

The Other Side of the Street April 20, 2008

Comments

``When I was Secretary of the Treasury I was not supposed to say anything but `strong dollar, strong dollar,`` O'Neill said today. ``I argued then and would argue now that the idea of a strong dollar policy is a vacuous notion.``

The end game continues.

I have run out of colorful ways to describe what we are witnessing.

The low light of the week may be claims that LIBOR is being understated. As discussed below, LIBOR is the most important rate in the world. It is used as a benchmark for everything from \$500 limit credit cards to \$500 billion dollar notional value derivatives. That anyone would think it is being understated would have been a ticket to the funny farm a few years ago. Having read the stories and seeing who is making the allegations, I think it more likely than not that it is being falsified by operation of the input underlying it.

Then to start out the week ahead, reports from Britain that the Bank of England is now going to exchange 100B of government securities for mortgage backed garbage. As in the United States, such actions merely delay the inevitable and in the short term transfer wealth from the responsible to the irresponsible.

Meanwhile Wall Street partied like it was 2003,4,5,6,7. The momentum players went wild running up GOOG almost \$100 in a day and taking BIDU back to a 130 P/E for a company whose triple digit growth days are in the rearview mirror (earnings are PROJECTED to rise 60% YOY the next 2 years, which would give it a 53 P/E Based on hoped for 2009 earnings). RIMM rocketed higher on GOOG news even though NOK blew up. All of which is to say that it has been a very painful couple of weeks to base investing on fundamentals/logic/sanity.

In closing, I will simply point out to the day dream believers that the BOE action, which is coming more than a year after the first of the credit problems burst onto page 1 is noted as being an action "after [a series of] interest rate cuts . . . failed to ease" the credit market declines. There will come a time in the upcoming months when a realization hits that the collective central banks of the world and all the conspiratorial lying about credit conditions will not "fix" the problems. Only time and massive actual losses will. Perhaps all that is good news for equities, the "bottom is IN" and 2008, 9 and 10 will be just like the previous five years where horrible investing has been rewarded. My guess is that 2008, 9 and 10 will have much more in common with 1930-2 . . .

Stock Notes

- J.B. Hunt Transport Services (JBHT \$29), the first of the major trucking firms to report, said 1Q revenues rose 10% to \$878 million, but EPS slipped to \$0.28, less than the Street's estimate of \$0.30 per share. High fuel costs and "extreme weakness in freight demand" in the truck segment were responsible for the shortfall, the company said.
- Shares of **Crocs (CROX, \$10.11, -7.68, Spy)** were pummeled on the day and closed down -43.2%, after the footwear maker sharply cut its first-quarter earnings outlook. The company cited slowed sales and costs associated with a Canadian factory closure as reasons for the revised guidance. As such, Crocs said it now expects to post Q1 results that range from a loss of -5 cents per share to breakeven on a per share basis, down from prior guidance that called for a profit of 46 cents per share. The company also lowered its first-quarter sales forecast to a range of \$195-\$200 million from previous guidance for sales of \$225 million. The average forecast on Wall Street was calling for Q1 earnings of 45 cents per share on sales of \$223.3 million. – **this is how momentum stocks die. CROX was at 75 in October (i.e. it has dropped 65 bucks in less than 6 months; more than 85%)**

Notes

- Ground travel is reaching a price milestone of its own. **The average U.S. price of gas hit \$3.38 this morning** -- up a full 10-cents in less than a month. Gas is nearly 20% more expensive than it was at this time last year. DR

Web links

Credit

- April 21 (Bloomberg) -- The Bank of England will today announce a plan to swap about 50 billion pounds (\$100 billion) of government bonds for mortgage-backed securities to lower credit costs, people familiar with the matter said. **The plan will "unfreeze the situation we've got at the moment," Chancellor of the Exchequer Alistair Darling said yesterday in an interview with the BBC, without specifying how much would be made available.** "What the Bank of England will do is, in effect, lend the banks that money. In the meantime, the Bank of England will take a security." **Prime Minister Gordon Brown's government is trying to encourage lending after a surge in borrowing costs prompted banks to withdraw their best mortgage offers, threatening to exacerbate the worst housing downturn since 1992. The plan is a change of approach by the Bank of England after three interest-rate cuts since December failed to ease the logjam.** "It's been a long time coming, but what's important is that the bank is recognizing commercial banks' problems," [this is truly priceless – it is good news that the BOE now recognizes there is a problem – saints be praised indeed] said Philip Shaw, chief economist at Investec Securities in London. Success may depend on the credit ratings of the securities the Bank of England accepts and the duration of the plan, he said. **The swap is double the value of loans and**

guarantees Governor Mervyn King extended in September to prop up Northern Rock Plc. The government in February nationalized the mortgage lender, the first U.K. bank to fall victim to the credit freeze stemming from the collapse of the U.S. subprime market. The central bank announced its last measure to tackle the credit crisis at 9 a.m. on March 20, when it said it would extend additional emergency funds. The Bank of England wouldn't comment on the timing of the swap announcement or give further details of the plan. Investec's Shaw said the central bank may provide the funds on a rolling basis as needed by financial institutions. The British Broadcasting Corporation was the first to report on April 18 that the offer may total 50 billion pounds. **The central bank's move allows financial institutions to add government bonds to their inventory of liquid assets and make it easier for them to both raise cash and lend, especially to consumers seeking home loans. In return, the government will hold the riskier mortgage-backed assets as security.** `Essential' Step ``This is an essential initial step in trying to get the financial market stabilized and that in turn will help the mortgage market," Darling said. ``**We can re-open the financial markets because that is an essential pre-condition for the provision of mortgages.**" To date, the Bank of England has widened its collateral requirements just for three-month lending. It accepts only top- rated government securities at its weekly auctions. **Investec's Shaw says the term of the Bank of England's swaps may need to be longer than those under the terms of the Fed's program, maybe as long as a year. The U.S. central bank lends Treasuries for 28-day periods.** Size Matters Former Bank of England policy maker Willem Buiter, now a London School of Economics professor, said on April 18 the plan's success ``all depends on the scale." ``**In total, they would have to do -- not in one big go --at least 100 billion for it to really actually make a difference to the liquidity position of banks, but also act as the catalyst for getting that market going again,**" he said. The risk is that a slide in house prices worsens, undermining support for Brown's government. Mortgage lenders including HBOS Plc and Lloyds TSB Group Plc have raised the cost of loans, even after three, quarter-point rate cuts by the Bank of England to 5 percent. House prices dropped 2.5 percent in March from a month earlier, the biggest drop since 1992, HBOS, the country's largest mortgage lender, said April 8. Brown's approval rating dropped faster than for any U.K. leader on record as support for the opposition rose to the highest in 16 years, a poll published on April 13 showed. **Darling urged patience, saying the credit crunch partly needs time to work itself out. He said one analogy was to someone with a dose of food poisoning, which ``just has to work its way through the system."** **Bank of England Will Unveil Bond Swap to Ease Mortgage Market**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a1Xcc.MQyy.g&refer=home>

- April 17 (Bloomberg) -- **The Bank of England said financial institutions bid for 50 billion pounds (\$99 billion) in its weekly auction, three times the amount offered and the most since January, as the credit shortage worsened. The Bank of England offered 13.7 billion pounds in today's sale, it said in a statement in London. The amount the banks sought as a proportion of the auction, or cover ratio, increased to 3.7, the most in a month.** The gap between the central bank's benchmark interest rate and the cost of borrowing pounds for three months **rose this week to the highest since December as financial institutions struggled to raise money.** Their shortage of cash is

forcing Prime Minister Gordon Brown and policy makers to find new ways to end the logjam in credit markets and prevent a recession. "It shows the scale of the problem," said Nick Parsons, head of market strategy at NABCapital in London. **"There is not enough money being shifted around the system. You can understand why there is political pressure being brought about to solve problems in the markets."** [if the government is "solving the problem" it is not by definition a "free market" – global socialism only instead of helping the poor it is rewarding the wealthy who in essence robbed the poor] The gap between borrowing pounds for three months and the Bank of England's benchmark rate, currently at 5 percent, rose to 93 basis points on April 14. That was the biggest spread since December. The three-month rate fell 2 basis points to 5.91 percent today. Complaint The comparable rate for dollars jumped the most since markets seized up in August, climbing 9 basis points to 2.82 percent. **The British Bankers' Association yesterday threatened to ban members that deliberately understate their borrowing costs. Participants complained that banks may be submitting inaccurate information amid the global credit squeeze.** Brown said yesterday he's looking for ways to inject funds into the mortgage market and is studying measures already taken in the U.S. While the government and the central bank haven't announced when they will publish their plan, it is likely to come in the next two weeks. **"We need more liquidity and on longer terms," Sue Anderson, a spokeswoman at the Council of Mortgage Lenders, said in a Bloomberg Television interview. "Wider collateral would be helpful, and longer maturities would be helpful. We'd like lending to go out 12 or 24 months."** Liquidity Operations "These operations may be attracting more attention from primary institutions because the liquidity measures haven't been finalized," said Peter Dixon, an economist at Commerzbank AG. "Their attitude may be that they don't know what's coming so they'll take what they can when they need it." Speculation that the Bank of England will announce a plan to help financial institutions as soon as next week helped push the pound from a two-week low against the dollar today. The currency traded at \$1.9840 as of 3:26 p.m. in London. **British house prices, which have tripled in the past decade, are falling as mortgage lenders such as HBOS Plc and Barclays Plc's Woolwich unit withdraw their best deals and raise rates.** [where was the "government intervention when rampant speculation using artificially LOW interest rates causes this bubble?????] The Bank of England has reduced its benchmark rate three times since December. "The housing market is an issue that we have got to focus on," Brown told National Public Radio in Washington today. "To get the credit through to the housing market is something that is not easy to do. There is going to have to be greater examination of how we can make that possible." House values dropped 2.5 percent in March from a month earlier, HBOS, the country's largest home-loan provider, said last week. Taylor Wimpey Plc, Britain's biggest homebuilder, said today sales this year dropped "significantly" and full-year profit will be at the lower end of its estimates. Unlocking Credit **"They have to unlock the credit markets to prevent a full-blown recession from coming out of the credit market crisis," Robin Marshall, director of fixed income at Smith & Williamson, Investment Management, which oversees about \$20 billion in assets, said in an interview with Bloomberg Television. "However you dress this up, the banks can't borrow all their money from the Bank of England."** Financial reporting regulators are seeking to speed up new rules that may force banks to disclose off balance-sheet interests to tackle the

