The Oil Drum: Canada
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

The Round-Up: July 3rd 2007

Posted by Stoneleigh on July 3, 2007 - 4:40am in The Oil Drum: Canada
Topic: Miscellaneous
Tags: atlantica, biofuel, bond rating, climate change, consolidated debt obligation, credit crunch, equalization, leveraged buyout, lng, private equity, resource royalties, smart metering, subprime loans, uranium [list all tags]

Dried-up Arctic ponds evidence of global warming, study says

> A University of Alberta scientist has uncovered dramatic evidence of climate change in the Arctic, where ponds that have been part of the landscape for more than 6,000 years are drying up as global warming has nearly doubled the length of the brief northern summer.

Greenland's ice meltdown quickens

> Peterson is keenly aware of a cruel irony: a recent spike in tourism may portend the beginning of the end for an ancient way of life among 56,000 Greenlandic people scattered across the treeless and harsh landscape. Inuit hunters, who rely on cold ocean temperatures and extensive winter sea ice to stalk seals, whales and polar bears, may soon come up empty-handed.
>
> The Greenland ice sheet, second only to Antarctica in the volume of water locked in its deep freeze, has been a barometer for researchers measuring the effect of the world's growing consumption of coal, oil and gas on heating up the planet.
>
> What their instruments have confirmed is that the news out of Greenland is bad -- and getting worse.

Sask. uranium mine promises large yield

> You could say Cameco Corp. is sitting on a veritable gold mine these days, but such a compliment would actually undersell the value of the high-grade uranium buried in its flagship McArthur River mine in northern Saskatchewan.
>
> With spot uranium prices around $135 a pound and the mine producing an industry best 21 per cent pure uranium ore, the product piped up from the half-kilometre deep deposit is far more valuable than anything you'd find in a typical gold mine.

Harper's Fearless 'Dirty Gary'

> Gary Lunn, the federal minister of natural resources, is trying to push nuclear power, rev up the oil sands, and make way for more pipelines and supertankers on B.C.'s coast. He also happens to represent one of the most environmentally conscious ridings in the country, Saanich-Gulf Islands.

[Hike Royalties and Start Debate on Them]

> All the political posturing on equalization by the Calvert government is designed to divert the attention of the public from their policy on the extraction of our natural resources, and in particular oil and natural gas.
>
> The NDP government has consistently pursued two policies since 1991. First, the province will do everything in its power to promote and enhance the export of our oil and gas to the United States, as fast as possible. There is no regard for the finite nature of these non-renewable resources nor our future needs.
>
> The United States, with five percent of the world's population, consumes 25 percent of the world's energy. Saskatchewan extracts around 152 million barrels of oil per year, and over 70 percent of that is exported to the United States. The U.S. armed forces alone consume 124 million barrels of oil per year, more than the annual consumption of Sweden.
>
> The second policy is to try to maximize the profits of the oil and gas corporations operating in Saskatchewan. All kinds of direct subsidies are offered to the industry. But the key factor has been the steady reduction of royalties and taxes imposed on the industry.

[Resource revenue AND transfer payments — Calvert wants to eat the cake and have it too]

> During the NDP government of Allan Blakeney (1971-82) resource royalties and taxes were increased. Saskatchewan became a "have province" and for a few years did not receive equalization payments. The last three provincial governments have all steadily reduced the royalties and taxes on the use of natural resources.
>
> This policy has been warmly received by the owners of the corporations who extract our resources, for their income and profits have greatly increased. Of course, this policy has reduced provincial revenues. But is it fair that this pro-business policy be offset by equalization grants from the federal treasury?

[Sending our energy resources south]

> Deep integration discussions between Canada and the United States make frequent reference to a "North American energy market" or "North American energy security." The SPP identifies energy security as a priority. In the context of Atlantica, it means Canada sending oil and gas reserves to American companies, regardless of our own energy needs.

> The Atlantica proposal includes the creation of an energy corridor for the quick export of unrefined oil and gas to the United States, leaving Atlantic Canadians to face the social, economic and environmental concerns without the financial benefits. While there is a proposal for an oil refinery in St. John, New Brunswick, there is no timeline for its creation. In the meantime, Atlantic Canadians will also lose out on job creation, as raw, unprocessed resources are sent to the United States where they will be refined by U.S. workers. The products will then be sold back to Canadian consumers.

