Financial Aspect of Crisis Far From Over

[This is an article I forwarded to friends on Feb. 23, 2009, along with my own summary of it. –S.H.]

Hi everybody,

The article appended below contains some technical stuff about the LIBOR spread, and such, but also some very telling comments indicating that there is a growing recognition among the bourgeoisie itself that the financial crisis which struck in a major way last fall is by no means over.

Of course we Marxists understand that the financial crisis is an epiphenomenon of the underlying crisis in the "real economy" (arising from the contradictions inherent in the capitalist system of production, especially the fundamental contradiction between social production and private appropriation). But it is certainly true that the financial crisis is also an extremely serious aspect of the crisis as a whole.

A few of the highlights for those who don't wish to read the whole article:

1) Certain technical indicators, such as the LIBOR (London InterBank Offering Rate) spread, despite some improvement since last fall, still indicate tremendous uncertainty and fear in the world financial markets.

2) The widespread and growing expectation that the financial crisis will continue for at least another year or two.

3) The comments by several people in this sphere that the situation in this crisis is still "far worse than many people realize", despite all that has already happened.

4) The suggestion that financial markets are so fragile that we may yet soon return to panic conditions as bad as, or worst than, last fall.

5) The statement that "U.S. financial losses may reach $3.6 trillion, suggesting the banking system is 'effectively insolvent'". That is, NOT just a few of the big banks are insolvent, but *the financial system as a whole!*

6) And this *despite the fact* that the U.S. has already spent or pledged at least "$9.7 trillion" to try to combat the financial crisis.

7) The growing recognition that it may be necessary to "nationalize" the big banks for a while (in order to have the government assume and eliminate all their bad debts before selling the banks back to private corporations for a song).

In earthquake terms, folks, it really does seem quite certain that this crisis is the "Big One" that many of us have been expecting for decades. The bourgeoisie is obviously floundering in its attempts to resolve it (despite all the trillions of dollars), and things are continuing to get worse and worse. And that goes for both the financial crisis and the overall crisis of the real economy.

Scott

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Greenspan's Libor Barometer Shows Markets Stay Frozen (Update3)

By Gavin Finch and Liz Capo McCormick

Feb. 23 (Bloomberg) -- For all the $9.7 trillion pledged by the U.S. to combat the financial crisis, money markets show the world's biggest banks see no recovery before 2010.

The premium banks charge each other for short-term loans, the so-called Libor-OIS spread, rose above 1 percentage point last week for the first time since Jan. 9. Contracts traded in the forward market indicate the gauge, which measures banks reluctance to lend, will remain higher for the rest of the year than before Sept. 15, when the bankruptcy of Lehman Brothers Holdings Inc. froze credit markets.

"Libor-OIS remains a barometer of fears of bank insolvency," former Federal Reserve Chairman Alan Greenspan said in an interview. "That fear has been substantially reduced since mid-October, but the decline has stalled well short of any semblance of normal markets."

The lack of lending between banks helped send the U.S. economy into a recession and may delay any recovery. Turmoil in money markets stoked last year's tumble in stocks and fueled demand for the relative safety of Treasuries, gold and Japanese yen. Since Lehman collapsed, the Standard & Poor's 500 Index lost 35 percent, 10-year Treasury yields fell below 3 percent, gold topped $1,000 an ounce and the yen climbed 12 percent.

"The fundamental outlook hasn't changed," said Jay Mueller, who manages about $3 billion of bonds at Wells Fargo Capital Management in Milwaukee.

Bank Nationalizations

The Fed's quarterly Senior Loan Officer survey released Feb. 2 found that more than 65 percent of banks restricted lending the previous three months even as they received about $200 billion of taxpayer funds from the government.

U.S. gross domestic product probably shrank 5.4 percent in the fourth quarter, the biggest contraction since 1983, according to the median estimate of 60 economists surveyed by Bloomberg. Moody's Investors Service says corporate defaults may rise to 16.4 percent by November, the highest since the Great Depression and about three times the current rate.

After taking about $1.1 trillion of writedowns and losses since the start of 2007, the financial system remains so troubled that the government may have to nationalize some banks for a short time, Senate Banking Committee Chairman Christopher Dodd said.

“I don’t welcome that at all, but I could see how it’s possible it may happen,” Dodd, a Connecticut Democrat, said in a Feb. 20 interview on Bloomberg Television’s “Political Capital with Al Hunt.”

Not ‘Normal’

Citigroup Inc., the recipient of $45 billion in U.S. government aid, is in talks with federal officials that may increase state ownership of the bank, the Wall Street Journal said today, citing people it didn’t identify.

