FINANCIAL TIMES

Warnings over oil debt are getting louder

By Dan McCrum

Banks have been cutting exposure to the industry and conversations about borrowing will get tougher

Identify this very large industry: it has about $2.5tn of debt outstanding, a good chunk of which is considered junk by the credit rating agencies. About half the debt is American, and about half the $2.5tn is owed to banks in the form of loans. Oh, and the price for the industry's main product has fallen by more than a third in the past 12 months.

Lenders who support the oil industry can take some comfort from a recent recovery in the price of crude, with debt prices rebounding since January. As the oil price decline only became a rout in November, perhaps swift recovery can be rationalised as well. Most companies that suck oil out of the ground agree a price for their product well in advance, so it is sold today at last year's prices, giving indebted companies some time to adjust.

Still, few sold their 2016 production two years early and they are now having to talk to lenders about their rolling credit facilities, which are part of the $1.2tn of outstanding oil industry loans identified by credit strategists at UBS.Such "bank revolvers" tend to be agreed every 6 months, in April and October. Early this year, a price of $100 a barrel did not seem so distant, but banks have been cutting exposure to the industry and the autumn conversations are likely to be tougher.Those who assess oil borrowers have started to sound warnings as well. Credit rating agency Fitch has said defaults start to appear about nine to 12 months after price declines begin. Moody's last month predicted default rates for exploration and production companies (responsible for a third of the debt total) will rise from 3 per cent in March to 7 per cent next year. UBS thinks defaults could be twice that rate, in which case the spread between energy debt and the high yield index might be expected to double, from about 150bp to about 300bp.

High yield debt markets remain generally sanguine. The price of non-oil related US debt rated triple C, for instance, implies a similar environment to the 2004 to 2007 period, when corporate failures were rare. Yet remember the industry number above. The stock of energy related debt is a big one, accounting for about a fifth of the index. It may be worth trying to guess the effect.

dan.mccrum@ft.com