More than an economic union

> According to the New Brunswick Telegraph Journal, Atlantica has $500 million earmarked in transportation and energy investments on both sides of the border over the next seven years with little input from the public about the impacts of such a massive project. In fact, it is the government of Maine that is leading a study looking at the proposed Atlantic transportation corridor, which would support the Atlantica initiative, with government representatives from Quebec, PEI, New Brunswick, Ontario and Nova Scotia participating in study committees. Transport Canada is also participating as a nonvoting member. In a Ministerial Declaration from a trilateral transportation meeting held in April 2007, government officials from Canada, the United States and Mexico confirmed that they will be using the SPP to further the Atlantica agenda even though the SPP has never been outlined, discussed or voted on by the Canadian public.

Is metering plan really so smart?

> Ontario's energy ministry and local electric utilities might take this as a wake-up call, because it's not entirely clear that "potential future functionality" has been adequately considered in the design of the province's smart meter program. The fact that the sector is running to meet a political deadline hasn't helped matters.
>
> "They're rushing into this, basing their decisions on old technology," says one industry source closely following the program. "Now you have a hodgepodge of non-uniform technologies across Ontario. What happens if technology changes or a vendor goes belly up? All that infrastructure is wasted."

TransCanada and Petro-Canada Receive Approval From the Quebec Government for the Cacouna Energy Project

> The Cacouna Energy LNG terminal would be capable of receiving, storing and re-gasifying imported LNG, with an average annual send-out capacity of approximately 500 million cubic feet a day of natural gas. This approval follows a release earlier today from the Government of Canada in favour of the report from the Environmental Assessment Joint Review Panel for the proposed Cacouna project.

Ethanol boom squeezes biodiesel supply

> Farmers saw high prices for corn this spring and planted even more than expected. That may help hold down food prices, but it's bad news for struggling biodiesel makers who depend on soybean oil.
>
> The U.S. Department of Agriculture reported Friday that farmers nationwide planted 92.9 million acres of corn this year - 19 percent more than last year and 3 percent more than the government had projected in March. The demand for ethanol led U.S. farmers to plant the most corn since 1944.
>
> But that extra corn acreage means that farmers planted 15 percent less land to soybeans.
>
> The price of soybean oil is "almost to the point where it's not economically feasible to make biodiesel," said Dan Holesinger, manager of Clinton County Bio Energy.

Cellulosic ethanol: A clean but worthless biofuel?

> With biofuels being blamed for rising food prices and offering limited environmental benefits, diverse luminaries such as former United States vice-president Al Gore and Microsoft's Bill Gates are throwing their considerable support behind cellulosic ethanol, a second-generation biofuel.

Two necessities, fuel and food, create spiral of rising prices

> Now comes the biofuels movement. For a variety of reasons, ranging from an attempt to become less dependent on foreign oil to a desire for cleaner fuels, millions of acres of farmland are being redirected to corn-based ethanol.
> If hundreds of planned new ethanol refineries are built, the United States could very shortly be producing about 30 billion gallons of corn-based fuel per year, using one of every four acres planted to corn for fuel. This dilemma of food or fuel is also appearing elsewhere in the world as Europeans and South Americans begin redirecting food acreages to corn-, soy-, or sugar- based biofuels.
> Corn prices in America have spiked. And since corn is also a prime ingredient for animal feeds and sweeteners, prices likewise are rising for poultry, beef and everything from soft drinks to candy.
>
> There is more corn acreage - about 90 million acres are predicted this year - than at any time in the nation's last half-century. But today's total farm acreage is either static or shrinking; land for biofuels is usually taken from wheat, soybeans or cotton, ensuring those supplies grow tight as well.
>
> In the past, the genius of our farmers and the mind-boggling innovation of American agribusiness meant that farm production periodically doubled. Indeed, today we are producing far more food on far fewer acres than ever before.
> But we are nearing the limits of further efficiency - especially when such past amazing leaps in production relied on once-cheap petrochemicals, fuels and fertilizers.

Hollowing out?