fallout from the market turmoil. The International Accounting Standards Board and the U.S.-based Financial Accounting Standards Board will discuss next week how to accelerate a series of projects, the London-based IASB said in an e-mail today. **BOE Received Most Bids in Three Months at Auction** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aYloQpbi9EB4&refer=home>

- April 17 (Bloomberg) -- Iceland's credit ratings were cut for the second time in less than two years by Standard & Poor's, which said the vulnerability of the nation's banks to the credit crunch may cause its economy to shrink faster than anticipated. The country's long-term foreign-currency debt rating was lowered one step to A, five levels below the highest investment-grade rating, from A+, S&P said in a statement from London today. The ratings remain on a negative outlook, meaning they are more likely to be lowered than left unchanged or increased. The downgrade "reflects increasing economic policy challenges, largely due to pressure on Iceland's external funding for the nation's commercial banks," Eileen Zhang, a London-based credit analyst at S&P, said in the statement. Iceland's economy may "contract more and for a longer period." S&P last cut Iceland's ratings in December 2006. Iceland's krona has lost almost a quarter of its value against the euro this year and 17 percent versus the dollar. Investors are concerned the country will struggle to finance a current-account deficit equivalent to more than 15 percent of gross domestic product while the debt-financed expansion of Iceland's banks poses a risk to public finances. The krona lost 1.2 percent to 74.96 per dollar by 3:50 p.m. in London today. It declined to 119.19 per euro, from 118.28 late yesterday. The Icelandic economy will contract for the first time since 1992 next year, the government said this week, changing a previous projection of 0.4 percent growth. The central bank last week unexpectedly raised its key interest rate to a record 15.5 percent, the second increase in three weeks, in a bid to strengthen the krona and quell inflation. **Iceland Has its Credit Ratings Cut by S&P on Banks** <http://www.bloomberg.com/apps/news?pid=20601087&sid=alinRujUNL5s&refer=home>
- April 17 (Bloomberg) -- Mark Mobius, executive chairman of Templeton Asset Management Ltd., **said the global credit-market crisis that has caused billions of dollars in losses at banks and brokerages worldwide is "near the end."** "Most of the bad news is already in the market," the 71-year-old fund manager, who oversees \$47 billion in emerging-market equities, said in a Bloomberg Television interview today. "The writedowns are coming in fast and furious." Mobius said he has been buying shares of banks including Bank of China Ltd. and Industrial & Commercial Bank of China Ltd. because of their valuations. Energy stocks were his biggest investment because of rising oil prices, he said. Malaysian equities are also becoming "more and more attractive," while the dollar is "not going to revive anytime soon," he said. Mobius's \$376 million Templeton Emerging Markets Fund has gained 15 percent in the 12 months through yesterday, compared with a 19 percent advance by the MSCI Emerging Markets Index. **Templeton's Mobius Says Credit Crisis Is Near End** <http://www.bloomberg.com/apps/news?pid=20601087&sid=a6BfDEUIQgx&refer=home>
- April 15 (Bloomberg) -- **Most Federal Reserve banks, before the near-collapse of Bear Stearns Cos., favored a smaller reduction or no change at all in the charge for**

direct loans to banks than Fed governors approved last month. Six of the 12 banks sought a half-point discount-rate cut before the March 14 announcement of emergency aid to Bear, while three asked for no change, according to minutes of Fed board meetings released today in Washington. The Fed board then lowered the rate by a quarter point on Sunday, March 16, and again by 0.75 percentage point at the regular meeting March 18. The report may reinforce investor expectations that the Fed is unlikely to keep up this year's pace of interest-rate cuts, the fastest in two decades. Harvard University economist **Martin Feldstein**, an early advocate of aggressive rate reductions, called on the central bank today to halt the cuts. The Fed release "confirms the perception that the regional reserve banks are quite a bit more hawkish than their Washington colleagues," said **Michael Feroli**, a former Fed researcher who is now an economist at JPMorgan Chase & Co. in New York. **"There are a number of people who are probably getting increasingly uncomfortable with where monetary policy is going."** The Fed minutes don't provide details on the rationale for the unscheduled quarter-point rate cut, the Bear Stearns loan or the lending program for primary dealers the Fed announced on March 16. Directors of the regional banks tell the Fed Board of Governors in Washington their preference for the discount rate, which the policy makers consider when changing the federal funds rate. The Fed Board of Governors in Washington has final approval over the discount rate. **Closely Watched** The discount rate is now 2.5 percent. The Federal Open Market Committee, on March 18, voted 8-2 to cut the more closely watched federal funds rate by 0.75 percentage point to 2.25 percent, bringing the total reduction to 3 percentage points since September. The federal funds rate determines the cost of overnight lending between banks. Dallas Fed President **Richard Fisher** and Philadelphia Fed President **Charles Plosser** dissented, favoring "less aggressive action," the March 18 statement said. In fact, the Dallas and Philadelphia Fed board directors, along with Kansas City's, voted on or before March 13 to leave the discount rate unchanged at 3.5 percent. The Sunday, March 16 discount-rate cut was one of several emergency steps by the Fed to avert financial turmoil when Asian markets opened that evening. The board also voted to open up lending to Wall Street dealers at the discount rate and take on \$30 billion of Bear Stearns assets as an incentive for JPMorgan to purchase the company. **Further Reduction** After those decisions, the Boston, New York and San Francisco district banks asked for a cut in the discount rate to 2.5 percent. **"Economic prospects were unusually uncertain, and they believed that considerable downside risks to the economy remained and, for now, outweighed the upside risks to inflation,"** today's report said. **"Under these circumstances, directors generally agreed that an appreciably more accommodative stance for monetary policy was warranted."** **[focus on "economic prospects unusually uncertain the next time you see 11% of ALL TIME HIGHS on CNBC "reporting" on the Dow index]** San Francisco's directors were the earliest in calling for a 0.75 percentage-point cut, making such a request on March 13 and again on March 17, today's minutes showed. The minutes also showed that only one other bank, the Chicago Fed, submitted a discount-rate request between the March 16 and March 18 decisions, asking for a half-point cut. **Trader Anticipation** While traders anticipated the FOMC would lower the federal funds rate by a full percentage point heading into the March 18 meeting, none of the Fed district banks sought a rate cut greater than 0.75 percentage point, the minutes indicated. At the FOMC meeting, many Fed policy makers judged that "some contraction in economic activity"

was likely, and some saw the danger of a "prolonged and severe downturn," according to minutes of the session that were released April 8. The presidents of the district banks are separate from the district's boards of **directors**, which are composed mostly of executives from banking and other industries, and picked by member commercial banks and the Fed Board of Governors. Each Fed bank president is nominated by its board of directors and approved by the Board of Governors. The Fed's so-called primary discount rate applies to financially healthy institutions with short-term cash needs. The rate beginning in August was set at a half percentage point above the federal funds rate before the gap between the two rates was narrowed to a quarter-point. The secondary discount rate, now set 0.75 percentage point above the overnight lending rate, is for banks that may be less financially sound and are having difficulties finding funds in money markets. **Most Fed Banks Wanted Smaller Rate Cut Before Bear**
<http://www.bloomberg.com/apps/news?pid=20601068&sid=aaGUV2jjAKYE&refer=economy>

