough to jolt the global financial system, but it lifts the lid on one of the most frothy cauldrons of the emerging market kitchen. Contagion has already spread to those Russian banks that are sagging under the weight of foreign

> debt – like Northern Rock.
>
> ... Russia's central bank has taken a series of emergency steps, injecting almost $11bn of extra liquidity each day in August to stave off a liquidity crisis... Russia is not going to default, any more than Britain was at risk of defaulting over Northern Rock.
>
> ... Compared to the $2,000bn market for US subprime and "Alt-A" housing debt, the sums lent to finance East Europe's exuberant embrace of capitalism are in themselves not enough to cause a global financial crisis. But the sums are not small either, and just like the subprime debacle, we don't know who holds the hot potatoes.

2d/ UK housing: How storm clouds gather [podcast] (Telegraph, Wed 17 Oct)

http://www.mediaplayer.telegraph.co.uk/

Comment: Podcast, 3m 26s. Click on the 'Business' tab. Top story as of 19 Oct. Apparently the IMF now thinks the US sub-prime crisis is going to affect 'everyone', and they are particularly worried about the UK property market.

> The International Monetary Fund has cut its growth forecasts for the UK economy and warned of the downside risk to the housing market as Edmund Conway tells Robert Miller.

3 / Energy-rich Caspian becomes center of U.S.-Russia power struggle (International Herald Tribune, Wed 17 Oct)

http://www.iht.com/articles/2007/10/17/business/caspian.php?page=1

Comment: "Is the Caspian a sea or a lake?" This week Iran, Russia, Azerbaijan, Kazakhstan and Turkmenistan met to resolve this question, without success. It makes a difference because it decides how the hydrocarbons of the Caspian will be carved up.

"the vast energy reserves under its [Caspian] depths" – they are not so vast.

> Is the Caspian a sea or a lake?
>
> The answer has immense repercussions for the energy industry. If it is a lake, there are no obligations by countries that flank it to grant permits to foreign vessels or drilling companies. But if it is sea, there are international treaties obliging those countries to an array of permits.
>
> The Caspian, one of the world's largest enclosed bodies of water, has become the center of a new power game involving the United States and Russia as well as its bordering countries, including Iran, over who should control the vast energy reserves under its depths.
>
> The Caspian's status has been in dispute since the collapse of the Soviet Union in 1991.
>
> ... "The summit in Tehran was about the future status of the Caspian Sea," said Johannes Reissner, Middle East expert at the German Institute for International and Security Affairs in Berlin. "Iran and Russia have enormous interests in resolving this

status. But there are major disagreements between them."

In addition to Iran and Russia, Azerbaijan, Kazakhstan and Turkmenistan also have Caspian coastlines. And while all of them want a large stake in the oil reserves, and to use of the sea for transportation, none of them have been able to agree on the status of the coveted waters.

Russia and Iran, historically, have agreed that the sea was a lake and that it should be shared equally between the two of them.

That all changed after the collapse of the Soviet Union in 1991. Iran and Russia wanted earlier agreements, signed in 1921 and in 1940, to continue. Moscow had obtained consent from the newly independent republics of Azerbaijan, Kazakhstan and Turkmenistan that they would be bound by any agreements signed by the Soviet Union, of which they had been a part.

But in 1998, Azerbaijan declared that since the Caspian was an international lake, it should be recognized as such. In practice, this would mean that the surface and seabed would be divided into five sectors determined by the length of each country's shoreline. Under such a scenario, Russia would lose out, and Iran even more so.

... Vladimir Milov, director of the Institute of Energy Policy in Moscow, said he was skeptical about a pipeline under the Caspian. "The perspectives for a trans-Caspian pipeline, putting aside the U.S. optimism, appear bleak due to unresolved Caspian seabed division disputes," he said last month.

As if to confirm this, the Caspian summit produced no breakthrough. IRNA, the official Iranian press agency, said the five leaders agreed to form an economic cooperation organization. They are to meet next year in Azerbaijan, leaving open for the moment the viability of a trans-Caspian pipeline and the Nabucco project but confirming Russia's influence in the region.

4/ China’s drive for wealth means end of our low-carbon dreams (The Times, Wed 17 Oct)

http://business.timesonline.co.uk/tol/business/columnists/article2673579...

Comment: Carl Mortished takes a rather brutal look at the Kyoto treaty in light of current trends in China’s coal consumption, and explains rather neatly why global coal prices are on the increase: “If Mr Hu had a message for the world in his address to the Communist Party National Congress, it was this: we will burn our coal and, if we have to, we will burn yours, too.”

Jeremy Leggett emphasized in his presentation at ASPO-6 in Cork a month ago that from a climate change / CO_2 emissions point of view, it is coal consumption that we have to worry about, not so much oil (see slide 25, “The arithmetic of carbon ‘resources’: IPCC view” from Jeremy’s ASPO-6 PP presentation: Warning 12.6 Mb PDF file, http://www.aspo-ireland.org/contentfiles/ASPO6/3-1_ASPO6_JLeggett.pdf).

