The Finance Round-Up: October 23rd 2007

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Big banks continue to try to put together a rescue fund in order to avoid a firesale of the assets backing off-balance-sheet structured investment vehicles, but the voices of the critics who would like to see an 'orderly repricing' of these asets grow louder. Alan Greenspan , who now says the credit crunch was "an accident waiting to happen", is notable among them.

It remains to be seen how orderly such a repricing of such assets would be, as well as how broadly and how quickly financial contagion could spread the fallout.

UPDATE:

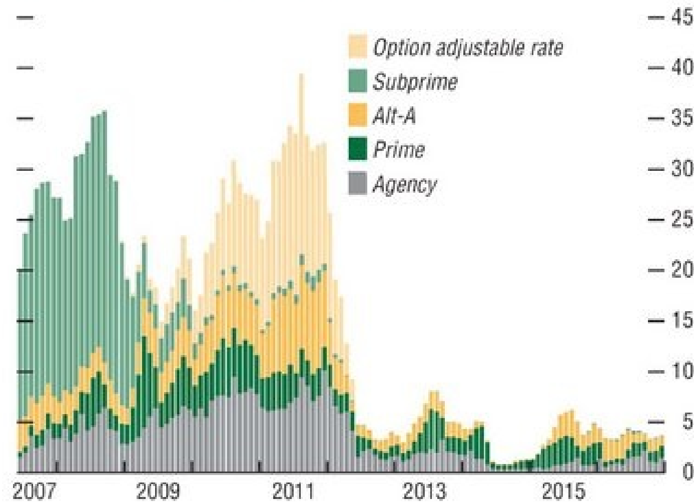
You Tube: The lighter side of the subprime fiasco from a British perspective

Give it up for the Long Johns

This 8 min. movie both explains subprime better than we could, *and* has us rolling off our chairs.

Don't miss it, it’s too funny!

IMF: Mortgage Reset Chart



[US loan default problems deepen]

The Financial Times is reporting that poor quarterly results from banks across the US over the past two weeks suggest credit problems once confined to high-risk mortgage borrowers are spreading across the consumer landscape, posing new risks to the economy and weighing heavily on the markets.

US banks have raised reserves for loan losses by at least $6 Billion over the second quarter and by even larger amounts from last year, indicating financial executives believe consumers will be increasingly unable to make payments on various consumer loans.
Banks are adding to reserves not just for defaults on mortgages, but also on home equity loans, car notes and credit cards debts.
“What started out merely as a subprime problem has expanded more broadly in the mortgage space and problems are getting worse at a faster pace than many had expected,” said Michael Mayo, Deutsche Bank analyst, reported the Financial Times.

“On top of this, there is an uptick in auto loan problems, which may or may not be seasonal, and there is more body language from the banks that the state of the consumer was somewhat less strong [than thought].”

Dick Bove, analyst at Punk Ziegel, said bank earnings indicated “there are problems with consumer debt that extend beyond the well-known issues in the real estate markets. Auto loans are clearly a new area of concern”. At Wachovia bank, credit card debt loss provisions more than doubled from the second quarter to $408m.

The Financial Times reports that across the US, banks are reporting debt troubles.

[People Still Asking for Nothing Down Loans: This Free Bus is Coming to a Stop]

Many people think that market demand has come to a screeching halt and it is a function of buyers not wanting to buy homes. You will be amazed at how many people are still willing to pay current market prices if only they could get someone to fund them a loan. We all know that demand has dropped off and prices are coming down. Is it because people suddenly do not want to buy? Is it because of current prices? Sometimes it is hard to separate cause and effect but in current high priced metro areas it is clear that mortgage funding is the primary reason why the spigot has turned off.

When you speak in generalities, you paint with a very broad brush. Are there people buying discounted homes with conservative mortgages and are doing perfectly okay? Absolutely. However, these are exceptions to a pervasive rule. For the past decade the rule was that buying a home required nothing out of your pocket. Everything was financed.That is why even in today's market where you can still get a loan with 5 percent down, a large part of the market has taken a walk because they have been weaned on this "everything in life is free" mentality.

Bankers saw crisis coming, but were powerless

The world's biggest bankers said Sunday their greed made them powerless to prevent the train wreck in credit markets, even though they recognized that markets weren't pricing the risk of subprime default appropriately.

"No one was surprised" by the meltdown of the U.S. subprime market and the resulting impact on credit markets, said Josef Ackermann, chairman of Deutsche Bank AG and chairman of the Institute of International Finance, a group of hundreds of major banks from all over the world that was set up 25 years ago in reaction to earlier financial crises. "We worried about these things."

The banks knew the dangers of buying and selling securities that were untethered to reality, but had to keep buying and selling them because of the pressure to keep profits growing, the bankers said.
"When do you want to stop taking the risks as long as so much revenue is being realized," Ackermann told journalists at the IIF annual meetings, which are occurring simultaneously with the annual meeting of the International Monetary Fund and the World Bank.

Crisis was "accident waiting to happen": Greenspan

An unusually high degree of risk taking across asset classes made recent financial market turmoil all but inevitable, former Federal Reserve Chairman Alan Greenspan said on Sunday.

"The financial crisis that erupted on August 9 was an accident waiting to happen," Greenspan said in a speech on the sidelines of the International Monetary Fund and World Bank meetings. "Credit spreads across all global asset classes had become suppressed to clearly unsustainable levels."