- April 16 (Bloomberg) -- **JPMorgan Chase & Co., hours after saying the credit-market crisis is almost over, made plans to raise \$6 billion in its biggest offering of perpetual preferred stock**, according to data compiled by Bloomberg. The non-cumulative securities priced to yield 419 basis points more than U.S. Treasuries due in 2018 and pay a fixed rate of 7.9 percent for 10 years. If not called, the debt will begin to float at 347 basis points more than the three-month London interbank offered rate, a borrowing benchmark, currently set at 2.73 percent. A basis point is 0.01 percentage point. JPMorgan is raising capital as a sagging labor market and economy hurt its clients' ability to pay credit cards and consumer loans on time. Banks and brokerages have raised \$163 billion from public and private investors since July as losses on subprime-linked securities surged to \$255 billion. New York-based JPMorgan, the third-biggest bank in the U.S., has posted about \$10 billion of asset writedowns and credit losses since the start of the subprime-mortgage turmoil early last year. The bank said it set aside \$1.1 billion in the first three months of 2008 for future home-equity loan defaults, after boosting those provisions by \$395 million in the fourth quarter. **Writedowns have reduced JPMorgan's Tier 1 capital ratio, which regulators monitor to assess a bank's ability to absorb loan losses, to 8.3 percent from 8.4 percent. That compares with ratios of 7.5 percent at Wachovia Corp. and 7.1 percent at Citigroup Inc. as of Dec. 31. The minimum for a "well-capitalized" rating from regulators is 6 percent.** The assets are calculated by weighing each type relative to its chance of default. Net Income Drop JPMorgan today said net income dropped 50 percent to \$2.37 billion, or 68 cents a share, from \$4.79 billion, or \$1.34 a share, a year earlier. **Joseph Evangelisti**, a JPMorgan spokesman, declined to comment about the preferred stock sale. JPMorgan's depositary shares are rated Aa2, the third- highest ranking, by Moody's Investors Service and one step lower at AA- by Standard & Poor's. Chief Executive Officer **Jamie Dimon**, 52, said on a conference call with reporters that the credit-market crisis is more than halfway finished as financial firms reduce leverage, and may be as much as 80 percent over. "That side is working itself out," Dimon said. "That doesn't mean the recession won't get worse or better." Lehman Brothers Holdings Inc., the fourth-largest securities firm, sold \$4 billion of preferred shares on April 1 that pay a coupon of 7.25 percent and are convertible to stock when Lehman shares reach \$49.87. Citigroup, which has reported subprime losses of \$24 billion and raised more than \$30 billion in capital since

November, pays 8.13 percent for preferred stock it sold in January. Bank of America Corp. is paying 8 percent on perpetual preferred shares sold the same month. **JPMorgan Raises \$6 Billion in Biggest Sale of Preferred Stock** http://www.bloomberg.com/apps/news?pid=20601087&sid=aiUU_.dPkuNc&refer=home

- April 14 (Bloomberg) -- **Federal Reserve Governor Kevin Warsh said the central bank's aid to financial markets isn't a cure-all for the credit crisis and financial institutions should raise capital rather than only rely on liquidity provided by the Fed.** Financial companies, by paring their dividends and stock buybacks, will yield "concomitant benefits on real economic activity," Warsh said at a panel discussion today in New York. The central bank "should remain at center stage as long as is necessary, but no longer," said Warsh, the only Fed governor with work experience on Wall Street. The Fed rescued **Bear Stearns Cos.** from bankruptcy and opened up lending to other securities firms last month to avert a chain-reaction of defaults among financial institutions. "We must be careful to not ask policy to do more than it is rightly capable of accomplishing," Warsh, an investment banker at **Morgan Stanley** from 1995 to 2002, said at **New York University** law school. **"The problems afflicting our financial markets are indeed long-in-the-making. Correspondingly, the curative process is unlikely to be swift or smooth."** Warsh, Chairman **Ben S. Bernanke** and other Fed officials voted March 14 to provide a three-day, \$13 billion loan to Bear Stearns after the company told regulators it planned to file for bankruptcy. Two days later, the Fed agreed to take on \$30 billion of Bear Stearns's mortgage securities and other assets so **JPMorgan Chase & Co.** would agree to purchase the company. Fed's Actions The Bear loans, along with a March 16 commitment to lend to 20 Wall Street securities firms, represent the Fed's first extension of credit to non-banks since the Great Depression. **While the Fed's funding tools and interest-rate cuts are "partially offsetting" the effects of the credit squeeze, the central bank can't fix everything right away, Warsh said. "Time is an oft-forgotten, yet equally essential, tool."** The collapse of the U.S. subprime-mortgage market has prompted record home foreclosures, a decline in mortgage and other lending and \$245 billion in asset writedowns and credit losses by the world's biggest financial companies since the beginning of 2007. In addition to the direct lending for Wall Street dealers, the Fed is also injecting liquidity by loaning as much as \$200 billion of Treasury securities, and by auctioning \$50 billion of funds to commercial banks twice a month. Seeking Normalcy The Fed is monitoring the \$330 billion market for auction-rate securities following its collapse, he said. With student loans declining and interest rates rising for municipalities, the Fed is "trying to make sure these markets go back to functioning on a more normal basis," Warsh said in response to a question from the audience. "The auction-rate securities market, particularly around student lending, is really a symbol of these greater credit market challenges," he said. The Fed's policy tools "are incredibly powerful, but they don't work overnight," Warsh said. "We should recognize that Fed-supplied liquidity is a poor substitute for private-sector-supplied liquidity," said Warsh, 38, who served as an economic-policy adviser to President **George W. Bush** before joining the Fed in February 2006. "Moreover, Fed- provided liquidity should not be mistaken for capital." Fed Vice Chairman **Donald Kohn** said on April 12 that financial-market "turmoil has not settled down." "Fragile Situation" "It's still a fragile situation out there," Kohn told reporters in Washington at a press conference for

the [Financial Stability Forum](#) group of regulators, which released a 100-day action plan to strengthen market regulation. Warsh said the Fed's 3 percentage points of reductions in the [benchmark interest rate](#) since September, along with the liquidity actions, are "intended to promote growth and mitigate downside risks to economic activity." At the same time, Warsh indicated he may be concerned about inflation. "We also need to be alert to risks to price stability," Warsh said, citing higher food and fuel prices that are "putting upward pressure on core inflation and inflation expectations." "We will continue to monitor the inflation situation closely," said Warsh, who has voted with the majority on every rate decision in his two years at the Fed. "And, more broadly, in my view, as financial intermediation channels reset, monetary policy will become still more efficacious." Warsh said in response to a question afterward that any central bank, including the Fed, cannot be "indifferent to the value of its currency." Three days ago, finance chiefs from the U.S. and other Group of Seven nations signaled concern on the dollar's slide and said the global economic slowdown may worsen amid an "entrenched" credit squeeze. **Fed's Warsh Says Central Bank Aid Isn't a Cure-All**
<http://www.bloomberg.com/apps/news?pid=20601068&sid=amXyMBT2vdm0&refer=economy>

Commercial Real Estate

Commodities

- April 17 (Bloomberg) -- **Crude oil and gasoline rose to records after the Energy Department reported unexpected declines in U.S. crude inventories and refinery operating rates. Oil climbed to \$115.21 a barrel in New York, the highest since futures began trading in 1983.** Oil inventories fell 2.36 million barrels to 313.7 million in the week ended April 11, the department said yesterday. Refinery capacity was 81.4 percent, the lowest since October 2005 following hurricanes Katrina and Rita. "Refiners are probably not ordering crude oil because they don't need it," said [Phil Flynn](#), a senior trader at Alaron Trading Corp. in Chicago. "This is a time of year when refineries are supposed to be focusing on gasoline production, but they have no incentive this year because demand is anemic and refinery margins are poor." The median price of crude oil will be \$92 a barrel this quarter, according to 30 analyst forecasts compiled by Bloomberg News. The median price for the entire year will be \$91.71 a barrel, the estimates show. "Buy Gasoline" "Refineries aren't buying crude oil and they certainly aren't using it to the extent they were expected to," said [Tim Evans](#), an energy analyst at Citigroup Global Markets Inc. in New York. "The decline was on the West Coast and there was a build at Cushing, which blunts some of the impact of this report." **Gasoline inventories dropped 5.52 million barrels to 215.8 million barrels, the report showed. It was the fifth straight fall and the biggest decline since August. A 1.8 million-barrel decline was forecast in the Bloomberg News survey. Oil Rises to Record in New York on Unexpected Drop in Supplies**
http://www.bloomberg.com/apps/news?pid=20601087&sid=aMaJPUsH_iN8&refer=home

- **April 15, 2008 - Agricultural commodities rose yesterday and overnight, as well.** Rice found a new record high as we slept, leaping 58 cents, to \$21.90. Wheat surged too, up over \$9, on word that Kazakhstan has banned all wheat exports. The former Soviet nation is the world's sixth largest wheat exporter, grinding out some 8 million tons of the chaff last year alone. Kazakh officials said domestic prices for bread and other wheat products merit the ban. In Chicago, wheat has nearly doubled in the past 12 months. DR

