US airlines confront cheap oil's flip side: costly hedges

REUTERS, New York

Some major US airlines including Delta and Southwest are rushing to finance losing bets on oil and revamp fuel hedges as tumbling crude prices leave them with billions of dollars in losses, according to people familiar with the hedging schemes.

In theory, airlines are among the top beneficiaries of a six-month slump that halved crude prices to five-year lows. Oil is the biggest variable cost for airlines, often representing a third or more of their total operating expenses.

But now, carriers such as Delta Air Lines and even Southwest Airlines, known for a successful hedging program that locked in cheap fuel prices before they rose a decade ago, see some of the benefits of cheap fuel eaten away by hedging costs.

That is largely because they have used common but risky hedging strategies, among them a "costless collar": selling financial options that pay off when oil prices fall and using the proceeds to buy protection against soaring costs when prices climb, according to three people familiar with the programs.

The two carriers have been moving quickly to strategize how to meet demands from brokers and banks for additional collateral to cover potential losses from a strategy that made perfect sense just six months ago, those people said. The airlines have also held a series of meetings that included airline executives, brokers and consultants, according to the people, who declined to be named because of the sensitive nature of the discussions.

REUTERS/FILE

Delta Airlines planes wait on the tarmac at Hartsfield-Jackson International Airport in Atlanta, Georgia.

With oil prices tumbling faster and further than anyone had anticipated, the collar hedges left the airlines with insurance against high costs they no longer need and on the hook for protection they sold against a further slide, with potential liabilities on the rise.

Southwest spokesman Chris Mainz said the meetings were part of a routine, although a rapidly changing market called for close attention. "We continue to benefit from declining fuel prices," Mainz said in an email. "Obviously we're going to move faster when the price drops in the 40 percent range. (Our fuel team) have been very busy actively managing our portfolio to respond to the changes we are seeing in the market."

Delta spokesman Trebor Banstetter said the Atlanta-based carrier was not surprised by the slide, having been prepared to meet its financial obligations if needed.

Southwest, Delta and other carriers that sources declined to name, will benefit from the drop in oil prices because they hedge only a portion of the fuel they buy. Southwest, for example, expects to cover only 20 percent of its fuel consumption with hedge contracts this quarter.

Delta expects a \$1.7 billion gain from lower fuel prices in 2015, despite \$1.2 billion in estimated hedge losses. Yet rival American Airlines, which has not entered any hedge contracts since late 2013, are set to see a greater boost to their bottom lines.

Industry consultants say hedged airlines have a few choices to deal with the price slide, including selling forward positions on crude oil or jet fuel, changing the prices at which they hedge or selling assets, such as planes. What airlines exactly plan to do remains unclear, people familiar with the discussions said.

A lack of disclosure requirements makes it almost impossible to tell how or when airlines have hedged, and none would discuss details of their strategies.

Collar transactions looked well suited to the market when prices hovered around \$100 per barrel for most of the past four years, allowing airlines to cap their fuel costs at little or no cost, analysts said.

"(Costless) collars are an effective strategy that works best when prices stay within a range," said John Saucer, vice president of research and analysis, at Mobius Risk Group. "But it becomes a very different animal when the market goes against that."

In their October quarterly filings, Southwest and Delta said they used a mix of options and fixed-price swaps.

Southwest also explained that collar trades "carry more risk than purchased call options" because of possibly greater liability when the contracts expire.

The world's biggest low-cost carrier said that a 25 percent decline of crude prices from Sept. 30 would probably force it to pay \$615 million in cash collateral, aircraft collateral and letters of credit.

Delta said it would pay \$800 million to counterparties if oil fell 20 percent between Oct. 1, 2014 and Dec. 31, 2015. Brent LCOc1 already has tumbled 36 percent since then to trade at about \$60 a barrel on Monday.

China's shadow banking adapts and grows as rules tighten

REUTERS, Beijing

New players in China's shadow banking sector are growing rapidly despite attempts to clamp down on opaque lending, taking advantage of a regulatory anomaly to prosper but also raising the risks of a build-up of debt in the slowing economy.

Authorities have sought to rein in the riskiest elements of less-regulated lending after a series of defaults, including a 4 billion yuan (\$640 million) credit product backed by Evergrowing Bank in September, because of the danger such debts could pose to the health of the world's second-largest economy.

And a government measure created in 2011 to capture shadow banking, total social financing (TSF), shows some success, with shadow banking contracting in the second half of 2014 to roughly 21.9 trillion yuan (\$3.5 trillion), according to a Reuters' analysis of central bank data.

But that fails to capture as much as 16 trillion yuan (\$2.6 trillion) of financing mostly created in the past two years by firms overseen by the China Securities Regulatory Commission (CSRC) rather than the banking regulator, according to a Reuters calculation based on third-party statistics.

When including that financing, shadow banking is roughly equivalent to more than 45 percent of loans in the conventional banking system.

"We can observe this, but we don't have concrete statistics, so we're unclear on the scope," said Zeng Gang, director of the banking department at the Chinese Academy of Social Sciences, a think tank that advises the central government. Shadow banking is therefore harder to regulate, he said. Indeed, the State Council called on the central bank last December to develop new statistics to measure shadow banking.