"Something had to give."

"If the crisis had not been triggered by a mispricing of securitized U.S. subprime mortgages, it would eventually have erupted in some other sector or market," Greenspan said.

Defaults on subprime loans, made to borrowers with poor credit records, have spiked in recent months, setting off a chain reaction that has tightened credit conditions around the globe.

Once Again, 'Paging Mr. Bernanke'

During the past few weeks, bond investors were coming around to the view that the Federal Reserve's job of managing the credit crisis was pretty much done. Now, it looks like the nation's central bank still has a lot of work cut out for it.

With the Fed's next policy meeting now a little more than a week away, the bond market is pricing in rising odds that Fed Chairman Ben Bernanke will cut the short-term federal-funds rate for a second time in six weeks to address the broadening effects of market turmoil and the housing downturn.

Friday, futures markets were implying a greater than 90% chance of a quarter-percentage-point rate cut, to 4.5%. Behind this view: Mounting troubles in the housing market and a growing sense that the financial turmoil that ripped through credit markets hasn't gone away as quickly as some investors were starting to believe after the Fed's September rate cut.

SIVs Pose Risks for Money-Market Funds

Complex investments known as SIVs are roiling Wall Street and the world of high finance. But the investment vehicles also are threatening trouble in a seemingly unlikely place: money-market funds, the choice for many individual investors seeking safety.

In recent years, the short-term debt issued by such structured investment vehicles, or SIVs, had become a favorite for many money-market funds, thanks to their attractive yields, high credit ratings and added diversification.

As a result, many money-market mutual funds were holding 10% to 20% of their portfolios in debt issued by SIVs. Funds overseen by Bank of America Corp.'s Columbia Management Group, Credit Suisse Group's Credit Suisse Asset Management, and Federated Investors Inc. recently held big stakes in SIVs, including some of the most troubled names.

The point of M-LEC

There has been an odd hiatus. Back in August, SIVs were dooming us all. Barely a day would go by without some bank disclosing funding lines to a troubled conduit. And then -

ah-whoom - it all went quiet. The world seemed to have moved on. Wall Street's Q3s were coming, the Fed cut rates, banks didn't implode, equities soared, and there was a great collective relaxing of shoulders.

Until October. Then a plan by three big banks to build a new "superconduit" - M-LEC - reminded everyone of the forgotten SIV. Problem. Why, everyone wondered, did we need M-LEC? Thing's were alright, no?

Since SIVs were last in the limelight, things have not improved. In fact, asset prices in SIVs have continued to slide.

Banks' Plan to Help May Itself Need Help

Does the rescue plan for the credit markets need to be saved?

The plan is still being developed, but the roughly $75 billion effort to snap up troubled securities is struggling to get off the ground, days after it was disclosed by the country's three biggest banks with the support of the Treasury Department.

Citigroup, Bank of America, and JPMorgan Chase back the plan but are just beginning to hammer out the details. Bank regulators are aware of the discussions but some say they are out of the loop. And market participants are puzzled, with investors like Pimco and T. Rowe Price balking at buying in.

Yesterday, Citigroup executives said separately that they bought some time by securing $80 billion in financing through the end of the year. That provides some relief because Citigroup can avoid a fire sale of assets at distressed prices, but it is not a long-term solution for the bank or the industry. A greater amount of backup financing is needed.

More firms expected to join SIV fund: officials

More financial firms are expected to join the "Super SIV" special fund to help guarantee liquidity in the commercial paper market, officials said Saturday....

....The fund could be up and running within 90 days, according to a statement issued by Bank of America. The fund will be worth as much as $75 billion and backers said that it won't buy subprime loans.

Citigroup SIV funds won't have to sell assets in '07
Investors had feared US$80B securities sell-off

Citi said its SIVs have secured financing for 98% of their assets through the end of the year.

SIVs are funds that finance their purchase of longer-term assets in large part with shorter-term debt, including commercial paper. If a SIV cannot refinance its short-term

> debt, it must sell off assets to pay back investors....
>
> ....Investors had feared that, if SIVs were unable to sell commercial paper, they would dump billions of dollars of bonds, pushing bond prices down and borrowing costs up, potentially slowing U.S. and European economic growth.
>
> SIVs have had trouble financing themselves because investors are concerned about the quality of the assets they hold.

Bankers say subprime rescue fund risky
'Might be better to let markets work it out'

> Bankers remain wary of plans to launch a massive investment rescue fund to soften the blow of the U.S. subprime meltdown, saying it could interfere with a market recovery and stall a resolution to the credit crisis. Carl Stalberg, executive chairman of Swedbank, said on the weekend he doubted the fund would be an effective way for banks to liquidate billions of dollars in structured debt in markets where buyers have effectively gone on strike....
>
> ....But despite the U.S. government's active role in seeking support for the plan, many bankers and investors remain cautious -- with some saying they have nothing to gain by participating.
>
> "Markets are rather suspicious about that policy. It could interfere with the market mechanism and introduce biases," said Olivier Garnier, deputy general manager at Societe Generale Asset Manageme.