Currency

- April 16 (Bloomberg) -- Former Treasury Secretary **Paul O'Neill** said the "strong dollar" policy that he and every other Treasury chief since 1995 endorsed is "a vacuous notion." **"It implies in it that somehow we have the ability to manage the relationship between the value of the U.S. dollar and other currencies around the world,"** O'Neill, now a special adviser to Blackstone Group LP, today said in an interview with Bloomberg Television. O'Neill roiled currency markets when he was in office from 2001 to 2002, at one point with comments in an interview with a German newspaper that the U.S. pursued a policy of a strong economy, rather than currency. The current Treasury Secretary, **Henry Paulson**, has repeatedly stated that he is a "very strong" supporter of the "strong dollar" policy. **"When I was Secretary of the Treasury I was not supposed to say anything but 'strong dollar, strong dollar,'" O'Neill said today. "I argued then and would argue now that the idea of a strong dollar policy is a vacuous notion."** The U.S. currency today fell to a record low against the euro, and has declined 15 percent against its European counterpart in the past year. "The markets actually have control over those relationships. When people say strong dollar, if they don't mean that 'we believe intervention can work and we're prepared to intervene,' then 'strong dollar' is ridiculous." G-7 Meeting Finance chiefs from the Group of Seven major nations ended their April 11 meeting in Washington with a statement signaling concern over the slide in the dollar by denouncing "sharp fluctuations in major currencies," and their "possible implications for economic and financial stability." **Paulson emphasized to the G-7 "our commitment to a strong dollar," he said at a press conference after the meeting.** O'Neill, President **George W. Bush's** first Treasury secretary, said during his tenure he repeated the mantra originated by Clinton Treasury chief **Robert Rubin** that a "strong" dollar is in the best interests of the U.S. **O'Neill Says U.S. 'Strong Dollar' Policy Is 'Vacuous Notion'**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ackYQhodd4Nk&refer=home>

Diversification

Derivatives

Housing

- April 17 (Bloomberg) -- **Richard Lee spent 5.3 million pounds (\$10 million) buying 20 rental homes across the U.K. with just 150,000 pounds of his own money. Today, the properties are worth about 60 percent less and owned by the banks that**

financed the purchases. Lee was one of thousands enticed by one of Europe's top five best-performing residential property markets during the past decade. Now repossessions are mounting and properties stand empty as many investors fail to find the tenants needed to cover their mortgages after a building boom flooded cities, especially Leeds and Manchester, with apartments. The unraveling buy-to-rent investment market contributed to a 2.5 percent drop in **home prices** last month, the biggest since 1992, a report by mortgage lender HBOS Plc shows. Britain is among the countries most likely to follow the U.S. into a housing slump, according to the International Monetary Fund. Prices may drop 10 percent this year and next, said **Michael Saunders**, a London-based economist at Citigroup Inc. "Buy-to-let investment was a bubble inside the housing market bubble," Saunders said. "It's turning out worse than I thought." The "virtuous circle" of rental investment that powered the U.K. housing market was broken by falling property values and banks' retrenchment following record mortgage-related losses, Saunders said. Banks and securities firms have disclosed about \$245 billion of asset writedowns and credit losses since the beginning of 2007. The number of available buy-to-let mortgages dwindled to 926 in the first week of April from 3,362 at the start of August 2007, according to personal finance Web site **Moneyfacts**. Average two-year fixed-rate mortgage rates have climbed to 6.5 percent, or 1.5 percentage points more than the gross rental yield from a property in the first quarter.

Vulnerable Investors Investors such as Lee, who have high levels of debt, and homebuilders that focused on developments in the center of English cities such as Leeds and Manchester are now the most vulnerable to the deflating buy-to-let market. Buy-to-let investors who were **behind** on their mortgages by three months or more increased by 25 percent to 7,584 in the fourth quarter, according to the London-based Council of Mortgage Lenders. **Repossessions** rose 26 percent to 1,247. Connells Asset Management in Leighton Buzzard, England, which sold more than 10,000 repossessed homes last year, expects the number of foreclosures to rise from the 20 percent gain already reported, led by cities in the northern part of the country.

High-Rise Condos The skyline of central Leeds is dominated by construction cranes erecting high-rise condominiums, 60 percent of which were sold before completion to buy-to-let investors, according to London-based real estate broker CB Richard Ellis Hamptons International. "Leeds is where we are seeing more city-center apartments coming onto our books," said Managing Director Mike Pudney. Thousands more apartments are being built in the center of the city, where two-bedroom homes lost 12 percent of their value in the past two years, according to London-based research firm **Hometrack Ltd**. Brokers report average rents for these properties have dropped by about 20 percent and about 13 percent of city-center apartments are empty, according to Leeds City Council estimates, based on local tax returns. "Twelve months ago, development was an easy way to make your fortune," said Tom Bloxham, chairman of Manchester-based **Urban Splash**, which develops derelict sites. "Today, it's a disaster zone."

'Mini-Floridas' City center condominium developments like what's happening in Leeds represent Britain's "mini-Floridas," said **Alastair Stewart**, who tracks homebuilders at Dresdner Kleinwort Securities in London. The state of Florida had the third-highest foreclosure rate in the U.S. in March, with one foreclosure for every 282 households, according to RealtyTrac Inc., the Irvine, California-based seller of data on mortgage defaults. In Leeds, the market got so bad that a unit of Taylor Wimpey Plc, the U.K.'s largest homebuilder, delayed the planned

800-unit Green Bank condominium project in November. It may seek a zoning change to allow a mixed development of offices, shops and apartments. [Taylor Wimpey](#) dropped 40 percent in the past six months in London trading on concern about the collapse of the buy-to-let market and the slide in land values and home prices. Investment Clubs Newly built apartments accounted for a "significant part" of the investments made by 61 percent of new buy-to-let investors over the past six years, [Savills](#) reported. Many of those purchases were brokered by the dozens of Internet-based property investment clubs that sprang up since 2000. **The clubs often attracted novice buyers, some of whom lacked "an understanding of the risks that such investments pose," according to U.K. regulators at the Financial Services Authority.** In May 2005, the government forced two of the clubs into liquidation to protect investors. For a fee, the clubs offer members residential developments before construction work begins. They negotiate a price with homebuilders that is below the valuation made by an appraiser, and collect a percentage of the purchase price as a fee. The clubs also offer their dues-paying members property management, home insurance, legal and mortgage-brokering services. **Vacant Homes in U.K. Prove Speculator Nightmare as Losses Mount** <http://www.bloomberg.com/apps/news?pid=20601109&sid=alavZ8rOJcfc&refer=home>

- April 16 (Bloomberg) -- **The U.S. housing implosion worsened in March, while manufacturing stabilized and a stagnant economy limited the ability of companies to pass higher food and energy costs on to consumers.** Work began on 947,000 homes at an annual rate, the fewest since March 1991, the Commerce Department said today in Washington. Industrial production gained 0.3 percent in the month, according to the Federal Reserve, and the Labor Department reported that consumer prices rose 0.3 percent, matching economists' forecasts. While foreclosures are pushing down property values and undermining construction, record exports have kept factories running to help make up for the damage. Stocks advanced after earnings from Intel Corp., JPMorgan Chase & Co. and Coca-Cola Co. eased concern that the economic slowdown is dragging down profits. "The economy is slow, but it's not plummeting," said [Michael Moran](#), chief economist at Daiwa Securities America Inc. in New York. "Housing is accounting for most of the slowdown. The slow pace of activity is helping to keep the rate of inflation" from climbing further, he said. Building permits, a gauge of future construction, fell to a 927,000 rate from 984,000 the prior month. Housing starts, which dropped 11.9 percent, were projected to decline 5.2 percent to a 1.01 million pace from an originally reported 1.065 million rate in February, according to the median forecast in a Bloomberg survey of 72 economists. Homebuilding Outlook "Home construction is probably going to continue to fall right through this year," [Mark Vitner](#), a senior economist at Wachovia Corp. in Charlotte, North Carolina, said in a Bloomberg Television interview. "While we see a bottoming in sales in 2008, we really don't see an improvement until later 2009, early 2010" in home building. JPMorgan Chase & Co., the third-biggest U.S. bank, today reported a 50 percent drop in first-quarter profit after \$5.1 billion of writedowns and provisions, and said the credit-market crisis is almost over. **"It's hard in almost all these mortgage areas to say exactly what's going to happen with behavior," said JPMorgan Chase's Chief Executive Officer Jamie Dimon.** **"What's going to happen to home prices? We expect they're going to go down another 7, 8, 9 percent in '08."** Production Revisions The increase in industrial production followed a revised 0.7 percent drop in February that was larger than

previously reported, the Fed said. **Capacity** utilization, which measures the proportion of plants in use, rose to 80.5 percent. **Less Spending** Higher prices, combined with falling home values and mounting job losses, is leading to cutbacks in consumer spending that may push the economy into a deeper recession. Fed officials anticipate that the weakening economy will pull down the inflation rate. "Economic conditions have weakened since the last report," the central bank said today in its regional business survey, known as the Beige Book for the color of its cover. "Nine Districts noted slowing in the pace of economic activity, while the remaining" three "described activity as mixed or steady." **U.S. Economy: Housing Starts Slump, Production Gains**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=aSQqoMWWnPJc&refer=realstate>

