The Round-Up: December 29th 2006

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Canada gas exports to U.S. could plunge

> Canadian natural gas exports to the United States could post the largest drop in a generation in 2007, an analyst says, as exploration cuts reduce supply and home-grown demand to fuel oil sands output booms.
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> Martin King, who follows energy commodities at FirstEnergy Capital, a Calgary investment bank, expects exports to fall by up to a billion cubic feet a day next year, down about 10 percent from current shipments around 10 billion cubic feet a day.
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> "The supply picture is looking rather negative," King said. "You have to go back to 1984 to see a (similar) downward trend."
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> King speculated the cut in exportable gas will come on both the supply and demand side.

U.S. firms take First Steps In LNG plant bid

> A new Canada- U.S. border disputemay be closer now that two U.S. companies are seeking U.S. government approval to build controversial liquefied natural-gas plants near the Bay of Fundy.
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> Downeast LNG applied yesterday to the U.S. Federal Energy Regulatory Commission to construct a US$500-million LNG plant in Robbinston in the northeastern corner of Maine next to New Brunswick.
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> Late last week, rival Quoddy Bay LNG filed an application with U.S. federal energy regulators to build a LNG plant in the same part of Maine.
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> Massive LNG tankers heading to either plant would have to sail through Canadian waters, something Ottawa says it will prohibit. The U.S. government says Canada cannot deny access to its ports.

Ottawa favours Candu reactors

> Federal Natural Resources Minister Gary Lunn says it is "imperative" that Crown-

owned Atomic Energy of Canada Ltd. be awarded the multibillion-dollar contract to build Ontario's first new nuclear reactors in more than two decades.

"I'm quite prepared to say on the record that we are not technology neutral," Mr. Lunn said in an interview. "We are very favourable to the Candu technology."

However, his comments are at odds with those of Canada's nuclear safety regulator, who has said that Atomic Energy does not have the hometown advantage over global vendors.

Ontario rejects Ottawa's Candu stand

The Ontario government made it clear Tuesday that much more than politics will go into deciding who gets the nod to build a new nuclear plant in the province and that global vendors can count on an open competition.

A spokesman for Ontario Energy Minister Dwight Duncan said that the provincial government has not yet decided whether Crown-owned Atomic Energy of Canada or a global company will be awarded the contract to build the province's first new reactors in more than two decades.

"Our preference is to use Canadian technology, but ultimately our first priority is to Canadian taxpayers to ensure we get the best deal possible," Steve Irwin said.

Income trusts in for a rocky 2007

Takeovers and consolidation will be common themes for income trusts over the next 12 months as the industry copes with the reality of the four-year phase-out of its tax-free status.

Following the Halloween bombshell dropped by Federal Finance Minister Jim Flaherty that knocked trusts for a multibillion-dollar loop, the real question is how many will be left standing at the end of 2007.

A lot fewer than the 256 which currently exist, says George Kesteven, president of the Canadian Association of Income Funds.

"Those infrastructure assets... have been somewhat vaporized over the last six or seven weeks," said Mr. Kesteven, who worries about the far-reaching ramifications of American interests potentially taking over the Canadian funds.

Trans Canada buys U.S. Pipeline

"We are very much solidifying our position as the leading North American energy infrastructure company," Trans Canada's president and CEO Hal Kvisle said on a conference call.

Calgary-based Trans Canada, long known for its natural gas pipeline system in Alberta, is diversifying its business by pursuing power generation opportunities -- from a major wind farm in the Gaspe region of Quebec to its 47% stake in the Bruce nuclear power facility in western Ontario.

It is also planning a pair of liquefied natural-gas regasification projects, one in Gros Cacouna, Que., and the other off the coast of Rhode Island.

[An economy of buccaneers and fantasists]

The nature of the global financial system has changed radically in ways that have nothing to do with virtuous national economic policies that follow IMF advice. The investment managers of private equity funds and major banks have displaced national banks and international bodies such as the IMF. In many investment banks, buccaneering traders have taken over from more cautious and traditional bankers and owners. Buying and selling shares, bonds and derivatives now generate higher profits, and taking far greater risks is now the rule among what was once a fairly conservative branch of finance.