Greenspan questions 'superfund'

> Alan Greenspan on Friday raised serious doubts over the plan to create a $75bn-plus investment fund to buy the assets of troubled investment vehicles, warning that it could prevent the market from establishing true clearing prices for asset-backed securities....
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> ....The former Fed chief did not say he opposed the superfund and did not advocate selling assets at firesale prices. He said the 1998 Fed-sponsored rescue of Long-Term Capital Management worked because it took a set of assets that would otherwise have been dumped at firesale prices off the market, allowing prices to find a true equilibrium. But he said today "we are dealing with a much larger market".
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> Mr Greenspan's doubts about the proposed fund are shared by some of the world's most successful investors.
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> Warren Buffett told Fox Business Network that "pooling a bunch of mortgages, changing the ownership" would not change the viability of the mortgage instrument itself. "It would be better to have them on the balance sheets so everyone would know what's going on."

Greenspan critical of rescue plan

> In a move that will likely provide fuel for critics of the Montreal proposal, Alan Greenspan has questioned a plan by a group of major banks to create a "super fund" to bail out part the U.S. commercial paper market. It's a market that like non-bank sector in Canada has frozen up, and Mr. Greenspan said yesterday the bailout itself will undermine already shaky investor confidence.
>
> The banks involved, including Citigroup, Bank of America and JPMorgan Chase, hope to raise as much as US$100-million to buy the assets of troubled issuers of commercial paper. But the former federal reserve chairman said in a magazine interview published yesterday that the strategy will only add to market uncertainty by creating the impression that "some form of artificial non-market force" is boosting prices.
>
> In a criticism that may have a familiar ring to investors in seized up asset backed Canadian commercial paper, Mr. Greenspan said the best way to deal with the problem is to allow market forces to function freely, which he said might mean allowing prices to fall far enough that genuine buyers would be attracted.

Champions of U.S. superfund seen losing argument

> Whether a $75 billion fund to rescue the battered mortgage-backed securities market takes off or not, its sponsor U.S. Treasury Secretary Henry Paulson seems to be losing the argument over its merits, strategists and economists said.
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> The fund, announced last week by Citigroup, Bank of America and JP Morgan with Paulson's support, aims to prevent structured investment vehicles (SIVs) from making panic sales of bonds linked to U.S. subprime mortgages.
>
> Many of the SIVs -- off-balance sheet vehicles holding some $370 billion in assets that rely on short-term financing to make a return -- are struggling to stay afloat as investors shy away from buying their commercial paper.
>
> The plan has faced a rising tide of criticism, not least from former Federal Reserve Chairman Alan Greenspan, who said last Friday the superfund may do more harm than good.
>
> Financial strategists contacted by Reuters said time is running out for the plan's champions to regain the initiative and the fund risks being still-born.

Bankers say subprime rescue fund risky

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> Carl Stalberg, executive chairman of Swedbank, said on the weekend he doubted the fund would be an effective way for banks to liquidate billions of dollars in structured

debt in markets where buyers have effectively gone on strike....

....But despite the U.S. government's active role in seeking support for the plan, many bankers and investors remain cautious -- with some saying they have nothing to gain by participating.

"Markets are rather suspicious about that policy. It could interfere with the market mechanism and introduce biases," said Olivier Garnier, deputy general manager at Societe Generale Asset Management.

No easy answer when it comes to credit crunch

In past financial crises, governments and financial institutions scrambled to sort things out, but in the end, monetary authorities usually had to step in and cut interest rates - flooding markets with liquidity and greasing the wheels of the global economy.

But each time, the rate cutting becomes less effective, Mr. White argues. And in today's case, the source of the problem was too much liquidity - which led to easy credit, excessive borrowing and lax standards. For central banks to push markets to the other side of the credit crunch by injecting even more liquidity is questionable at best.

Call for transparency in $75bn superfund

A committee of top international bankers on Sunday warned that the proposed $75bn mortgage securities superfund must be transparent in its pricing of assets if it is to help restore market confidence.

The statement by the Institute of International Finance reflected concern that the superfund, which is backed by Citigroup, JPMorgan Chase and Bank of America, is proposing to buy assets from troubled investment vehicles at higher than true market prices. Josef Ackermann, chief executive of Deutsche Bank and chairman of the IIF, stressed the importance of “proper valuations” and the need for financial institutions to “take the hits”.

Big banks accept blame for global credit turmoil

“There have been mistakes. The weaknesses in business practices and market dynamics that have been revealed have highlighted the areas where industry practices need to improve. To be frank, this most recent experience calls on all of us to hone our practices.” The IIF said that a group was to study ways to tighten standards on liquidity, risk, transparency and off-balance-sheet vehicles. Mr Ackermann insisted, however, that the financial system was “stronger than ever” and that, despite Friday’s sell-off, “the equity market will continue to be relatively strong”.

The banks’ move to avoid a regulatory backlash came after weekend talks among

ministers from the G7 leading economies deferred action to toughen supervision. The G7 set up a team to report by April on what action to take.

Banks respond to pressure for cleanup

Representatives of the world's top financial institutions, under growing pressure to act decisively to clean up the high-risk credit markets, are vowing to improve their risk-management practices and wean themselves from credit-rating agencies.

“We shall seek to find ways to contribute to the restoration of market confidence and enhance it going forward,” said Josef Ackermann, chairman of Deutsche Bank AG and chairman of the board of directors of the Institute of International Finance (IIF).