- April 15 (Bloomberg) -- **U.S. foreclosure filings jumped 57 percent and bank repossessions more than doubled in March from a year earlier as adjustable mortgages increased and more owners gave up their homes to lenders.** More than 234,000 properties were in some stage of foreclosure, or **one in every 538 U.S. households**, Irvine, California-based RealtyTrac Inc., a seller of default data, said today in a statement. Nevada, California and Florida had the highest foreclosure rates. Filings rose 5 percent from February. **About \$460 billion of adjustable-rate loans are scheduled to reset this year, according to New York-based analysts at Citigroup Inc. Auction notices rose 32 percent from a year ago, a sign that more defaulting homeowners are "simply walking away and deeding their properties back to the foreclosing lender" rather than letting the home be auctioned,** RealtyTrac Chief Executive Officer James Saccacio said in the statement. **"We're not near the bottom of this at all,"** said Kenneth Rosen, chairman of Rosen Real Estate Securities LLC, a hedge fund in Berkeley, California and chairman of the Fisher Center for Real Estate at the University of California at Berkeley. "The foreclosure process will accelerate throughout the year." About 2.5 million foreclosed properties will be on the market this year and in 2009, Lehman Brothers Holdings Inc. analysts led by Michelle Meyer said in an April 10 report. U.S. home price declines will probably double to a national average of 20 percent by next year, with lower values most likely in metropolitan areas in California, Florida, Arizona and Nevada, mortgage insurer PMI Group Inc. said last week in a report. Borrowers who owe more on their mortgages than their homes are worth may be buffeted by increasing job losses in a "very substantial recession," Rosen said. **About 8.8 million borrowers had home mortgages that exceeded the value of their property, Moody's Economy.com said last week.** "At least 2 million jobs will be lost because of this recession, so we'll get a cumulative negative spiral," Rosen said. "A normal recession is 10 months. We think this one may be twice as long." Nevada had the highest U.S. foreclosure rate in March at one for every 139 households, almost four times the national rate, RealtyTrac said. Filings there increased almost 62 percent from a year earlier to 7,659. Florida, Ohio **California** had the second-highest rate at one filing for every 204 households, and the most filings for the 15th consecutive month at 64,711. Foreclosure filings more than doubled from a year earlier and were up about 21 percent from February. **Florida** had the third-highest rate, one filing for every 282 households, and ranked second in total filings at 30,254. Foreclosures increased 112 percent from a year earlier and decreased almost 7 percent from February, RealtyTrac said. Ohio ranked third

in filings at 11,273 and had the seventh- highest foreclosure rate, one for every 448 households. Georgia, Texas, Michigan, Arizona, Illinois, Nevada and Colorado also ranked among the top 10 states with the most filings, RealtyTrac said. Foreclosure filings in New York rose 37 percent in March from a year ago and fell 3 percent from February. The state ranked 30th with 5,088 filings. "I've had people sitting in my office in tears because there are no loans available," said Goldman. **"There are no loans for someone who's upside down on their house."** **U.S. Foreclosures Jump 57% as Homeowners Walk Away**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ahJfJhKyxAWI&refer=home>

Housing Finance

Macro Economic

- April 17 (Bloomberg) -- **Manufacturing in the Philadelphia region contracted more than forecast in April, as measures of new orders and shipments reflected weakening demand.** The Federal Reserve Bank of Philadelphia's general economic index fell to minus 24.9, the lowest since 2001, from minus 17.4 in March, the bank said today. Readings less than zero signal contraction. The Philadelphia Fed's general economic index averaged 5.1 in 2007. A housing slump in its third year is weakening demand for building materials and furniture, prompting more job cuts and undermining consumer and business spending. Federal Reserve officials, some of whom said at their last meeting that a recession "now appeared likely," are forecast to cut rates again later this month to contain the slowdown. "The Philly Fed index corroborates a lot of other evidence out there that the economy is in a recession," said **Kevin Logan**, senior market economist at Dresdner Kleinwort in New York. "Demand is down. That is partly related to the housing recession and also to the fact that costs have risen." **Leading Indicators Rise** Another report showed the index of leading U.S. economic indicators rose in March for the first time in six months as cash poured into the banking system and the Federal Reserve lowered the benchmark interest rate. The Conference Board's gauge increased 0.1 percent, as forecast, after falling 0.3 percent in February, the New York- based private research group said today. The measure points to the direction of the economy over the next three to six months. Today's report from the Philadelphia Fed provides one of the month's earliest clues to the state of manufacturing nationwide. It contrasts with a report from the New York Fed released April 15 showed its manufacturing index tipped into positive territory this month after falling to its lowest level on record the prior month. **Jobless Claims Increase** A government report earlier today showed more Americans filed first-time jobless claims last week, bringing the total number receiving benefits to the highest level in almost four years, a sign the labor market continues to weaken. **Initial applications for unemployment insurance increased by 17,000 to 372,000 in the week that ended April 12, the Labor Department said today in Washington. The number of people on benefit rolls climbed to 2.98 million, the most since June 2004.** The Philadelphia Fed's measure of new orders declined to minus 18.8 from minus 9.3 the prior month, and a measure of shipments decreased to minus 8 from minus 6.3 the prior

month. Consumer and corporate demand have weakened as the housing market faces its worst recession in a generation, costing jobs and undermining confidence. Tighter credit spawned by subprime mortgage defaults last year is further hampering growth in orders and output. Carpenter Technology Corp., a steel and specialty-metals producer, said April 14 its third quarter profit excluding one-time items fell as costs increased and slowing economic growth eroded demand. "Results for the 2008 third quarter reflected reduced demand in Carpenter's economically sensitive automotive, industrial and consumer end markets, combined with higher operating costs," the Wyomissing, Pennsylvania-based company said. Inventories A gauge of unfilled orders rose to minus 16.8 from minus 18.7, while the index of inventories dropped to minus 26.2 from minus 13.5. The employment index fell to minus 11.1 from minus 4.7 a month earlier, the Philadelphia Fed said. Fed policy makers, in their latest monetary meeting March 18, also saw increased likelihood of a downturn this year. "Many participants thought some contraction in economic activity in the first half of 2008 now appeared likely," according to the minutes of Fed's March meeting released last week. **Philadelphia Fed Index Declines More Than Forecast**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=alRaGPOP8E48&refer=home>

- April 17 (Bloomberg) -- **The Bank of England should take care when it invests public funds in risky or money-losing ventures, according to documents being sold by Christie's International.** The warning is no reference to the U.K. central bank's role in the rescue of Northern Rock Plc. **The London-based auction house said it refers to what might be called "ye olde credit crunch" of 300 years ago. The 1715 pamphlets "The Ruine of the Bank of England, and All Publick-Credit Inevitable" and "The Directors of the Bank of England, Enemies of the Great Interest of the Kingdom"** may fetch as much as 20,000 pounds (\$40,000) in a London sale on April 30. The forecasts of doom were written by John Holland, co-founder of the Bank of Scotland, who criticized the British government for converting the national debt into the stock of the ill-fated South Sea Company. "Holland is trying to warn people that the government is getting into a messy situation by involving itself with the South Sea Company," Julian Wilson, a specialist in Christie's books and manuscripts department in London, said in a phone interview. In 1711, the British government converted 10 million pounds of its war debt into the stock of the newly established South Sea Company, which had been granted exclusive trading rights in Spanish South America. The promise of a monopoly led to the share issue being heavily subscribed and quickly rising in value. Meanwhile, little trading took place in the South Seas itself. South Sea Wilson said "The Ruine" attacks the Bank of England's plans to convert a further 800,000 pounds of debt into the South Sea's speculative stock. "This is indeed very Dreadful to think on, and will put many thousand Families under the greatest Consternation and Distress," wrote Holland. The South Sea stock price reached a high of 950 pounds in July 1720, collapsing to less than 200 pounds in September, economic historian Larry Neal said in his 1990 study, "The Rise of Financial Capitalism: International Capital Markets in the Age of Reason." Among the most famous of the thousands of victims of the bubble was the scientist **Isaac Newton** who, according to his niece, lost 20,000 pounds. "I can calculate the motions of the heavenly bodies, but not the madness of people," said Newton. In September 1720 the Bank of England attempted to support the South Sea share price by promising to

exchange the company's bonds for silver at a price of 400 pounds, according to <http://www.moneyweek.com> in November 2007. Panicking South Sea stockholders immediately lined up outside the company offices to get their savings, moneyweek said, echoing the panic around the time of the 55-billion pound rescue for Northern Rock. **Ye Olde Credit Crisis: 18th Century U.K. Bank Warning for Sale** http://www.bloomberg.com/apps/news?pid=20601068&sid=aTXNB.uT0_VM&refer=economy