Hu Jintao wants to make every Chinese twice as rich by 2020. He has done it once – in just five years, income per capita doubled to $2,000 (£983) - and the only obstacle in the Chinese President’s path is the fuel needed to stoke the boiler in China’s locomotive.

The president needs more copper, iron ore, zinc and natural gas. Above all, he needs more coal to keep the power stations humming nicely and more oil for Chinese cars and lorries. China accounts for more than a third of world demand for coal and the price in

> Australia soared this year as the People's Republic switched from being an exporter to being an importer. If Mr Hu had a message for the world in his address to the Communist Party National Congress, it was this: we will burn our coal and, if we have to, we will burn yours, too.
>
> What does this mean? Put bluntly, it means that the Kyoto treaty on greenhouse gas emissions is dead and so is any prospect of persuading Beijing to bind itself to other curbs on carbon emissions. We can stop kidding ourselves that China will sign up to any green thingy that hinders his party's ten-year plan to get rich quick. Instead, the ravenous demand for minerals and metals will continue and the desperate land grab by Chinese state companies in their pursuit of resources in Central Asia, Africa and Canada will become more politically embarrassing.
>
> ... That means that competition for resources will ratchet up in intensity. In Europe, we have not even begun to consider the consequences for our half-hearted strategy of pursuing a low-carbon economy. In an effort to rein in the cost of electricity, British power generators have been switching from natural gas to coal, traditionally a cheaper fuel. However, it is rapidly losing its lower-cost allure, the European price having doubled to $100 per tonne. Even so, analysts at Société Générale calculate that the cost of carbon permits is still so low that, on the basis of current gas and coal prices, it remains cheaper to burn coal than to switch to cleaner natural gas.
>
> ... The four great energy companies of the West – ExxonMobil, Shell, BP and Total – have quietly turned their backs on the low-carbon option. Alternative technologies simply do not deliver the power required to achieve the economic growth targets of China and India. These companies are investing tiny sums in alternative energy...

5/ Iran plans $130bn gas investments (Arabian Business, Thu 18 Oct)

http://www.arabianbusiness.com/index.php?option=com_content&view=article...

Comment: Note that the huge investment is to help meet domestic demand. Iran is currently a net importer of natural gas (from Turkmenistan), and domestic consumption has been growing at about 9-10% per year since 1990 according to the IEA's Natural Gas Market Review 2007. As the article states, Iranian winter demand outstrips supply, which is why Iranian exports to Turkey stopped on several occasions last winter.

> Iran is to invest $130 billion over the next 20 years to help meet rising domestic demand for natural gas.
>
> The National Iranian Gas Co (NIGC) will allocate $90 billion to gas transmission projects according to Shana, reported Dow Jones.
>
> Managing director of the state-run firm, Seyed Reza Kazzaeizadeh, said "Based on the 20-year outlook plan, $130 billion will be invested, out of which $90 billion will be allocated to the gas transmission projects" the newswire reported.
>
> The company will add to its existing pipeline network with 53,000 new kilometres of pipelines and 140 gas booster stations.
>
> "Under current circumstances, demand for gas in cold season is higher than supply and the output falls to meet the need" Kassaeizadeh said.

6/ Wheat Export Tax to Soar Fivefold (FC Novosti, Fri 29 Oct)

http://www.fcinfo.ru/themes/basic/materials-rfcm-index.asp?folder=3352

Comment: The Russian government has already put a 10% export tax on wheat, but it has had little effect. Despite the Russian wheat harvest being a good one this year, the record high prices at the global level are encouraging wheat exports from Russia, which in turn is pushing up prices of wheat and wheat products in Russia. Bread prices are increasing and the Russian people are not happy, and there is a presidential election coming up. The plan is to increase the wheat export tax so that exports drop to zero – "The government is currently discussing the move".

> Russian Grain Union President Arkady Zlochevsky said he did not rule out another rise in grain export duties. He said the export duty on wheat could be upwardly revised to 50%.

7a/ Global Oil Output Has Already Peaked, Pickens Says (Bloomberg, Fri 19 Oct)

http://www.bloomberg.com/apps/news?pid=20601103&sid=ajMgRIfZrNVk&refer=news

Comment: The limitation with this article is that it is from a News Agency (not a mainstream newspaper), and is very unlikely to get reported widely in the general media. Last year - 2006, between April and August as the price of oil rose to just under $80/barrel, both Reuters and Bloomberg published several articles promoting discussion of Peak Oil, and relating PO to the high oil prices. The media avoided printing these articles like the plague.