> BY ANY standard the sums are enormous. For $32.6 billion in cash and the transfer of $15.9 billion in debt, Bell Canada Enterprises (BCE), owner of the largest telephone company in Canada, has agreed to be taken over by an Ontario pension fund and two American private equity firms. If it is completed, the takeover would not only be the largest in Canada's history but the biggest leveraged buyout anywhere.

[Debt markets turn grouchy as creditors ask for more]

> Although modest repricing is going on, investors are still willing to take risks if they are paid a little more to do so, and plenty of deals are still going ahead. Yet all is not well. "There's so much leverage in the system that it wouldn't surprise me to see more problems," says Jim Reid, credit strategist at Deutsche Bank. The place to look for a decisive shift in sentiment is in the buy-out market, which has been fuelled by a trio of habits that in more sober times would have had lenders reaching for the Alka-Seltzer.
>
> The first of these lies in the burgeoning market for "covenant-lite" loans. Loans normally require borrowers to maintain financial thresholds, like limiting debt to five times cashflow. But a huge number are now lacking such "maintenance covenants", which means that banks have less grip on borrowers when business turns sour. The total amount of covenant-lite loans issued in the first two quarters of 2007 has been $105 billion, which tops the $32 billion of all such loans written from 1997 to 2006, according to Standard & Poor's, a rating agency.

[Chorus of fear grows over cheap money]

> We reported a few weeks ago on the misgivings that the CEO of New York banking giant J.P. Morgan Chase has expressed about the dangerously cheap money that's fueling the global takeover boom. He's since been joined, last week, by the CEO of the huge Swiss bank UBS AG. Separately, a panel of European bankers fretted last week about a coming liquidity crunch if some of the recent, highly-leveraged takeover megadeals go sour. So did Michael Nobrega, also last week. Nobrega is CEO of Ontario Municipal Employees Retirement System (OMERS), which has more than 20 per cent of its assets tied up in infrastructure projects, whose price tags are getting way out of hand, Nobrega says.

[What We're Hearing]

> A hedge fund whose identity we know is having subprime-related problems similar to Bear Stearns, one veteran investment banking source told us. We are not releasing the name of the fund until we can confirm more information about the fund and its problems. Stay tuned. Meanwhile, several sources tell us that the CDO (collateralized debt obligations) market is in serious trouble. CDOs that invested in subprime assets are being hammered. "Most of these are held by insurance companies and foreign accounts," said one banker, requesting anonymity...

Wary investors peak over the hedge

> Shell-shocked mortgage bond traders who just closed the books on a surpassingly ugly June are eyeing the calendar warily, waiting for the next two weeks to bring the first word of just how much damage hedge funds sustained as a result of the subprime mortgage mess.
> With a series of bad bets on subprime bonds and arcane structured securities triggering the near-collapse of two Bear Stearns hedge funds, wide swaths of the $6 trillion mortgage-backed bond market have sold off sharply. In turn, it is believed that many investors - especially hedge funds, which can borrow over a dozen times their capital base - have seen their already lackluster performance shellacked.
>
> If the performance of subprime investors is as bad as expected, institutional hedge fund investors and the investment banks that loan funds money and clear their trades will be faced with investors' concerns over capital withdrawal, matched by the banks' need for better collateral and reduced exposure.
>
> With a fear of lawsuits for breach of duty and a lack of faith in the quality of the loans backing the subprime mortgages, there could be little incentive to ride out the storm.

Deepening debt crisis hits close to home

> Once that insurance is breached, two very bad things happen.
>
> First, the investors who elected to buy the equity tranche, attracted by the possibility of an equitylike return on a fixed-income investment, get killed. And unfortunately, those big losses won't be limited to Wall Street or to the sophisticated investors in hedge funds.
>
> Hedge funds bought about 10% of equity tranches in 2006, according to Bear Stearns. But pension funds bought more -- 18%. Insurance companies bought even more -- 19%. And asset managers bought even more -- 22%. When pension funds take big losses, parent companies have to make up the loss or workers have to take smaller pensions. When insurance companies take the loss, insurance rates go up. When asset managers take the loss, well, we all cry when we open our monthly mutual-fund statements....
>
> ....And second, after the insurance is stripped away, the prices of higher-rated slices of the debt pool start to tumble to reflect that greater risk. That's the worry facing the market right now. Merrill Lynch's (MER, news, msgs) attempt to auction off the collateral from the sinking Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Fund revealed that the market is well beyond the 5% price drop that Grant's Interest Rate Observer pegged as a danger point. Merrill Lynch succeeded in auctioning off some collateral at 90 or 95 cents to a dollar, but other collateral didn't sell at all, even at discounts of more than 50%.
>
> Last year, global sales of CDOs hit $503 billion. In 2006, sales of CLOs broke $150 billion. We've just started to see a massive re-pricing of all the debt in those massive pools.