- April 17 (Bloomberg) -- **Toyota Motor Corp.'s operating profit may decline about 20 percent this fiscal year because of slowing U.S. sales and a stronger yen, the Nikkei newspaper reported.** "Consumer demand in the U.S. has gone ice cold," said Yuuki Sakurai, who helps manage the equivalent of \$41.5 billion at Fukoku Mutual Life Insurance Co. in Tokyo. **"Growth in emerging markets won't be able to cover that drop in earnings."** Toyota spokeswoman Shiori Hashimoto declined to comment. The company is scheduled to give a forecast for the current year on May 8 in Tokyo when it publishes results for last fiscal year. "Toyota's possible profit decline is within the range that's already priced into the stock," said Koji Endo, a senior analyst at Credit Suisse Group in Tokyo, who rates the company "outperform." "Investors are relieved." **Toyota's Earnings May Fall 20% This Year, Nikkei Says** <http://www.bloomberg.com/apps/news?pid=20601087&sid=apfhKp.og2iw&refer=home>
- April 16 (Bloomberg) -- The Federal Reserve said economic growth has slowed in nine of its 12 districts since February, hurt by "anemic" real estate markets and a slowdown in consumer spending. **"Economic conditions have weakened since the last report," the central bank said in its regional business survey, known as the Beige Book for the color of its cover. "Nine Districts noted slowing in the pace of economic activity, while the remaining" three "described activity as mixed or steady."** The anecdotal reports are part of a package of analysis and data that will be used by Fed policy makers as they decide on interest rates at their two-day meeting April 29-30. Today's release underscores a weakening economy, though with manufacturing benefiting from record exports. "What this report says is that the recession really hasn't begun to roll yet," said former Fed governor Lyle Gramley, now a senior economic advisor at the Stanford Group in Washington. "This is an economy that is started over the edge, but it is not plunging at this point." **Consumer spending "weakened in most" districts, the report said. Retailers outside the auto industry "reported that sales were sluggish or declining in 10 districts."** "Growth in consumption and business-investment spending has slowed markedly after years of robust performance, and, as a result, the economy has all but stalled and could even contract over the first half of the year," San Francisco Fed Bank President Janet Yellen said in a speech in Alameda, California today. **"Downside risks to growth are significant."** Private employers cut payrolls for four consecutive months through March. The unemployment rate stands at 5.1 percent. Fed Chairman Ben S. Bernanke said that U.S. gross domestic product may "contract slightly" in the first half of the year, in testimony April 2 to Congress. **Faltering Job Market "Labor markets were mostly described as weakening since the last report, though a few Districts reported ongoing shortages of skilled workers and some districts noted wage pressures,"** the Beige Book said. The last report covered a period through Feb. 25. The Beige Book said "housing markets and home construction remained sluggish throughout most of the nation." Housing starts in the U.S. dropped in

March to a 17-year low, a report today showed. Residential construction is "generally anemic," the Fed's report said. U.S. foreclosure filings jumped 57 percent and bank repossessions more than doubled in March from a year, Irvine, California-based RealtyTrac Inc., a seller of default data, said yesterday. JPMorgan Chase & Co. said today it set aside \$1.1 billion in the first three months of 2008 for future home-equity defaults, after boosting those provisions by \$395 million in the first quarter. Dimon Warning Chief Executive Officer Jamie Dimon said he expects home prices to drop as much as 9 percent this year. **"Real estate is getting worse,"** Dimon said in a conference call today with investors after the bank, the third largest in the U.S., reported first-quarter earnings. "Home prices we still expect to go down." Banks reported tighter lending standards, and **"credit quality was reported to have deteriorated, on balance, since the last report,"** the Beige Book said. The survey said business contacts in all districts "continued to report increases in input costs and output prices." "Most manufacturers have or are planning to increase prices in response to rising input costs, while the response of service firms has been more mixed, in part due to differences in competitive pressures," the Beige Book said. Margin Pressure The report said input costs have risen faster than retail prices, "putting pressure on margins for many firms." Manufacturing was "varied, with several districts noting that activity was mixed or had held steady," the Fed said. **"Demand was reported as strong for aerospace, aircraft, and defense goods, as well as for steel and food."** [let's see that would be "weapons and canned goods" a good investment policy to follow] Industrial production increased 0.3 percent last month, following a 0.7 percent drop in February, the Fed said today in a separate report. **"Many districts cited strong exports generally,"** [not clear if this includes jobs, but probably should] the Beige Book said. Still, excess capacity led to production declines in the technology industry in the Dallas district. "Uncertainty about economic conditions is leading to a varied, but generally subdued, outlook for manufacturers." The Beige Book's regional anecdotes are gathered through hundreds of telephone calls, news clippings and personal contact by the staff of the 12 Fed banks, whose districts cover all 50 U.S. states. The anecdotes are designed to supplement quantitative forecasts of the Board of Governors staff. Today's report was prepared by the New York Fed, based on information collected on or before April 7, 2008. **Fed Beige Book Says Economy Weakened** Since February http://www.bloomberg.com/apps/news?pid=20601087&sid=aYEr66G_zZmU&refer=home

Retail

- April 17 (Bloomberg) -- **Nokia Oyj, the world's biggest maker of mobile phones, reported first-quarter profit that missed analysts' estimates and said the value of the global handset market will shrink in euro terms this year.** Nokia dropped as much as 12 percent in Helsinki trading, the biggest slide in four years. Net income rose 25 percent to 1.22 billion euros (\$1.95 billion), missing the 1.38 billion-euro average of 14 analyst estimates compiled by Bloomberg. Sales increased 28 percent to 12.66 billion euros. The dollar's decline and slower U.S. and European economic growth will reduce the value of the mobile-phone market in 2008, Chief Financial Officer [Richard Simonson](#) said in a Bloomberg Television interview. Simonson also predicted selling prices will fall as a

result of the dollar. About half of Nokia's revenue is in dollars or closely linked currencies. **“It's a pretty disturbing situation if volumes grow by 10 percent and lower average selling prices and a weaker dollar erase the gain in value,”** said Thor Udenaes, who manages \$500 million, including Nokia shares, at SEB Asset Management in Stockholm. “The recent era of growth rates of 20 percent is now over, what remains is a fight over market share.” Chief Executive Officer **Olli-Pekka Kallasvuo** increased Nokia's market share to 40 percent in 2007 with handsets costing less than \$50 and pricier models with satellite navigation at the expense of rivals including **Motorola Inc.** Nokia's stock lost 24 percent in the first quarter, the most since the second quarter of 2004, on concern sales growth in developed markets will slow. Currency Effect The dollar has lost about 15 percent against the euro in the past year, reducing revenue in euros. At constant currencies, Nokia still anticipates the global handset market will grow this year, Simonson said, calling the currency situation “crazy.” The weaker dollar may also hurt sales and prices this quarter. In today's statement, Nokia also cited “the general economic slowdown in the U.S., and possibly going forward some economic slowdown in Europe” for the new market forecast. Nokia reiterated the global handset market will rise 10 percent by units this year and the company aims to increase its market share. Average selling prices will continue to fall. **“The mobile phone is a necessity item,” Kallasvuo said on a conference call today, responding to whether higher food prices would affect sales.** Unit Shipments Nokia's global market share in the first quarter rose to 39 percent from 36 percent a year earlier, trailing the 40 percent predicted by analysts. The company forecast its second-quarter market share will rise sequentially. Kallasvuo said Nokia plans to unveil “lots” of new devices in the second half. The company shipped 115.5 million devices in the quarter, an increase of 27 percent from a year earlier, and a decline of 13 percent sequentially. The average selling price of its phones fell to 79 euros from 83 euros the previous quarter, and from 89 euros a year earlier on increased sales in emerging markets. Analysts had anticipated shipments of 115 million units and an average selling price of 80 euros. Nokia's market share tops the combined share of its three closest rivals, **Motorola Inc.**, Samsung Electronics Co. and Sony Ericsson Mobile Communications Ltd., according to researcher Strategy Analytics. Motorola, which lost its position as the second-largest maker of mobile phones last year to Samsung, plans to separate its handset business after failing to introduce a model to match the success of the Razr. Schaumburg, Illinois-based Motorola and South Korea's **Samsung** report earnings next week. Emerging Markets In **emerging markets**, Nokia has increased its market share after Motorola withdrew from competing on price as the strategy led to losses last year. Nokia derives more than half of its revenue from outside Europe and North America, while China and India are its two single biggest markets. To stay ahead of competitors, Nokia grouped Internet services such as music, map and game downloads under the Ovi brand and agreed with **Vivendi SA's** Universal Music to sell phones with a year of unlimited access to millions of tracks. In October, the company offered \$8.1 billion for U.S. digital mapmaker **Navteq Corp.** The purchase is currently under review by European Union competition authorities. Nokia also forecast global networks industry growth will be “flat” this year in euro terms, down from an earlier prediction of “very slight” growth.

Nokia Profit Misses Estimates; Forecasts Market Slide
<http://www.bloomberg.com/apps/news?pid=20601087&sid=auyhPBgw5PTQ&refer=home>