Article has been reported by Business Week: Oilman Pickens says $100 oil coming (http://www.businessweek.com/ap/financialnews/D8SCJ5G01.htm)

> World oil output has already peaked, and prices that have surged to record highs above $90 a barrel are a sign of things to come, said investor Boone Pickens, chairman of Dallas-based BP Capital LLC.
>
> Global production has peaked at 85 million barrels a day, Pickens, 79, said in an interview today at a Houston conference sponsored by the Association for the Study of Peak Oil & Gas, a non-profit think tank. Oil will rise to $100 a barrel before falling to $80 again, he said. Earlier this week, he said crude would reach $100 by year's end.
>
> ``As this unfolds, you're going to have to find alternatives that are going to do the job that oil is doing," Pickens said. ``Everyone is going to have to come to grips with this in the next two or three years. People are going to have to figure it out."
>
> Peak oil is the theory that world production has reached or is about to reach its zenith, after which it will begin an unstoppable decline. Critics say it's impossible to know when petroleum output has peaked, given uncertainties estimating global reserves. Previous efforts to peg a date for peak output have been wrong, they say.
>
> Investors such as Pickens and analysts like Matthew Simmons of Houston investment bank Simmons & Co. International support the peak oil theory. Executives from companies such as Exxon Mobil Corp. have downplayed the possibility.
>
> ``They talked like $50 was going to be difficult, and $60 and $70. We went through those like a knife through hot butter," Pickens said.

> Last month, Pickens predicted that oil would reach $100 a barrel after falling to $78. Futures in New York dropped as low as $78.35 on Oct. 8, and touched a record high of $90.07 today...

7b/ Saudi Aramco may miss production goals, says Simmons (Business Intelligence Middle East, Fri 19 Oct)

http://www.bi-me.com/main.php?id=14118&t=1&c=33&cg=4

> SAUDI ARAMCO. Saudi Aramco, the world's largest state oil company, probably isn't on target to meet its oil production goals, said Matthew Simmons, Chairman of Simmons & Co International.
>
> "I'm dubious they can hit their targets," Simmons said today at a Houston conference sponsored by the Association for the Study of Peak Oil & Gas, a non-profit think tank. "If they had hit their targets, they would be more forthcoming."
>
> Simmons is the author of 2005's 'Twilight in the Desert: The Coming Saudi Oil Shock and the World Economy', which argues that global oil production has already peaked and Middle East reserves estimates are overstated.
>
> Aramco is boosting spending on projects to raise the Kingdom's daily output capacity from 11.3 million barrels to 12.5 million barrels by 2009. Simmons has called on national oil companies and other producers to disclose field output figures.
>
> "Amid all these long-term projections of demand, Saudi Arabia's output has to grow or other supply has to come out of the air to replace it," Simmons said.
>
> Oil futures traded on the New York Mercantile Exchange today rose above US$90 a barrel for the first time after the US Dollar declined to a record low against the euro, enhancing the appeal of commodities as an investment.
>
> Oil and natural-gas producers are pouring money into oilfield services that can stem production declines from aging fields in the North Sea, Saudi Arabia and Mexico.
>
> Simmons, who has predicted crude will exceed US$200 a barrel or more, reiterated he believes today's prices are cheap.
>
> "At US$40, US$50 and US$60 they said it's just traders and speculators," he said. Light, sweet grades of oil in Malaysia were US$90 a barrel earlier this month, Simmons said.
>
> "That to me is not speculation; that's refiners struggling to find light, sweet crude," Simmons said. "I don't know what fundamentals they're looking at. The fundamentals I'm looking at say fasten your seat belts."
>
> Critics of Simmons' peak-oil assertions say it's impossible to know when petroleum production has peaked, given uncertainties estimating global reserves, and point out that previous theories pegging a specific date for peak oil output have been wrong...

9/ Wall St caught in a perfect storm (The Telegraph, Sat 20 Oct)

http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2007/10/20/cndow1...

Dow Jones plunges 367 points in an eerie repeat of October 1987 crash

The Dow Jones plunged almost 370 points in a perfect storm of surging oil costs, a sliding dollar, and fresh fears of paralysis in the credit markets.

Twenty years to the day since Black Monday, when the Dow slumped 508 points in a day, Wall Street was rocked by rumours of defaults and heightened fears that the US economy may be heading for a recession.

There were frantic scenes in the last hour of trading on Wall Street yesterday, as traders on the floor of the New York Stock Exchange fell over one another to place sell orders in all of America's biggest companies.

The Dow finally closed down 366.94 points at 13522.02 recording its biggest one-day loss since August 9, the start of this summer's credit crisis.

In total, 1.75bn shares changed hands on the NYSE, 1.65bn were sell orders. The panic selling was compounded by the unwinding of options.

The broader S&P 500 index fell 74.15 points to 2725.16, while the FTSE 100 in London closed down 81.5 points at 6527.90. It is expected to open lower on Monday morning, leaving traders with a nervous weekend.

... Fed chairman Ben Bernanke warned on Thursday that "considerable strains remain" in the financial markets. He said cited a risk that "housing weakness might spill over to other parts of the economy".

He left no doubt that the Fed is now seriously worried about the severity of the downturn. "Intuition suggests that stronger action by the central bank may be warranted to prevent particularly costly outcomes," he said.

Credit markets have priced in a 70pc chance of a rate cut on October 31, an abrupt change since last week.

It is unclear, however, whether the Fed can act as aggressively as it might wish, given stubborn inflation now running at 2.8pc and concerns that the dollar slide could get out of hand if managed badly by Washington.

This is hauntingly similar to events in October 1987, just before Black Monday.