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Family Finances Key for Fed

If the Federal Reserve tightens policy too soon, it may risk putting the squeeze on U.S. consumers.

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Fed policy makers meet Tuesday and Wednesday, and with the economy shrugging off the tough winter, the world looks a little different from when they last gathered. There have been two consecutive jobs reports showing an unemployment rate of 6.3% versus the 6.7% seen at the Fed's April meeting. Inflation, while low, has picked up. Measures of financial conditions, ranging from credit spreads to stock-options prices, have gotten easier.

Taken alone, those would argue for policy makers stepping up plans for raising the target for overnight rates, perhaps sooner than in mid-2015 as markets expect. But U.S. households' balance sheets still are in a precarious enough state that, absent a good deal of improvement in their income outlook, raising rates could stifle spending more than the Fed is prepared for.

To judge by how much their debts are cutting into their paychecks, Americans' finances are in fine condition. The household debt-service ratio -- interest and debt payments as a percentage of after-tax income -- fell to 10% last year from a 2007 peak of 13.2%, putting it at its lowest level since the Fed began tracking it in 1980. To some extent, that reflects progress people have made toward working off their debt (sometimes through walking away from it) since the financial crisis. Indeed, the level of household debt to income, at 103% in the first quarter, was down substantially from its 2007 peak of 130%.

But that only brings it back to where it was at the end of 2002 -- a level that, with the debt people took on to keep spending through the 2001 recession, seemed high at the time. So much of the drop in the debt-service ratio is a function not of lower debt levels, but lower interest rates. There has been a huge amount of mortgage refinancing activity over the past five years. Rates on new auto loans and credit cards are at their lowest levels in years.

With debt levels still high, rate increases could pack more punch. The way out is for wage growth to increase to the point it can support spending through higher rates. Until then, the Fed may opt to hang loose.

-- Justin Lahart

Woodside Investors Win

Woodside Petroleum is finally coming out of its shell.

Royal Dutch Shell said Tuesday it is selling most of its shares in Woodside for $5.7 **billion**, reducing its **stake** in the Australian gas producer from around 25% to 4%. The deal, which involves Shell selling part of its holdings to institutional investors and part to Woodside in a share buyback, finally removes a nasty overhang for investors in Woodside.

An attempted full takeover of Woodside by Shell was blocked way back in 2001 by Australian regulators on national-security grounds. Shell has been unhappy to be stuck with a large **stake** and no chance to take full control. Speculation about when Shell would sell has weighed on Woodside shares since. It sold a 10% chunk in 2010.

The stake Shell is selling to institutional investors was priced at a small discount to Woodside's last trading price before shares were halted, which happens to be near a three-year high. Woodside, meanwhile, will buy back the other slug of Shell shares, representing 9.5% of the company, at a 15% discount.

Given Woodside's high levels of cash and few prospects for investing the money since abandoning the Israeli Leviathan gas project last month, it is $2.7 billion wisely spent.

Some Woodside investors have groused that the share buyback, which also comes with tax benefits, is only on offer to Shell. The consolation is that for investors who hang on, the reduction in share count should boost cash returns. Assuming payout ratios stay the same, Macquarie Group estimates the deal will add 7% to earnings per share in 2015, bumping up the dividend yield that year from 6.9% to 7.6%.

But even with Shell departing its shareholder register, Woodside's main long-term problem remains: finding fertile new patches to drill as its existing production plateaus.

The company has said it is interested in doing deals up to $5 billion. After spending cash on the Shell share buyback, a big acquisition still seems manageable. Woodside's net debt to equity after the deal will likely be under 25%. Given the strong cash flows from its Pluto gas field and recent share-price performance, the company is well positioned to be opportunistic.

Woodside investors should be pleased to have Shell out of the way. Now the company must show it can find new projects to support its buoyant share price.

-- Rebecca Thurlow

Anton Follows China Into Iraq

Iraq once again has the U.S. vexed, though China's oil industry might also want to pay heed this time. China's growing dependence on Middle Eastern oil means turmoil there can hit its companies -- in particular, a Hong Kong-listed oil-services firm.

With more than half China's oil imports coming from the Middle East, the world's biggest net oil importer cares about protecting its supplies, including from Iraq. China bought about 30% more Iraqi crude oil this year through April compared with the same period a year ago, even as imports from Saudi Arabia fell, according to Amrita Sen at Energy Aspects, a London-based consultancy. That explains why China's state-controlled energy firms made Iraq one of the largest recipients of overseas investment last year, according to data from Sanford C. Bernstein's Neil Beveridge.

These state giants, in turn, have taken Chinese services firms abroad with them. Iraq has already become the top overseas market for Anton Oilfield Services, accounting for 16% of its total revenue last year.

Anton's southern Iraqi fields so far haven't been affected by the battles in the north. But if trouble spreads, Anton's existing revenue and growth may be affected. Anton relied on overseas markets for 48% of new contracts in the first quarter, as antigraft investigations into China's local industry slowed local business, according to Credit Suisse.

Anton investors have other reasons to worry. The company has expanded buying of drilling rigs and pressure pumps, instead of leasing them, making its asset-light model a great deal heavier. Capital spending tripled last year and pulled down return on invested capital to 11.6%, when its more conservative rival SPT Energy Group returned 16.8%.

China has pushed its state-controlled energy giants toward shale gas exploration, which in theory should boost oilfield services, since the country's tough geology invites the kind of specialization the sector excels in. It is unfortunate, then, that 30% of Anton's revenue currently comes from a geologically simpler basin that invites competition, Mr. Beveridge said.

Investors following Beijing's shale lead sent Anton shares up nearly 350% from mid-2012 before they leveled off. Industry multinational Schlumberger buying 20% of Anton helped validate the Chinese upstart in the eyes of global investors, too. The shares have shrugged off Iraq concerns and now command 19.6 times earnings for the next 12 months. In contrast, global peers trade in the mid-teens.

Anton's stock has little room for error. Investors should watch out that Iraqi chaos doesn't tip it into quicksand.

-- Abheek Bhattacharya

CO fed : Federal Reserve Board | rnlp : Royal Dutch Shell PLC

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