- April 16 (Bloomberg) -- **J.C. Penney Co. Chief Executive Officer Myron Ullman said he will moderate growth plans in the next year to cope with a "consumer environment that's very hard to predict," as customers beset by housing and stock market upheaval cut spending.** "I've been in the business 39 years, and **I don't think I've ever seen an environment that was as unpredictable as the current environment,"** Ullman, 61, said during the opening of the Plano, Texas-based company's analyst meeting in New York yesterday. Through 2009 "is a very difficult outlook for us." Ullman said the retailer's five-year growth plan may be "elongated" and laid out a "bridge plan" that includes reducing store openings and renovations, monitoring headquarters' expenses and calibrating store staffing to match demand. The retailer will reduce major store renovations to 20 from 65 this year, Ullman said. J.C. Penney has said it will scale back new stores to 36 from the 50 initially planned this year. "It was good for us. The customer tends to spend it on apparel," and Americans will receive checks in time for back- to-school shopping, he said. "It's not going to save the year, but it's not insignificant," he said. Lower Home Values In his remarks, Ullman cited volatility in the stock and housing markets as factors causing consumers to pare spending. The Standard & Poor's 500 index has declined 9.1 percent this year, and housing values have dropped for the first time since the Great Depression. J.C. Penney, the third-largest U.S. department-store chain, **rose 82 cents** to \$39.53 yesterday in New York Stock Exchange composite trading. The **shares** have fallen 10 percent this year after a 43 percent decline last year. **J.C. Penney, like other retailers, has seen consumers beset by higher food, fuel and housing costs cut spending on non- necessities.** The company lowered its first-quarter sales and profit forecasts last month by at least a third and last week reported its worst monthly same-store sales decline in at least 15 years. The slowdown comes as J.C. Penney pitches its pricier American Living collection by Polo Ralph Lauren Corp. **March sales at stores open at least a year fell 12.3 percent,** J.C. Penney said last week. **J.C. Penney's Ullman to Slow Expansion in 'Unpredictable' Time**
http://www.bloomberg.com/apps/news?pid=20601109&sid=absuyGf_iSU8&refer=home
- Retail sales unexpectedly "rose" in March** , reports the Commerce Department. Sales inched up 0.2%, beating the Street's expectations of a monthly flat line. But at closer inspection, there's no sign of a retail revival. The monthly uptick came entirely by virtue of gas station sales, which were up 1.1%. Without such sales, monthly growth would have been nonexistent. . . . **Indeed, eight well-known retailers have filed for bankruptcy in the past six months.** Many of them took on debt to try to stay afloat, and their inability to pay is sending ripples across the economy. Sharper Image, for example, went belly up with a \$6.6 million tab at UPS. Shopping mall staples like Zales and Foot Locker have also announced hundreds of store closures thanks to dismal sales. Generally speaking, retail store closings are on track for their first nasty year since 2004. DR

Retirement

Risk

Savings Rate

Tech

Wall Street

- April 17 (Bloomberg) -- New York Attorney General [Andrew Cuomo](#)'s office issued subpoenas to 18 banks and securities firms as part of a criminal probe into the marketing of auction-rate bonds to investors and issuers, a person familiar with the investigation said. The subpoenas were issued under the Martin Act, which gives New York investigators broad powers. John Milgram, a spokesman for Cuomo's office, declined to comment. Securities regulators in nine other states led by Massachusetts separately today said they formed a task force as they investigate the auction market. **``We're all getting complaints on a daily basis from retail investors and they all have the same the story: they were told by their brokers these were safe as cash and they're not,"** said Bryan Lantagne, the securities division director for Massachusetts Secretary of State [William Galvin](#) and head of the task force. Regulatory scrutiny of Wall Street has been growing since the \$330 billion auction-rate market collapsed in February, leaving some issuers paying higher penalty [rates](#) and investors unable to sell their securities. The Securities and Exchange Commission last week said it is working with the Financial Industry Regulatory Authority, which oversees brokerages, to examine firms' disclosures to clients who purchased the bonds. UBS, Merrill Subpoenas The Massachusetts Secretary of State's office said on March 28 that it subpoenaed information from [UBS AG](#), [Merrill Lynch & Co.](#) and [Bank of America Corp.](#) regarding the sale of the securities to investors in the state. A number of individuals have also filed lawsuits against Wall Street banks that sold the bonds. Auction-rate securities are long-term bonds sold by municipalities, student loan corporations and closed-end funds with interest rates that are reset on a weekly or [monthly](#) basis. Much of the debt was guaranteed by bond insurance companies that also backed subprime mortgage-related securities. Demand for the debt fell earlier this year after AAA rated bond insurers were downgraded because of their subprime guarantees. Wall Street banks running the auctions stopped stepping in to buy the bonds in February when there weren't enough bidders, permitting thousands of failures that triggered rates as high as 22 percent. New York Probe Cuomo is also asking for information about how bankers persuaded borrowers to issue the bonds and how the banks came to decide when to stop bidding in mid-February, the person familiar with the probe said. The banks Cuomo subpoenaed include Merrill Lynch & Co., UBS and JPMorgan Chase & Co., the person said. **Cuomo Subpoenas Banks in Auction Probe, Person** **Says**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=arU7gKln37IM&refer=home>
- April 17 (Bloomberg) -- FBI Director [Robert Mueller](#) said the agency's investigations into the subprime loan meltdown may uncover financial crimes committed by hedge funds and private equity firms. Federal Bureau of Investigation agents have opened 19

criminal probes of companies in connection with the lending crisis, focusing on accounting fraud, insider trading and allegations of deceptive sales practices. Mueller, speaking today to an American Bar Association group in Washington, said he expects more to come as housing prices continue to fall. **“These investigations may well lead to other instances of fraud, from investment banks and private equity firms to hedge funds,” Mueller said. “We do not take these investigations lightly.”** The collapse in the credit markets has shaken Wall Street and forced people from their homes. Mueller told Congress yesterday that the FBI has seen a “tremendous surge” in fraud cases related to subprime loans, which are made to borrowers with poor credit. Still, Mueller said the agency will be able to combat the mortgage problem. “We’ll put whatever agents onto this as necessary to address it,” he said. **FBI's Mueller Says Subprime Fraud Probe May Lead to Hedge Funds**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a8ULA6kmvOAA&refer=home>

- April 17 (Bloomberg) -- **Merrill Lynch & Co. posted its third straight quarterly loss and said it will cut about 3,000 more jobs after the credit seizure forced the investment bank to write down at least \$6.5 billion of debt.** The first-quarter net loss of \$1.96 billion, or \$2.19 a share, compared with earnings of \$2.16 billion, or \$2.26, a year earlier, the third-biggest U.S. securities firm by market value said today in a statement. Analysts had predicted a loss of \$1.72 billion, based on *estimates* compiled by Bloomberg. Merrill rose in New York trading. Chief Executive Officer **John Thain** said today he expects “more difficult” months ahead. Since taking the job in December, he has sold more than \$12 billion of equity to bolster capital and overhauled risk-management after the company booked more than \$20 billion of credit-market losses. Merrill's *stock* has fallen 50 percent in the past 12 months, trailing larger New York-based rivals Goldman Sachs Group Inc. and Morgan Stanley. “The current environment is still tough,” said **Rose Grant**, managing director in the investment-advisory division of Boston-based Eastern Bank Corp., which owns about 66,000 Merrill shares. “People are still reluctant to buy certain types of assets, and I don't think we'll see the end of that until later this year.” Merrill gained 87 cents, or 2 percent, to \$45.76 at 10:19 a.m. in New York Stock Exchange composite trading, after falling as low as \$43.23 earlier today. **‘Deteriorating Conditions’** The first-quarter writedowns included \$2.6 billion to account for the plummeting value of mortgage-related bonds including collateralized debt obligations. Merrill also reduced the value of bond insurance contracts by \$3 billion, and lowered the value of leveraged loans by \$925 million. The markdowns reflected in Merrill's *net loss* exclude a \$3.1 billion drop in the value of securities held in the firm's U.S. banks. Those declines were classified as “other comprehensive income,” an accounting category for securities that Merrill expects to keep until they pay off at maturity. Moody's Investors Service today said it may cut Merrill's credit rating for the second time in six months, citing “deteriorating conditions in the mortgage market” and the potential for \$6 billion of writedowns in addition to those announced in the past three quarters. Last October, Merrill's rating was lowered one level to A1, the fifth-highest of 10 investment-grade ratings. **Revenue Declines** Merrill's credit-default swaps have climbed to 172 basis points from 131 basis points at the end of November, according to prices from Phoenix Partners Group and CMA Datavision. At the current price, the swaps are trading as if the firm had a Moody's credit ranking of Baa3, the lowest investment-

grade rating, according to the ratings firm's credit strategy group. Credit-default swaps, contracts to protect against or speculate on default, pay the buyer face value if a company fails to adhere to its debt agreements. Merrill's total revenue fell 69 percent to \$2.9 billion in the first three months of 2008 from a year earlier. That included a 40 percent drop in investment-banking fees. The company's brokerage, the world's biggest with a network of 16,660 financial advisers, was the only major division to post a gain. Revenue in the unit increased 7 percent to \$3.3 billion. Fixed-income trading revenue was negative \$3.38 billion and equity-trading revenue was \$1.88 billion, down from \$2.39 billion a year earlier. Debt underwriting generated \$231 million in revenue, down 61 percent, while stock underwriting revenue dropped 45 percent to \$199 million. Investor Demands "Merrill Lynch has to show profitability," said Ken Crawford, senior portfolio manager at Argent Capital Management in St. Louis, which owns about 160,000 Merrill shares. "They can't have negative return-on-equity quarters and expect to make investors happy." **Merrill Posts Loss on Mortgage Writedowns, Cuts Jobs** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aIcCx0ipgovI&refer=home>