The stress is all reflected in the Libor-OIS spread, which measures the gap between the London interbank offered rate in dollars for three months and the overnight index-swap rate, or what traders expect the Fed’s target rate for overnight loans between banks to average over the term of the contract.

That spread averaged 0.11 percentage point between December 2001 and July 2007, before shooting to 0.73 percentage point the next month as losses from investments tied to subprime mortgages accelerated.

After Lehman filed for bankruptcy, the measure soared to 3.64 percentage points from about 0.87 percentage point as lending between banks seized up on concern more firms would collapse. While the spread has narrowed, Greenspan, the chairman of the Fed from August 1987 to January 2006, said in June he won’t consider markets back to “normal” until Libor-OIS falls to 0.25 percentage point.

Loss Forecast

Contracts traded in the forward market show traders expect the spread to narrow to 0.87 percentage point by December, according to data compiled by Tullett Prebon Plc, the second- biggest broker of transactions between banks, after ICAP Plc.

The difference between three-month dollar Libor and the Fed’s target rate for overnight loans reached a record 3.32 percentage points on Oct. 10, before narrowing to 1 percentage point today. It averaged 0.16 percentage point in the seven years to August 2007. Three-month Libor was unchanged at 1.25 percent today.

“We are nowhere near the levels that you’d want to see to indicate a well functioning banking system,” said Jeffrey Caughron, associate partner in Oklahoma City at The Baker Group Ltd., which advises community banks investing $20 billion of assets. “People still don’t get it in terms of how bad things are in the domestic and global economies.”

Public Funds

U.S. financial losses may reach $3.6 trillion, suggesting the banking system is “effectively insolvent,” New York University Professor Nouriel Roubini, who in January 2007 predicted the economy was headed for a “hard landing,” told a conference in Dubai on Jan. 20.

The administration of President Barack Obama will have to use as much as $1 trillion of public funds to bolster the industry, Roubini estimates. Obama’s $787 billion stimulus measure was enacted into law this month, bringing the amount pledged by the U.S. to bolster the economy to $9.7 trillion. Obama’s plan, one of the biggest economic-rescue efforts in U.S. history, includes tax breaks for individuals, aid for struggling homeowners and cash to revive cities and create jobs.

“We’re in a state of acute stress,” said Jan Misch, a trader in Stuttgart at Landesbank Baden-Wuerttemberg, Germany’s biggest state-owned lender. “Sentiment is extremely sensitive and fragile and it’s not going to take a big shock to shut down the money markets again.”

Debt Sales

Credit markets are showing signs of improving even as bank lending remains stalled. U.S. companies sold $226 billion of bonds in 2009, up 45 percent from the same period last year, according to data compiled by Bloomberg. Roche Holding AG, Switzerland's biggest drugmaker by sales, issued $16 billion of bonds last week to finance its bid for Genentech Inc. in the second-largest corporate debt offering, the data show.

Assets on the Fed's consolidated balance sheet fell to $1.92 trillion on Feb. 19 from a peak of $2.31 trillion on Dec. 17, as financial institutions found funding in the private markets.

"Slowly but surely markets seem to be repairing themselves," said James Tyree, chief executive officer of Mesirow Financial Inc., the 72-year-old Chicago-based investment firm that manages $31.7 billion.

Investor optimism took a hit last week amid renewed concern about the health of the banking system after Moody's said it may lower credit ratings of banks with units in eastern Europe.

Markets Froze

The Libor-OIS spread widened 0.05 percentage point to 1.02 points. The S&P 500 Index fell 6.9 percent to 770.05, its biggest weekly drop in three months. Ten-year Treasuries rallied for a second straight week, pushing yields down 10 basis points, or 0.1 percentage point, to 2.79 percent as investors sought the relative safety of government debt. Gold surpassed $1,000 an ounce in New York for the first time in almost a year.

As money-markets froze last year, government bonds outperformed the S&P 500 by 53 percentage points, according to Merrill Lynch & Co. indexes, the widest margin since the bank started calculating fixed-income returns in 1978. Treasuries gained 14 percent, the most since 1995, according to Merrill Lynch's Treasury Master Index. They dropped 2.7 percent this year.

The Dollar Index that tracks the currency against six of the U.S.'s biggest trading partners rose 18 percent from June to the end of November, and has gained 6.5 percent to 86.583 this year.

"This is far more serious than people realize," Howard Simons, a strategist at Bianco Research LLC in Chicago, Illinois, said of the economy. "We're dealing in relative shades of worse right now."

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