The institute represents 270 financial institutions worldwide, including almost all of the biggest banks.

Its board said Sunday that it will review the way banks evaluate the structured and highly leveraged loans at the centre of the market turmoil that boiled over this summer, and threatens to bubble up again.

It also said banks should also be more straightforward about how they are linked to companies that sell asset-backed commercial paper and other off-balance-sheet securities; they should change how they evaluate complex securities that contain a range of hard-to-assess assets.

Remember The Buckets

As the mortgage crisis unfolds, I think it is useful to remember that most mortgage-backed structured finance products use a cascade configuration. Practically, it takes some time until defaults are reflected in the cash flows of the AA and AAA tranches, because the first "hits" are taken against the lower-rated "buckets" and against whatever reserves were maintained as a cushion. From the perspective of the AA-AAA CDO holder, nothing has changed in his cash flow: he/she is still getting paid regularly....

....The sad truth is that there are no AA-AAA CDOs, not in the traditional corporate bond sense, anyway. Their structures make them inherently unstable past a critical point, after which their performance becomes non-linear on the downside. The banks know this very well (they engineered them, after all) and that's precisely why they don't want to hold them - it has nothing to do with lack of transparency or liquidity. Such products are large ticking bombs; their manufacturers can calculate with relative accuracy when they will explode, given timely data on delinquencies and defaults. As in any bankruptcy, how much money will be recouped will depend on the prices realized from the auctions, minus costs and fees.

That's why hedging via the ABX indices is becoming rapidly more expensive, even for the AAA tranches, and also why the rating agencies are finally starting to downgrade such issues by the tens of billions.

Paulson says banks credit rescue fund market-driven

> U.S. Treasury Secretary Henry Paulson said on Friday a multi-billion-dollar credit rescue fund that big banks were setting up was purely market-driven and was not intended to help banks dispose of bad assets.
>
> Paulson spoke to a few reporters after a news conference and was asked about criticism by former Federal Reserve Chairman Alan Greenspan, who said the fund might have "dire consequences" by delaying a necessary depreciation of the assets.
>
> "This is market-driven and market-based," Paulson said. "The purpose of this...is not to buy bad assets or assets that have credit problems (but) for end-investors, working with the banks, to buy assets that aren't credit-impaired."
>
> "That will accelerate the return to liquidity in parts of this market," Paulson said.
>
> The investment pool is intended to acquire mortgage assets held by so-called Structured Investment Funds. Essentially , it is a bank-led "super fund" called Master Liquidity Enhancement Conduit, and it will resell the assets to investors.

Destined To Fail

> The reason the SIV bailout must fail is simple: Living paycheck to paycheck gets harder. The calculus of living paycheck to paycheck in America is getting harder. Across the nation, Americans are increasingly unable to stretch their dollars to the next payday as they juggle higher rent, food and energy bills. It's starting to affect middle-income working families as well as the poor, and has reached the point of affecting day-to-day calculations of merchants like Wal-Mart Stores Inc, 7-Eleven Inc. and Family Dollar Stores Inc....
>
> ....Fraudulent buying of asset backed commercial paper at inflated prices in attempts to hide losses is simply not going to do a thing for the average Joe struggling to make his house payment. Nor is it going to do anything for those recently laid off, nor is it going to do a thing for waiters receiving smaller tips because of declining numbers of people eating out, nor is it going to do anything for Wal-Mart, Home Depot (HD), Lowes (LOW), or Target (TGT) all who aggressively expanded in an attempt to steal business from each other.
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> The real economy is suffering and has been for some time. It's going to get worse too as retail stores, once a huge driver of employment, start laying off. No amount of fraud by Paulson can hide those simple economic facts.

Northern Rock crisis 'very sobering'

> The chairman of the Financial Services Authority has admitted that the Northern Rock fiasco was "very sobering" for him and other market regulators, but warned that

authorities should not go too far in their clampdown on banks and ratings agencies.

Callum McCarthy, who was speaking in Washington in the wake of the major plunges in share prices on Friday, also acknowledged that the credit crunch was still causing problems in the market....

....Mr McCarthy has come under major scrutiny for his role in the crisis at Northern Rock, which last month suffered the first run on a British bank since the 19th century.

The FSA's role is to monitor the financial system and ensure banks are behaving prudently, but it has since emerged that Northern Rock continued to pile more debt on to its balance sheet, even after credit conditions in markets started to deteriorate.

The Credit Shock: "Weapons of Mass Financial Destruction"

In an exceedingly carefully phrased roll-out in major newspapers, details are beginning to emerge of the new discernable reality: its essential features are bribery papering over fraud.

The fraud, as defined by cratering secondary markets for mortgage backed securities, is exactly as Warren Buffett predicted of financial derivatives: they are proving to be "weapons of mass financial destruction."

The bribery appears to be in the creation of a new, multi hundred billion dollar fund-- the result of the meeting between the big banks and the US Treasury-- for which fees will be paid to Wall Street executives and lawyers in order to dispose in "an orderly way" off-book assets that are worth far less than banks have told their investors.

Cynics, gather 'round: it's nearly fascinating as watching the Greenland ice sheet melt. Both are happening slowly but with a fair degree of certainty that the end of the day is a big stinking mess we lack tools to clean up. The reality-based community of investors are not going to take this well.