Such traders are rewarded on the basis of profits, fictitious or real, and routinely bet with house money. Low interest rates, and banks eager to lend money to hedge funds and firms that arrange mergers and acquisitions, have given such traders and others in the US, Japan and elsewhere, a mandate to play financial games, including making dubious mergers that would once have been deemed foolhardy. In some cases, leveraged recapitalisations allow the traders to pay themselves enormous fees and dividends immediately, by adding to a companys debt burden. What happens later is someone elses problem.

Since the beginning of 2006 investment banks have vastly expanded their loans to leveraged buy-outs, pushing commercial banks out of a market they once dominated. To win a greater share of the market, they are making riskier deals and increasing the likelihood of defaults among highly leveraged firms living dangerously as the head of Standard & Poors bank loan ratings section put it. Observers are predicting a sharp increase in defaults among highly leveraged companies, the Financial Times noted in July (3).

But there are fewer legal clauses to protect investors, so lenders are less likely than ever to compel mismanaged firms to default. Hedge funds, aware that their bets are more and more risky, are making it much more difficult to withdraw the money with which they play. Traders have reintermediated themselves between traditional borrowers (national and individual) and markets, further deregulating the world financial structure and making it far more susceptible to crises. They seek to generate high investment returns and take mounting risks to do so.

[Democrats eye Big Oil profits as source of energy funding]

House Democrats in the first weeks of the new Congress plan to establish a dedicated fund to promote renewable energy and conservation, using money from oil companies.

That's only one legislative hit the oil industry is expected to take next year as a Congress run by Democrats is likely to show little sympathy to the cash-rich, high-profile business.

Whether the issue is rolling back tax breaks — some approved by Congress only 18 months ago — pushing for more use of ethanol and other biofuels instead of gasoline, or investigations into shortfalls in royalty payments to the government, oil industry lobbyists will spend most of their time playing defense.

[Ethanol demand pumps up price of corn]

Ethanol is an alcohol made from grains, used these days to supplement petroleum-based fuels with a cheaper, cleaner energy product. Ethanol currently makes up about 10 percent of gasoline at the pump; the goal is to increase that percentage as supplies become available.

``We wanted 7.5 billion gallons of biofuel (nationally) by 2012,'' Michigan State University agriculture economist Jim Hilker said. ``We'll hit that number probably in 2008.''

The federal energy bill passed in the summer of 2005 included incentives to push production of ethanol plants, Hilker explained.

Those incentives, combined with three years of bumper corn crops, low corn prices and rising gasoline prices, converged during harvest of the 2006 crop. Instead of the steady growth that economists had predicted would come when ethanol plants were up and running, there was a frenzy.

``The stars are lining up at this point,'' said Rod Stevenson, area technology development manager with Monsanto Co., which develops and sells seed corn. ``With the potential of five or six ethanol plants coming on in Michigan and heavy uses of biofuels across the country ... corn will be the crop to produce in 2007,'' he said.

``It's generated a huge demand for corn production that we haven't seen in agriculture -- ever.''

Wylie said the state's ethanol plants, including those in planning or under construction, have the capacity to process 242 million bushels of corn -- 84 percent of the state's current crop.

That kind of demand has farmers scurrying to meet it, looking for more land to plant to corn on and considering replacing other crops, such as hay, wheat or soybeans, with more corn.

[Iran’s nuclear drive linked to looming oil crisis: US study]

Iran's nuclear ambitions are motivated not just by a desire for regional supremacy but by a potentially devastating crisis in its oil industry, a US researcher said in a report made public yesterday.

Iran's image is of a muscular oil producer with plentiful reserves, but in fact it could soon face its own energy crunch owing to failing infrastructure and lack of investments, Roger Stern at Johns Hopkins University said.

Push on to cut barriers between provinces

> One of Canada's biggest challenges on the trade front will have nothing to do with a foreign country, but everything to do with the 10 provinces that make up the Confederation.
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> Interprovincial trade -- and a push for freer trade of goods and services -- has become a cornerstone of the federal Conservative government's economic agenda. The International Monetary Fund has weighed in, saying in a recent report that stripping down inter provincial trade barriers should be a "priority" item for the federal government if Canada is to record healthy economic growth.
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> Finance Minister Jim Flaherty has spoken of the importance of reducing trade barriers among the provinces. Helping Mr. Flaherty's cause are the governments of Alberta and British Columbia, which earlier this year signed a historic trade pact. That deal promises to give workers and companies the freedom to move across the border and operate, much like the nations that make up the European Union.

