Energy Insider by John Hoefle

Oil industry girds for depression

The oil price collapse means that very few of the Texas bank loans that were already a problem last year, will pay anything this year or next.

By oil industry standards, Sheikh Yamani's prediction of April 22 that oil prices would take two years to return to $28 per barrel must have sounded like cockeyed optimism. The "Seven Sisters" are chopping off both capital spending and personnel, on the assumption that oil prices will stay depressed indefinitely.

Exxon has adopted a policy of voluntary departures and early retirements to reduce its workforce by as much as 10% worldwide. One analyst estimates layoffs in the Houston area at 1,500, of a total local workforce of 15,000.

A letter from company president Randall Meyer reads, "The successful adaptation of our strategies and activities to the new business conditions will unfortunately require a significant reduction in staff. This has been a painful decision, but circumstances left us little choice."

Exxon had earlier announced a $2.8 billion reduction in planned 1986 capital expenditures.

Meanwhile, Shell and Exxon have abandoned a $3.8 billion North Sea oil project, blaming lower oil prices.

Analysts said it would be only the first of many. Alex Salmond, energy economist at the Royal Bank of Scotland in Edinburgh, told Reuters news service on April 23, "Clearly, if current levels become the basis for future expectations, all new fields will be in jeopardy.'" The scheme in question, the Gannet project, is not economical at a price of less than $20 per barrel.

The Geneva meeting of Organization of Petroleum Exporting Countries (OPEC) oil ministers which concluded on April 22 produced a brief rally in the oil futures market, but prices remain below the $13-per-barrel level—the point of no return for Alaskan oil, which represents 30% of all domestic U.S. production.

However, the non-results of this Geneva meeting, repeating the conclusion of the last three OPEC meetings, point prices downward, toward the single-digit range.

OPEC ministers failed to reach unanimity in their proposal for a new oil output ceiling. They split 10-3 in favor of a production ceiling of 6.3 million barrels per day in the third quarter of 1986, and 17.28 in the final quarter. This is not significantly greater than OPEC's current official—but widely ignored—ceiling of 16 million barrels per day. As usual, Iran, Libya, and Algeria were the dissenters.

EIR's earlier warning that the oil price crash could knock 7% off the Federal Reserve's industrial production index is bearing out, in the two months of consecutive production declines reported by the Federal Reserve for February and March.

The disaster in the oil belt, visible in layoffs and production declines, has not yet shown up in the balance-sheets of Texas banks, whose entire $200 billion deposit base is now in danger.

However, figures for the banks' bad loans as of December 1985 demonstrate, once again, that they are in no shape to withstand the present shock.

The top six Texas banks have an average of 44% of their non-performing loans set aside as loan-loss reserves, up from 36% at the end of 1985.

That is a disastrous sign: The collapse of oil prices means that very few of the loans that were already a problem last year, will pay anything this year or next.

But the Texas banks have not had the profits with which to cover their existing portfolio of troubled loans with loss reserves, let alone set aside reserves for new problem loans.

To indicate how far out of line the Texas banks are, the 1985 year-end ratio of loan-loss reserves to total problem loans for U.S. banks as a whole was 53%.

More disaster news is piling up in reports in *EIR*'s Houston bureau. More than 23,000 Houston families walked away from their home loans over the past two years, prompting talk among mortgage lenders about getting tough, warning that civil suits might be filed against defaulters.

However, this is mostly noise, since the lenders admit that most people walked out because they were broke.

Home prices in Houston, using 1979 as a base, were up 57% in 1982, but dropped to 27% in 1985, that is, 30% below the 1982 level.

Actual foreclosures jumped from 89 in 1981 to 1,829 in 1986, while posted foreclosures jumped from 400 to 3,097 during the same period.

Nonetheless, the Office of Management and Budget has given Congress a "very, very preliminary" estimate that the oil price collapse will cut the deficit by $10 billion, through higher economic growth—even though the federal government's direct loss, in the form of lower windfall profit taxes, will be several times the supposed savings.