Asset-Backed Commercial Paper Drops for 10th Week

U.S. asset-backed commercial paper shrank for the 10th straight week, extending the worst slump in seven years and underscoring the depth of Treasury Secretary Henry Paulson's challenge to revive the market.

The short-term debt maturing in 270 days or less fell $11 billion in the week ended yesterday to a seasonally adjusted $888 billion, according to the Federal Reserve in Washington. The broader commercial paper market was little changed at $1.87 trillion.

Paulson is attempting to break a logjam in short-term debt with an $80 billion fund to resuscitate the market. Investors fled asset-backed securities on concerns they may contain subprime mortgages. The retreat left some companies unable to roll over their commercial paper, forcing them to sell assets.

The market is ``separating the wheat from the chaff,'' said Jill King, senior portfolio

> manager of Chicago-based Horizon Cash Management. ``The chaff can't roll right now.''
>
> Businesses rely on commercial paper, usually maturing in three months or less, for expenses including payroll and rent.

[Risky assets in debt market, DBRS says]

> Credit-rating agency DBRS Ltd. suggested for the first time yesterday that some of the assets underlying the frozen portion of Canada's commercial paper market are at risk because of its ties to the controversial U.S. residential mortgage-backed security market.
>
> The $34-billion market for third-party asset-backed commercial paper has been frozen since investor demand dried up in August and is now being restructured by major banks. Throughout the turmoil, DBRS has said the assets were top quality and the market breakdown was a result of liquidity problems brought on by a global market rout.
>
> Yesterday, DBRS revealed that about three-quarters of the total amount is backed by complicated financial structures known as collateralized debt obligations, or CDOs, while only about 23 per cent comes from "traditional" assets such as mortgages and auto loans.
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> The vast majority of the transactions in the trusts continue to show strong credit characteristics, DBRS said, but about 7 per cent of the CDOs - or $1.8-billion - relate to U.S. residential mortgage-backed securities (RMBS) assets....
>
> ....The big ABCP investors who have banded together to seek a solution have set a Dec. 14 deadline to unveil plans to finally fix the market, which froze in mid-August amid concern that assets behind the paper would go sour because of links to subprime mortgages in the U.S.
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> Dozens of investors, from large pension funds to small companies to wealthy individuals, found themselves caught with no access to cash, prompting the restructuring discussions.
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> To get a deal by mid-December, the restructuring faces many obstacles. The biggest challenge is that some classes of ABCP are worth more than others because they either are backed by stronger assets, such as mortgage or car loans, or are supported by stronger bank loan agreements, or have fewer complicated derivatives trades. Another urgent problem is that some of the ABCP issuers have received calls for more collateral because the value of some of their underlying assets has declined.
>
> The people said investors with healthier ABCP are balking at any plan that would call for them to share the pain with holders of more-troubled classes of ABCP. However, these sources said, the committee is seeking to convince reluctant investors to join a collective bailout.

[Credit cleanup 2 months away]

A concrete plan to restructure all of the $34-billion of seized-up commercial paper in Canada should be ready by mid-December, but people involved in the cleanup caution that it's unlikely every investor will be fully repaid like holders of Skeena Capital Trust.

Skeena is the first of the asset-backed commercial paper (ABCP) issuers to be fixed in the two months since the market for the short-term investments collapsed in August amid concern they were tainted with subprime mortgages....

....By Dec. 14, the committee expects to have unveiled restructuring plans for each of the other 21 affected paper-issuing trusts, said Purdy Crawford, the veteran lawyer leading the restructuring. Skeena, however, shouldn't be seen as a precedent, he said.

That's because the other trusts are more complex, in deeper trouble and have less negotiating power with their banks.

ABCP market won't be fixed soon: Dodge
Timeline Unlikely; BOC deals blow to restructuring committee plans

Canada's seized-up asset-backed commercial-paper market will likely take longer than two more months to fix, David Dodge, governor of the Bank of Canada, said yesterday, apparently contradicting plans by a committee overseeing a restructuring of the $35-billion in notes that the job can be done by Dec. 14.

Speaking at a press conference in Ottawa yesterday, Mr. Dodge said the complexity of the underlying assets makes it difficult to fix the problem soon.

"It's not at all surprising to us that it couldn't be done in two months," he said. "Indeed, it probably won't be finished in another two months."

Commercial-paper markets around the world have been struggling amid the ongoing credit crunch, but in Canada an entire sector -- $35-billion of non-bank ABCP-- seized up in early August, leaving holders on the hook for what they believed was a safe investment.

One-night stands can't hold bank aloft, says Dodge

When credit markets imploded this summer, central banks around the world, including the Bank of Canada, reacted by injecting liquidity into short-term money markets. The extra cash relieved some of the pressure and panic, and some parts of the money markets eventually settled down.

Canada's rules say that the central bank can inject liquidity by lending out Government of Canada securities at the bank's key interest rate, for 24 hours. The infusions in August worked in that they were able to bring the overnight rate back down to the bank's target.

But the infusions didn't have the trickle down effect that the central bank had hoped for. Spreads in the term market — money markets that trade securities at terms longer

than overnight, such as one month or three months — have remained abnormally high.

And in recent weeks, the Bank of Canada has had another bout of trouble in keeping the overnight rate at its target, requiring billions more in cash injections.