Picture the domino effect

> You don't have to look far for signs of the speculative excess that marks the climactic phase of a raging bull market. With the notable exception of the world's stock markets, there is hardly an asset class that has not been caught up in a breathtaking investment frenzy.
>
> Nowhere has greed overtaken fear in a more cavalier fashion than in the credit markets, where the compensation for risk has shrunk to negligible proportions. The recent failed auction of assets seized from two failed Bear Stearns hedge funds showed that the pricing of debt long ago lost touch with what anyone might actually pay.

Credit crash fears surround debt whirlpool

> Could the fallout from hundreds of thousands of dodgy home loans given to poor people in the US cause a global credit crash? That question is being openly discussed after the near collapse of two big hedge funds run by the Bear Stearns investment bank.
>
> The funds are exposed to about $4 billion in toxic debt after they bought the risk of the home loans going bust in the secondary market through collateralised debt obligation.
>
> The worry is not that the two particular funds will go under but that the near collapse has exposed the ripple effects beyond the poor people who took the loans and the companies who made the loans into the secondary market.
>
> According to research published in the Wall Street Journal this week, there is $1.8 trillion debt in the secondary market. There are concerns that the figure is the tip of the iceberg in that market for people buying and selling the risk of default as the banks try to minimise their exposure.

The Rating Game Scam

> > You'll see massive losses from banks, insurance companies and pension managers," said Joshua Rosner, a managing director at investment research firm Graham Fisher & Co. in New York and co-author of a study last month that said S&P, Moody's and Fitch understate the risks of subprime mortgage bonds. "The longer they wait, the worse it's going to be.
>
> Mish comment: Corporate America always puts off until the bitter end anything and everything that looks smells or tastes like medicine, no matter how sick the patient is and how badly the medicine is needed. The reason is simple: short term profits are at stake and the greed and fees to be made by protecting improper relationships is simply too overwhelming.

Home Values Slashed in Half? The Housing Bubble Is About to Burst

> House prices will not collapse to nothing like the most ridiculous of the Internet stocks, but homes in the most-inflated markets could lose 30 to 50 percent (in real terms) from

their bubble peaks. Some people bought homes in these markets expecting to make great returns on their investments. Perhaps these people deserve their fate.

However, many homeowners followed the advice given to them by Realtors, politicians and financial advisors, and were simply pursuing the American Dream of homeownership. When the wreckage from the real estate bubble becomes clearer, these "experts" will have much to answer for.

Fannie, Freddie could have big subprime exposure-analyst

The continued writedown of subprime assets could hurt the two government-sponsored enterprises even though they hold highly rated mortgages, according to a report from Federal Financial Analytics in Washington.

"Looking only at their non-AAA positions, a writedown of 15 percent to 30 percent would mean a $1.8 billion to $3.6 billion hit for Fannie and a $1.5 billion to $3 billion hit for Freddie," the report said.

Neither government-sponsored enterprise has much of a cash reserve against losses of that size, and covering those costs could push the companies' capital below the levels agreed to with their regulator.

'Sub-prime Chernobyl': So gold has to be hit hard

The United States faces a severe credit crunch as mounting losses on risky forms of debt catch up with the banks and force them to curb lending and call in existing loans, according to a report by Lombard Street Research.

The group said the fast-moving crisis at two Bear Stearns hedge funds had exposed the underlying rot in the US sub-prime mortgage market, and the vast nexus of collateralised debt obligations known as CDOs.