In shadow banking's new incarnation, brokerages and fund management companies can pool retail investor funds or invest funds already gathered by a bank, acting as an intermediary rather than the actual investor.

Arab Opec sources see oil back above $70

REUTERS, Abu Dhabi

Arab Opec producers expect global oil prices to rebound to between \$70 and \$80 a barrel by the end of next year as a global economic recovery revives demand, Opec delegates said this week in the first indication of where the group expects oil markets to stabilise in the medium term.

The delegates, some of which are from core Gulf Opec producing countries, said they may not see - and some may not even welcome now - a return to \$100 any time soon. Once deemed a "fair" price by many major producers, \$100 a barrel crude is encouraging too much new production from high cost producers outside the exporting group, some sources say.

But they believe that once the breakneck growth of high cost producers such as US shale patch slows and lower prices begin to stimulate demand, oil prices could begin finding a new equilibrium by the end of 2015 – even in the absence of any production cuts by Opec, something that has been repeatedly ruled out.

"The general thinking is that prices can't collapse, prices can touch \$60 or a bit lower for some months then come back to an acceptable level which is \$80 a barrel, but probably after eight months to a year," one Gulf oil source told Reuters.

A separate Gulf Opec source said: "We have to wait and see. We don't see 100 dollars for next year, unless there is a sudden supply disruption. But average of 70-80 dollars for next year – yes."

The comments are among the first to indicate how big producers see oil markets playing out next year, after the current slump that has almost halved prices since June. Global benchmark Brent closed at around \$60 a barrel on Monday.

Their internal view on the market outlook will provide welcome insight to oil company executives, analysts and traders, who were caught out by what was seen by some as a shift in Saudi policy two months ago and have struggled since then to understand how and when the market will find its feet.

For the past several months, Saudi officials have been making clear that the Kingdom's oft-repeated mantra that \$100 a barrel crude is a "fair" price for crude had been set aside, at least for the foreseeable future. At the weekend, Saudi Oil Minister Ali al-Naimi was blunt when asked if the world would ever again see triple-digit oil prices: "We may not."

Saudi Arabia, the world's biggest exporter – and its close Gulf allies within the Organisation of the Petroleum Exporting Countries (Opec) – say it's time for others, whether that is countries like major exporter Russia or US shale drillers, to slow down; Opec can no longer slash output, ceding market share, to spare them a downturn.

As Naimi told the Middle East Economic Survey (MEES) in an interview this weekend: "It is not in the interest of Opec producers to cut their production, whatever the price is."

Without Opec to defend prices, oil entered a free-fall, but most of Opec's members are holding fast.

At this point, intervening in the market would simply invite new rivals to carry on pumping crude, eroding Opec's market share without any guarantee of a sustained price recovery, another Arab oil source told Reuters on the sidelines of a meeting in Abu Dhabi of the Organisation of the Arab Petroleum Exporting Countries (OAPEC).

"Every time prices fall, we would be asked to cut," the source said.

The second Gulf Opec source reiterated that Opec would not cut alone. Non- Opec producers such as Russia, Mexico, Kazakhstan and "anyone producing more than one million barrels per day" should also cut or at least freeze their output if they wanted a stable market and better prices, the Gulf Opec source said.

Air China buys 60 Boeing aircraft for $6b

BBC NEWS

China's national airline, Air China, is to buy 60 Boeing 737 aircraft in a deal worth more than \$6bn (£3.8bn) at list prices.

The aircraft will be delivered between 2016 and 2020, according to a regulatory filing by the airline.

The deal includes Boeing's "next generation" 737 and 737 MAX aircraft, known for their fuel efficiency.

In September, the world's biggest aircraft maker delivered the first of its seven 747-8 aircraft to Air China.

"We are excited to see that the 737 family will play a significant role in Air China's continued success," said Ihssane Mounir, Boeing's Northeast Asia vice president of sales and marketing in a statement.

In October, rival Airbus announced plans to open a second manufacturing plant in China in an attempt to boost sales of its A330 jetliner in the world's fastest growing aviation market.

Boeing, meanwhile, said in September that China would need more than 6,000 aircraft in the next 20 years as the leisure travel market booms in the world's second largest economy.

Apple pushes first ever automated security update to Mac users

REUTERS, Boston

Apple Inc has pushed out its first-ever automated security update to Macintosh computers to help defend against newly identified bugs that security researchers have warned could enable hackers to gain remote control of machines.

The company pushed out the software on Monday to fix critical security vulnerabilities in a component of its OS X operating system called the network time protocol, or NTP, according to Apple spokesman Bill Evans. NTP is used for synchronizing clocks on computer systems.

The bugs were made public in security bulletins on Friday by the Department of Homeland Security and the Carnegie Mellon University Software Engineering Institute. Carnegie Mellon identified dozens of technology companies, including Apple, whose products might be vulnerable. When Apple has released previous security patches, it has done so through its regular software update system, which typically requires user intervention.

The company decided to deliver the NTP bug fixes with its technology for automatically pushing out security updates, which Apple introduced two years ago but had never previously used, because it wanted to protect customers as quickly as possible due to the severity of the vulnerabilities, Evans said.

"The update is seamless," he said. "It doesn't even require a restart."

Apple does not know of any cases where vulnerable Mac computers were targeted by hackers looking to exploit the bugs, he added.