BMO buyback of $13B in ABCP 'a wise bet'

Asset-backed commercial paper is a type of security backed by a package of debt obligations, such as credit card debt or other loans.

A portion of Canada's ABCP market, known as non-banksponsored ABCP, worth $40-billion was hit by fallout from the U.S. subprime-mortgage crisis in August, leaving investors holding billions worth of commercial paper they could not redeem. While a team of investors, bankers and lawyers is working to thaw the non-bank ABCP market, there have been fears the problems could spill over into the banksponsored paper.

Mr. Mihelic said his analysis may show BMO raised funds by borrowing from other banks and by attracting commercial deposits, possibly in anticipation of problems in the ABCP market....

....Most recently, BMO has been dragged into the ABCP quagmire and has also been exposed as a significant player in the U.S. sector of the global credit crunch focused on structured investment vehicles or SIVs. The bank said this week it is not part of a group of top U.S. banks that has organized a US$80-billion fund to deal with the problems around SIVs, but said it is "following closely" developments regarding the proposed fund.

Fed fears housing slump spreading to key U.S. sectors

The slump in housing has spread to other vital parts of the U.S. economy, including consumer credit, commercial real estate and manufacturing, according to a monthly survey of businesses by central bank officials.

The Federal Reserve Board's beige book survey, although largely anecdotal, paints a picture of an economy that is now clearly gearing down....

....The Fed survey pointed out that tighter credit conditions are now being reported beyond mortgages, including consumer, commercial real estate and business loans.

Meanwhile, the recession in housing continues to get worse. Housing starts and permits fell to levels not seen in more than a decade, according to a U.S. government report released yesterday.

Housing Construction Plunges

> Problems in the housing industry intensified last month with construction of new homes plunging to the lowest level in 14 years. Consumer prices, meanwhile, rose at the fastest pace in four months, reflecting higher energy and food costs.
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> The Commerce Department reported Wednesday that construction of new homes fell 10.2 percent last month, compared to August, to a seasonally adjusted annual rate of 1.191 million units. That was the slowest building pace since March 1993 and was far bigger than the 4.2 percent decline that economists had been expecting.

[Vultures Are Circling Over Distressed Properties]

> Call them grave dancers, vulture funds, turnaround specialists or the more euphemistic "opportunity investors." However you identify them, the deal is the same: When hyperactive real estate markets lose their sizzle, or property owners no longer can afford to hang on to their houses, well-capitalized investors smell blood and move in.
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> That's happening in most of the "bubble" areas of the country that saw heavy speculative activity and razzle-dazzle financing from 2001 through 2005. But it's also happening in less volatile markets where unaffordable mortgages and economic distress are producing record numbers of panic sales to investors at fractions of former values.

[Probing the depths of the U.S. housing crisis]

> We knew it was bad, but we didn't know it was this bad.
>
> The American housing slump keeps getting deeper, and policy makers and economists are scrambling everywhere to slash their numbers and lower expectations.
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> U.S. Treasury Secretary Henry Paulson, Federal Reserve Board chairman Ben Bernanke, the Bank of Canada and the International Monetary Fund all rang alarm bells this week about the depth of the problems in the U.S. housing sector, and warned about widespread, sustained effects in the North American economy.
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> "The contraction in the housing sector is transitioning from an average downturn to among the worst in the post-World War II history of the U.S. economy," says Michael Gregory, senior economist at BMO Nesbitt Burns. "As the current downturn probes deeper depths, the risk of outright [gross domestic product] recession will mount." The data tell a painful story.

[Housing Flameout: California Falls Into The Sea]

> September sales figures for the rest of the country are not yet available, but what is taking place in California, is what we anticipated after the stock market “froze over” on August 16th. Most people don’t understand that the market nearly crashed on that day and that the tremors from that cataclysm changed the way the banks do business. Many

of the loans which were available just months ago (subprime, piggyback, ARMs, “no doc”, Alt-A, reverse amortization etc) are either much harder to get or have been discontinued altogether. Additionally, the banks are no longer able to bundle loans into securities and sell them to investors. In fact, the future of “securitization” of mortgage-debt is very much in doubt now....

....In other words, the credit meltdown on Aug 16 changed the basic dynamics of home mortgage-lending. Decreasing demand and mushrooming inventory are only part of a much larger problem; the financing mechanism has completely changed. The banks don’t want to lend money. And, when banks don’t lend money---bad things happen. The economy goes into freefall. Despite the valiant efforts of the Plunge Protection Team in engineering a late-day turnaround to the August rout; the damage is done. Tighter lending will put additional downward pressure on a housing market that is already in distress speeding up an unavoidable recession. The economic storm clouds are already visible on the horizon....

....There’s a myth that the Fed chief can wave a magic wand and make things better. But that is not the case. Bernanke’s decision to cut to the Fed’s Fund Rate last month did not affect long term rates and, therefore, did not make it cheaper to buy (or refinance) a home. The rate-cut was really just a gift to the banks that are currently buried under $500 billion in mortgage-backed debt and CDO sludge. The increase in liquidity hasn’t made these toxic securities any more sellable or solvent. Nor has it increased the banks willingness to provide new home financing to mortgage applicants. That process has slowed to a crawl. All the Fed’s repos have done is buy more time for the banks while they try to wriggle out of reporting their true losses.