A warning for the services sector

> The relentless pressure of globalization that has hammered Canada's manufacturing industry will soon spread to the services side of the Canadian economy, Bank of Canada Governor David Dodge warns. But he thinks Canadian companies are probably flexible enough to handle it.

Federal Subsidies Turn Farms Into Big Business

> The very policies touted by Congress as a way to save small family farms are instead helping to accelerate their demise, economists, analysts and farmers say. That's because owners of large farms receive the largest share of government subsidies. They often use the money to acquire more land, pushing aside small and medium-size farms as well as young farmers starting out.
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> "Historically, when you think of family farms, you think of Mom and Dad and three generations working a small or mid-sized farm. It gives you a warm and fuzzy feeling," said Alex White, a professor of agricultural economics at Virginia Tech. "In the real world, it might be a mid-sized farm. But it also might be a huge farm. It might be a corporation."
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> Large family farms, defined as those with revenue of more than $250,000, account for nearly 60 percent of all agricultural production but just 7 percent of all farms. They receive more than 54 percent of government subsidies. And their share of federal payments is growing -- more than doubling over the past decade for the biggest farms.

Goldman eyes ports, airports

> Goldman Sachs Group Inc. is stepping up its pursuit of ports, airports and regulated

> utilities around the world after the investment bank raised more than US$6.5-billion for its first infrastructure investment fund.

[U.S. housing prices rise at slowest pace in nearly a decade]

> Prices of U.S. single-family homes across the nation rose in October at the slowest rate in almost a decade, a housing index released Tuesday by Standard & Poor's showed, giving more evidence of the U.S. housing market's deceleration, which has affected many parts of the broader economy.
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> The S&P/Case-Shiller composite index showed a 2.4 per cent year-over-year increase in the price of a single-family home based on prices of existing homes tracked over time in 10 metropolitan markets. For its 20-city composite index, prices grew 2.9 per cent, the slowest rate ever for that data, according to the S&P index committee chairman, David Blitzer.
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> ”Home price gains are continuing their steep deceleration,” said Chief Economist Robert Shiller of MacroMarkets LLC. ”We can clearly see that the monthly price declines are wide spread nationally.”

[Sub-Prime Disaster in the making]

> A report released this week by the Center for Responsible Lending, a Durham, N.C. based research group, predicted that 1 in 5 sub-prime mortgages originated in the past two years would end in foreclosure. While most on Wall Street dismissed this survey as overly pessimistic, it actually represents a rather rosy outlook.
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> One of the report's deficiencies is that it fails to account for how the foreclosures it does expect will impact those loans that it regards as safe. A 20% default rate would put millions of homes back on the market, and would also inflict severe losses on sub-prime lenders, causing them to pull in their horns and tighten their lending standards. More inventory and higher rates will put more downward pressure on home prices. Many over-stretched borrowers, who made little or no down payment, will find themselves struggling to make mortgage payments on properties with negative equity. Higher rates and lower prices will also remove the cash out options that many borrowers expected would bail them out of ballooning adjustable rate payments.
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> Therefore, the secondary effects of the 1 in 5 sub-prime default rate will be a chain reaction of rising interest rates and falling home prices engendering still more defaults, with the added foreclosures causing the cycle to repeat. In my opinion, when the cycle is fully played out we are more likely to see an 80% default rate rather than 20%.

[China scuttles yuan float]

> China will keep the value of its currency, the focal point of trade disputes with the United States, at a stable level and will also act to curb investment growth, the central bank said Monday.

The statement by the People's Bank of China comes less than two weeks after a high-profile U.S. visit to China failed to win solid pledges of help from Beijing on floating the yuan and slowing a soaring trade gap.

“The meeting believed that China should ... actively expand domestic demand, reasonably control the growth of the investment and improve the trade balance,” said the statement on the bank's website, issued after a fourth-quarter meeting on monetary policy.

China has been under pressure to do something about the value of its currency, with many politicians in Washington and U.S. business leaders saying Beijing keeps the yuan undervalued, giving its exporters an unfair price advantage and hurting foreign companies.