"Excess liquidity in the global system will be slashed," it said. "Banks' capital is about to be decimated, which will require calling in a swathe of loans. This is going to aggravate the US hard landing."

Managers: Subprime Blame Lies With Rating Agencies

Robert Rodriquez, chief executive officer of First Pacific Advisors, was even more blunt. "We haven't seen much of a problem in the subprime area [but only] because the pricing is a fraud; the ratings are bullshit," said the two-time recipient of Morningstar's Fund Manager of the Year.

"I don't buy these prices, but as long as someone can provide capital to keep the finger in the dike, the charade will go on."

Rodriguez concurs with Gundlach that rising subprime mortgage delinquencies are a problem not just for hedge funds but also for major banks and other financial institutions.

"It is estimated that U.S. banks have invested 10% of their assets in collateralized debt obligations," he said. "And 40% of the CDOs are in subprime mortgages. I'm trying to get details on the components and I can't get any. This is setting up the next catastrophe."

[Moody's, S&P fell for 'hooker heels']

MOODY'S Investors Service and Standard & Poor's were duped by the make-up and "six-inch hooker heels" of CDOs (collateralised debt obligations) on which they gave investment-grade ratings, and investors now stand to lose all their money.

This is the view of Bill Gross, manager of the world's biggest bond fund.

Sub-prime mortgage bonds made up about $US100 billion ($119 billion) of the $US375 billion of CDOs sold in the US in 2006, Moody's and Morgan Stanley data show. CDOs are created by bankers and money managers who bundle together debt securities and divide them into slices with varying credit ratings.

With defaults on those sub-prime loans rising, buyers of the BBB pieces of some CDOs stood to lose their entire investments, said Mr Gross, chief investment officer at Pacific Investment Management Co. He manages the $US103 billion flagship Pimco Total Return Fund in Newport Beach, California.

[Grim worldview from the deck of the Titanic]

Like the allegory, I look to our leaders and wonder if they are clueless. But the fact of the matter is they know everything we know and much more.

I believe that most politicians know the awful truth confronting us but refuse to do anything about it as it will cost them their jobs. They hope to safely navigate through the ice field, fingers crossed. If this is the case, our leaders have failed us: It is their responsibility to lead us down certain paths, regardless the pain, if circumstances demand it.

[Will environmental lobby curb interest in gas line?]

Some wonder whether any company will offer to build the gas line from Prudhoe Bay, not for fear of rising construction costs but for fear of the cost of the political clout needed to obtain construction permits.

A strong new industry has sprouted up to oppose development of any kind in Alaska. It's the professional environmentalists - the Sierra Club, the Alaska Coalition, the Wilderness Society, the Southeast Alaska Conservation Council and others. One of the newest and most influential is the Alaska Wilderness League.

Superpower? Really?

> The Washington Post (May 8, p.D1): "Joseph E. Stiglitz [Nobel winner in economics] ... co-authored a study that predicts the Iraq conflict alone will eventually cost taxpayers more than $1 trillion, counting military rebuilding and health care for wounded veterans." Incredibly, we haven't paid for any of this yet. The Post article noted, "The war bill is going directly on the nation's credit card." Foreign investors, especially China, have been paying for this war.
>
> Now why would they do that? The answer: It's in their strategic interest to finance a war that drains America's financial, military, and leadership clout. They're paying for us to screw ourselves. It saves them the trouble. However, given the irresponsibility of America's military adventures and the equal irresponsibility of the American electorate in elevating someone like George W. Bush to power, why would China and the other investing nations finance the rebuilding of America's military might? How could that possibly be in their interest especially now that the euro has overtaken the dollar as a viable medium for world exchange? Hence China and others are making obvious moves to invest differently. We're about to be left behind.

Dirty bomb would cause panic, cost billions: Study

> A new federal study says the explosion of a small dirty bomb near the CN Tower would spew radioactivity over four square kilometres, resulting in mass anxiety, a rush on Toronto's medical facilities and an economic toll of up to $23.5 billion.
>
> The nightmarish scenario – detonation of a device containing a modest amount of americium-241, a silvery plutonium byproduct – is among several sobering projections quietly mapped out by federal officials to prepare for a terrorist attack in urban Canada.