Share Prices Are Up, But For How Long?

So, why cast doubt on the view that industrializing countries are stabilizing the economies of the industrialized countries? No reason in the short term, according to many economists. But others are striking a more cautionary note. In the midterm, China is especially at risk of being drawn into the vortex developing beyond the Atlantic.

After all, the Chinese economic boom is based on exports to the United States and other Western countries. Moreover, more than 45 percent of China's economic power goes into the somewhat erratic production of capital goods. Private consumption, which has become steadier, accounts for only 35 percent. That's a much riskier combination than was the case in Japan prior to its economic meltdown in the early 1990s. Add a banking system that is still vulnerable and overheated stock markets and there can be no doubt that the economy of the world's most populous country is more prone to crisis than tireless China-optimists like to believe.

If the United States should indeed slide into recession, as Yale University professor Robert Shiller and others predict, then China would be directly affected -- and with it, all of Asia. The other countries on the continent have long been exporting more to China than to the United States. China is the nerve center of an entire region -- and perhaps the entire world.

Critics are reminded of the brave new economic world of the late 1990s, when economists believed that crises had become a thing of the past. The creed of the time was that the productivity of the New Economy -- allegedly enormous -- had suspended the basic laws of economics, so that there could be sustained economic growth without

inflation and therefore steadily rising share prices, of course.
That bubble burst shortly thereafter, in 2000.

Wall St caught in a perfect storm

> Twenty years to the day since Black Monday, when the Dow slumped 508 points in a day, Wall Street was rocked by rumours of defaults and heightened fears that the US economy may be heading for a recession....
>
> ....Fed chairman Ben Bernanke warned on Thursday that "considerable strains remain" in the financial markets. He said cited a risk that "housing weakness might spill over to other parts of the economy".
>
> He left no doubt that the Fed is now seriously worried about the severity of the downturn. "Intuition suggests that stronger action by the central bank may be warranted to prevent particularly costly outcomes," he said.
>
> Credit markets have priced in a 70pc chance of a rate cut on October 31, an abrupt change since last week.

No knee-jerk regulations need apply

> The problems that emerged this summer as the credit markets melted should be addressed through "natural market forces," rather than intervention from regulators, the Bank of Canada's governor David Dodge said today.
>
> This summer's sub-prime mortgage crisis in the United States spooked asset-backed securities markets around the globe. Asset-backed securities are packages of debt ranging from credit card debt to car loans, and fears that some products may be loaded up with sub-prime mortgage debt made investors worried.
>
> The securities can be complex, and many investors made their investment decisions based on the advice of credit-rating agencies. This troubles have sparked calls for stricter regulations for these agencies, but again, Mr. Dodge believes market forces should be left to sort it out.

Fear and greed take a stranglehold on the oil market

> Hedge funds jumped into oil aggressively when it slipped below $50 in January and then began bailing out in August when the price reached $77.
>
> It's no coincidence that at the time the credit market was taking a terrible beating and stocks were tanking in the wake of the mortgage-backed securities meltdown. The hedge funds had to cash in their profitable oil positions to cover margin calls on their losing investments.

In the space of four weeks, the financial players dumped the equivalent of 100 million barrels of oil, lopping more than $5 off the price.

Now, we jump forward to October, and the financial speculators have climbed back in, placing aggressive bets that the price has much further to run. Was it because of a desire for a valuable hedge against the continuing weakness of the U.S. dollar, as several commodity watchers have argued?

No, Mr. Schork says flatly. "Whatever impact the cheap dollar has had was priced in weeks ago. It's just an excuse now that is being touted by bullish hedge fund managers and by talking heads in the media. It's just noise."

Right now, the futures market is in a state of backwardation, when spot prices are higher than those for future delivery. Which means it makes perfect sense for producers and financial buyers sitting on stored oil to empty their tanks and get it into the market. At some point, all this supply has to overwhelm demand and bring down prices, Mr. Schork says. "Right now that's not happening, and no one can tell you what the time frame is."

Mortgage Security Bondholders Facing a Cutoff of Interest Payments

For all the pain in the mortgage market, investors who hold bonds backed by risky home loans have continued to receive their monthly interest payments — until now.

Collateralized debt obligations — made up of bonds backed by thousands of subprime home loans — are starting to shut off cash payments to investors in lower-rated bonds as credit-rating agencies downgrade the securities they own, according to analysts and industry executives....

....With such a re-evaluation, owners of collateralized debt obligations — investment banks, hedge funds, insurance companies and public pension funds — may be forced to write down mortgage investments beyond the billions they have already written off. Some bonds, for example, may go from being valued at, say, 70 cents on the dollar to becoming largely worthless overnight, bankers and analysts say.

The adjustment could further erode the availability of credit to consumers and businesses.

Barclays and RBS line up Fed for £15bn

Barclays and Royal Bank of Scotland have lined up emergency funds of up to $30bn (£15bn) from the US Federal Reserve to bail out American clients caught up in the global credit crunch.

The Fed's board of governors wrote to both banks 10 days ago, granting them access to funds for customers "in need of short-term liquidity".

The letter to RBS made particular reference to investors holding mortgage-backed securities – which have been at the centre of the sub-prime crisis.

The request from the two banks is a stark reminder that the global liquidity freeze is far from over.

