



Written by [Bob Adelman](#) on January 13, 2015

Impacts of Lower Crude Oil Prices Continue to Spread

After oil forecaster Jeremy Warner got lucky last year when he accurately called the top in oil prices, with a fall to at least \$80 a barrel, he doubled down by predicting “that the oil price will remain low for a long time, sinking to perhaps as little as \$20 a barrel over the coming year before recovering a little.”

Warner got lucky once again when Goldman Sachs [confirmed his prognosis](#), setting off an eye-popping five percent decline in oil to \$45 a barrel which continued into Tuesday. Tuesday’s low was \$44.20. As Goldman Sachs noted, “We believe this bear market will likely be characterized by more of a U-shaped recovery in which markets take longer to recover and will likely rebound to far lower prices [than] where they sold off from.”

The investment banking firm predicted that oil would fall to \$41 in three months (by April), and then to \$39 in six months (by July) before recovering slightly to \$65 by the end of the year.

The shrinkage in the oil patch is accelerating, with rigs being idled to the point where those remaining will only be sufficient to maintain current production levels. The immediate impact will be felt by those oil-producing states that have led the recovery from the Great Recession over the last six years. They include North Dakota, which is estimated to lose some \$11 billion in tax revenues in 2015, Wyoming with estimated losses approaching \$1.5 billion, Alaska losing more than \$6 billion, and New Mexico to lose more than \$2 billion this year. In just those five states, lost revenues due to oil’s price decline are expected to exceed \$21 billion, according to Richard Barrington, the senior financial analyst for MoneyRates.

The decline is also putting pressure on oil-producing countries such as Venezuela, Iran, UAE, and Russia, who need high oil prices to balance their budgets. Venezuela needs \$117 a barrel, while Iran needs \$130 barrel. The United Arab Emirates (UAE) needs oil at \$77 a barrel to stay solvent, while Russia must have oil at \$98 a barrel.

Saudi Arabia, the primary instigator behind oil’s sharp decline, must have oil at \$106 a barrel, but it is prepared to go negative and stay negative for years, if necessary, to accomplish its purposes: inflict massive pain on Russia and especially on its arch-rival Iran. With an estimated \$750 billion in foreign reserves, it hopes it will be able to outlast its rivals and eventually regain its position as the world’s “swing producer.”

Although the Saudis and the Obama administration share common “enemies” in Syria and Iran, the U.S.-Saudi relationship was strained when Obama made secret nuclear negotiations with Iran in 2012





Written by [Bob Adelman](#) on January 13, 2015

and reneged on his pledge to launch military strikes against the Assad regime in Syria. As Nawaf Abaid, a scholar at Harvard University's Belfer Center, noted carefully: "The Saudis will remain America's most important strategic partner in the Middle East but not its closest."

Major banks are also feeling the pain of lower oil prices. Nearly 15 percent of Wells Fargo's investment banking fees last year came from the oil and gas industry, with Citigroup not far behind with roughly 12 percent. And investment bankers are having extraordinary difficulty in selling a billion dollars in oil loans to investors. Morgan Stanley, the leading underwriter of \$850 million in loans to Vine Oil and Gas, still holds much of it in inventory, being unable to find investors. Goldman Sachs and UBS did a joint underwriting of \$220 million to fund the purchase of Express Energy Services, much of which also remains on their shelves.

The pinch on banks will be two-fold as oil prices continue to decline: not only with existing loans, especially those of marginal, high-cost producers, but also as the value of the collateral underlying those loans continues to diminish as well.

And junk bonds are now anathema, as many of them are likely to turn out to be worthless. Martin Fridson, chief investment officer at Lehmann Livian Fridson Advisors, is predicting that at least six percent of junk bonds will default this year, with more to follow next year. He said: "As far as the high-yield market is concerned, the energy sector is in a recession."

About the only oil-producing country that is happily side-stepping the crash in oil prices is Canada, known for its vast reserves of oil-rich tar sands. The *Wall Street Journal* called oil-sands development the "unloved stepchild" of unconventional oil production, partly because of its remote location in northern Alberta and partly because its crude requires massive pipelines and expensive refining to bring finished product to market. Its primary redeeming feature, however, is its long-term development outlook.

Tar-sands development requires massive amounts of capital, but once in place the oil fields take decades, not months or years, to play out. That's why, on Monday, when oil prices dropped five percent, Canadian Natural Resources announced that it expects its capital spending to expand along with its overall output.

There's another reason Canada is exempt from the oil price turmoil: Once those fields are developed, the marginal cost of turning product into crude is less than \$30 a barrel. As Cenovus Energy CEO Brian Ferguson explained, "It's not well understood just how robust the oil sands are. If you stopped expansion of the oil sand tomorrow you would have no decline in the production base for decades. What we do is design for 30-year flat production lives." And as Steven Williams, CEO of Suncor Energy, another Canadian oil sands developer, put it, "We are able to take the perspective of pricing in decades," rather than in days or months.

The most optimistic view taken by industry observers is that the price of crude will hit a bottom sometime in the next few months and then rise to between \$65 and \$100 per barrel by the end of the year. More realistically, oil prices could go down further and stay down longer, squeezing out marginal producers, wreaking havoc among the members of OPEC, putting Iran and Russia into a severe negative cash flow situation, shrinking oil-producing states' incomes by billions and ending, temporarily at least, the remarkable job growth that has occurred there over the past several years. Wall Street will suffer at the margins, while junk bond investors will feel the pain. Banks serving the oil industry will be hard-pressed to stay profitable while those holding equity positions in the major producers are likely to



Written by [Bob Adelman](#) on January 13, 2015

watch their portfolios shrink even further.

Drivers will, however, will continue to enjoy ever-lower gas prices just in time for summer vacations and Canada will go marching on with their 30-year plans for oil sands development, scarcely being troubled by the passing parade of doomsters and naysayers.

A graduate of an Ivy League school and a former investment advisor, Bob is a regular contributor to The New American magazine and blogs frequently at www.LightFromTheRight.com, primarily on economics and politics.

Related article:

[Crude Oil Prices: The Politics, Implications, and Backlash](#)



Subscribe to the New American

Get exclusive digital access to the most informative,
non-partisan truthful news source for patriotic Americans!

Discover a refreshing blend of time-honored values, principles and insightful perspectives within the pages of "The New American" magazine. Delve into a world where tradition is the foundation, and exploration knows no bounds.

From politics and finance to foreign affairs, environment, culture, and technology, we bring you an unparalleled array of topics that matter most.



Subscribe

What's Included?

- 24 Issues Per Year
- Optional Print Edition
- Digital Edition Access
- Exclusive Subscriber Content
- Audio provided for all articles
- Unlimited access to past issues
- Coming Soon! Ad FREE
- 60-Day money back guarantee!
- Cancel anytime.