It is similar to those offered to Citigroup, Bank of America, JPMorgan Chase and Deutsche Bank at the height of the credit crunch.

IMF may be starting to fall apart

The IMFC put a brave face on the dissent that was within its ranks. Rather than concede that problems exist, it repeated the message from Fund officials over the past week that the global economy was still growing strongly, although it will be slowed by the credit squeeze.

The finance ministers and central bank governors who sit on the IMFC agreed that all relevant national and international bodies should study possible improvements for risk management in complex financial products, the accounting of off-balance sheet vehicles in banks, the work of credit ratings agencies, and the regulation of liquidity in financial entities.

Jean Claude Trichet, the head of the European Central Bank, said: "Certain areas of the regulatory framework may need to be reviewed, such as the treatment of liquidity risk and securitisation framework, in particular the treatment of liquidity exposures to special purpose vehicles and the assessment of risk transfer, given their significance in the recent financial turbulence."

Europe Feels Pinch As Housing Boom Slows

The housing boom was a global phenomenon, affecting virtually every developed country outside of Japan during the past 10 to 15 years. Former Federal Reserve Chairman Alan Greenspan is among those who argue that a period of sustained low interest rates and quiescent inflation world-wide after the Soviet Union's collapse encouraged a rush into housing.

Low interest rates were a potent stimulant in Spain, which experienced one of the biggest housing booms in Europe. The European Central Bank, mindful of slowly expanding, big economies on the Continent, kept interest rates low for much of the first part of the decade -- often lower than the rate of inflation in Spain. That encouraged Spaniards to borrow money.

Last year, Spanish families on average paid six times their annual salary to buy a home, compared with 3½ times salary in the late 1990s, according to the Bank of Spain, the central bank. Immigration and an influx of wealthy tourists scooping up coastal property fueled skyrocketing prices.

American Imports, Chinese Deaths: The human cost of doing business

With each new report of lead detected on a made-in-China toy, Americans express outrage: These toys could poison children. But Chinese workers making the toys - and countless other products for America - touch and inhale carcinogenic materials every day, all day long. Benzene. Lead. Cadmium. Toluene. Nickel. Mercury. Many are dying. They have fatal occupational diseases.

Mostly they are young, in their 20s and 30s and 40s. But they are facing slow difficult deaths, caused by the hazardous substances they use to make products for the world - and for America. Some say these workers are paying the real price for America's cheap goods from China. "In terms of responsibility to Chinese society, this is a big problem for Americans," said Zhou Litai, a lawyer from the city of Chongqing who has represented tens of thousands of dying workers in Chinese courts.

The toxins and hazards exist in virtually every industry, including furniture, shoes, car parts, electronic items, jewelry, clothes, toys and batteries, interviews with workers confirm. The interviews were corroborated by legal documents, medical journal articles, medical records, import documents and official Chinese reports.

Although these products are being made for America, most Chinese workers lack the health protections that for nearly half a century have protected U.S. workers, such as correct protective masks, booths that limit the spread of sprayed chemicals, proper ventilation systems and enforcement to ensure that the employees' exposure to toxins will be limited to permissible doses measured in micrograms or milligrams.

Chinese workers also routinely lose fingers or arms while making American furniture, appliances and other metal goods. Their machines are too old to function properly or they lack safety guards required in the U.S.

Social Tensions Confront China's Harmony

It was a sight to behold: Thousands of protesters massed on the streets of one of China's most prosperous cities, demanding that construction of a chemical plant close to their homes be stopped.

Demonstrators, many wearing yellow bands of cloth in a show of unity, faced down a wall of policemen, marching past skyscrapers and shopping malls as onlookers passed out bottles of water under the hot June sun.

The protest led the government to halt construction of the $1.4 billion facility, at least for now, and became emblematic of the simmering discontent facing Chinese leaders.

As Communist Party leaders gathering in Beijing this week call for creating a "harmonious society," signs abound that the country is far from it. In China's wrenching transformation from a poor, largely agricultural society to a prosperous industrial one, the party is wrestling with changes that have angered many Chinese.

"Farmers have lost their land, workers of state-owned companies have gotten laid off, people living at the bottom of society struggle in their daily lives, there is a huge difference in incomes of the rich and the poor, and a large amount of violence exists," said Ai Xiaoming, a professor at Sun Yat-sen University and an advocate for human rights and legal reform.

Outsourcing Government

> According to this radical vision, contractors treat the state as an ATM, withdrawing massive contracts to perform core functions like securing borders and interrogating prisoners, and making deposits in the form of campaign contributions. As President Bush's former budget director, Mitch Daniels, put it: "The general idea — that the business of government is not to provide services but to make sure that they are provided — seems self-evident to me."
>
> The flip side of the Daniels directive is that the public sector is rapidly losing the ability to fulfill its most basic responsibilities — and nowhere more so than in the Department of Homeland Security, which, as a Bush creation, has followed the ATM model since its inception.
>
> For instance, when the controversial border project was launched, the department admitted that it had no idea how to secure the borders and, furthermore, didn't think it was its job to figure it out. Homeland Security's deputy secretary told a group of contractors that "this is an unusual invitation. ... We're asking you to come back and tell us how to do our business."
>
> Private companies would not only perform the work, they would identify what work needed to be done, write their own work orders, implement them and oversee them. All the department had to do was sign the checks.

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