- April 16 (Bloomberg) -- **Jamie Dimon, Richard Fuld, Lloyd Blankfein, and John Mack say that the credit-market contraction is winding down. Investors whose bank stocks plummeted aren't convinced. Dimon, chief executive officer of JPMorgan Chase & Co., said today that the credit crisis is "maybe 75 percent to 80 percent" over. Fuld, CEO of Lehman Brothers Holdings Inc., told shareholders yesterday that the "the worst is behind us." Their comments followed similar remarks last week by Goldman Sachs Group Inc.'s CEO Blankfein who told investors "we're closer to the end than the beginning," and Mack, Morgan Stanley's chief, who said the crisis will probably last "a couple of quarters" longer. It's not the first time that banking executives expressed optimism that turmoil in the credit markets was contained or approaching an end. And they were wrong. Total writedowns were about \$97 billion at the end of December and surged to \$181 billion by the end of February. The world's biggest banks have recorded \$255 billion in asset writedowns and credit losses since the beginning of 2007.** Shareholders need "more proof before they start believing things are fine again," said Rose Grant, managing director of Eastern Investment Advisors, the money-management unit of Boston-based Eastern Bank, which owns Merrill Lynch & Co. shares. Until the firms disclose the full extent of their writedowns and credit losses "people are going to sit on the sidelines." Dimon Optimistic Investors get a closer look at the magnitude of the industry's woes this week. JPMorgan, the third-biggest U.S. bank by assets, said today that first-quarter profit fell 50 percent after \$5.1 billion of writedowns and provisions linked to bad home equity loans, financing for leveraged buyouts and subprime mortgages. Net income dropped to \$2.37 billion, or 68 cents a share, matching estimates. Dimon told analysts and investors today on a conference call that the credit-market crisis is more than halfway over and may be as much as 80 percent over. "That side is working itself out," he said. "That doesn't mean the recession won't get worse or better." The International Monetary Fund said last week that losses stemming from the U.S. subprime mortgage crisis may reach \$945 billion. The fund also predicted as much as \$90 billion in further losses from potential downgrades of bond insurance companies. The group estimates that more than \$500 billion of the losses will be related to banks. The collapse of the subprime market in the U.S. has reached its

eighth inning or "maybe top of the ninth," Mack said on April 8, referring to the final period of a baseball game. Europe is in the sixth inning and the market for commercial mortgage securities is "probably in the fifth," he said. "If we are in the ninth inning, it's a double-header," Sanford C. Bernstein's Brad Hintz, the third-ranked securities analyst according Institutional Investor magazine, said in a Bloomberg television interview yesterday. "It's going to take time for the market to settle down after this." Earlier Comments The optimistic comments by Fuld, Blankfein and Mack echoed those made by Wall Street executives in June 2007. Christopher O'Meara, former chief financial officer of Lehman, told investors that "we continue to believe that subprime market challenges are and will continue to be reasonably contained." Bear Stearns Cos. CFO Sam Molinaro said at the time that while declining value of subprime bonds was "a challenge" for the firm, "it hasn't spilled into other areas of the market." "Subprime continues to be weak" and yet "there's very little effect on other credit markets," David Viniar, the CFO of Goldman, told reporters on a conference call at the time. Stan O'Neal, Merrill's former chairman and chief executive officer, said that subprime defaults were "reasonably well contained." Bank of America Corp. CEO Kenneth Lewis said June 20 that the housing slump was just about over. "We're seeing the worst of it," he said. Bear Trigger Bear Stearns helped trigger the credit contraction after two of its hedge funds, which invested in securities linked to subprime mortgages, collapsed in July. The company's fourth- quarter loss of \$854 million was the first in its 85-year history. Credibility 'Lacking' Lehman, the fourth-largest U.S. securities firm, said last week it had to bail out five short-term debt funds last quarter that were crippled by frozen credit markets. Earlier this month Lehman raised \$4 billion from a stock sale, seeking to quell concern the firm was low on capital. Fuld said yesterday that the sale was intended to strengthen capital and send a message to investors. "The credibility of some of these people that are making these quotes is pretty lacking," said Jon Fisher, a Minneapolis- based portfolio manager at Fifth Third Asset Management which oversees \$22 billion in assets including JPMorgan shares. "I don't pay any attention to them. They don't have any credibility to be calling a bottom here." **Bank Chiefs See End for Woes Investors Can't Forget**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aIQ0yVC.x14w&refer=home>


Don't Fight The Fed

I Disagree . . . and why

[Article of the week:](#)

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LIBOR
Bankers
On Key Rate Amid Crisis

Cast

FOG
Doubt

By
April 16, 2008; Page A1

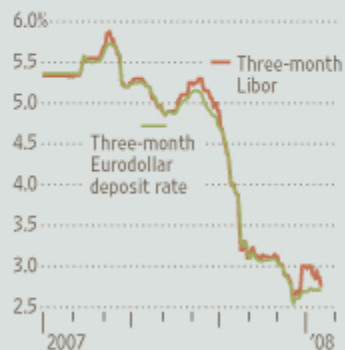
CARRICK

MOLLENKAMP

LONDON -- One of the most important barometers of the world's financial health could be sending false signals.

Broken Indicator?

Since the financial crisis began, the rate on three-month interbank loans has diverged at times from the comparable rate for dollars deposited outside the U.S.



Source: Reuters via WSJ Market Data Group

In a development that has implications for borrowers everywhere, from Russian oil producers to homeowners in Detroit, bankers and traders are expressing concerns that the London inter-bank offered rate, known as Libor, is becoming unreliable.

Libor plays a crucial role in the global financial system. Calculated every morning in London from information supplied by banks all over the world, it's a measure of the average interest rate at which banks make short-term loans to one another. Libor provides a key indicator of their health, rising when banks are in trouble. Its influence extends far beyond banking: The interest rates on trillions of dollars in corporate debt, home mortgages and financial contracts reset according to Libor.

In recent months, the financial crisis sparked by subprime-mortgage problems has jolted banks and sent Libor sharply upward. The growing suspicions about Libor's veracity suggest that banks' troubles could be worse than they're willing to admit.

The concern: Some banks don't want to report the high rates they're paying for short-term loans because they don't want to tip off the market that they're desperate for cash. The Libor system depends on banks to tell the truth about their borrowing rates. Fibbing by banks could mean that millions of borrowers around the world are paying artificially low rates on their loans. That's good for borrowers, but could be very bad for the banks and other financial institutions that lend to them.

True Borrowing Costs

No specific evidence has emerged that banks have provided false information about borrowing rates, and it's possible that declines in lending volumes are making some Libor averages less reliable. But bankers and other market participants have quietly expressed concerns to the British Bankers' Association, which oversees Libor, about whether banks are reporting rates that reflect their true borrowing costs, according to a person familiar with the matter and to government documents. The BBA is now investigating to identify potential problems, the person says.



Questions about Libor were raised as far back as November, at a Bank of England meeting in which United Kingdom banks, the firms that process bank trades and central bank officials discussed the recent financial turmoil. According to minutes of the meeting, "several group members thought that Libor fixings had been lower than actual traded interbank rates through the period of stress." In a recent report, two economists at the Bank for International Settlements, a sort of central bank for central bankers, also expressed concerns that banks might report inaccurate rate quotes.

On the Agenda

RESOURCES

- [Libor Loan Tutorial](#)¹
- [Libor Rate Mortgage Loans and more](#)²
- **Calculator:** [Fixed Rate Mortgage vs. LIBOR ARM](#)³

A spokesman for the BBA, John Ewan, said the trade group is monitoring the situation. "We want to ensure that our rates are as accurate as possible, so we are closely watching the rates banks contribute," Mr. Ewan said. "If it is deemed necessary, we will take action to preserve the reputation and standing in the market of our rates." Libor is expected to be on the agenda of a bankers' association board meeting on Wednesday.

In a recent research report on potential problems with Libor, Scott Peng, an interest-rate strategist at **Citigroup** Inc. in New York, wrote that "the long-term psychological and economic impacts this could have on the financial market are incalculable." Mr. Peng estimates that if banks provided accurate data about their borrowing costs, three-month Libor would be higher by as much as 0.3 percentage points.

A small increase in Libor can make a big difference for borrowers. For example, an extra 0.3 percentage points would add about \$100 to the monthly payment on a \$500,000 adjustable-rate mortgage, or \$300,000 in annual interest costs for a company with \$100 million in floating-rate debt. On Tuesday, the Libor rate for three-month dollar loans stood at 2.716%.

Libor has become such a fixture in credit markets that many people trust it implicitly. Concerns about its reliability are "actually kind of frightening if you really sit and think about it," says Chris Freemott, a Naperville, Ill., mortgage banker who depends on Libor to tell him how much his firm, All America Mortgage Corp., owes First Tennessee bank for a credit line that he uses to make loans.

The Libor system was developed in the 1980s. Banks were looking for a benchmark that would allow them to set rates on syndicated debt -- corporate loans that typically carry interest rates that adjust according to prevailing short-term rates. By pegging lending rates to Libor, which is supposed to represent the rate banks charge each other for loans, banks sought to guarantee that the interest rates their clients pay never fall too far below their own cost of borrowing.

Costly Credit

One indicator of worries about the financial health of banks—the difference between the three-month London interbank offered rate and the yield on a virtually risk-free three-month Treasury bill—has risen sharply several times since the financial crisis began last July.



Banks typically set their lending rates at a certain "spread" above Libor: A company with decent credit, for example, might pay an interest rate of Libor plus one-half percentage point. A risky "subprime" mortgage loan might carry an interest rate of Libor plus more than six percentage points.

Today, Libor rates are set for 15 different loan durations -- from overnight to one year -- and in 10 currencies, including the pound, the dollar, the euro and the Swedish krona. They serve as the basis for payments on trillions of dollars in corporate loans,

mortgages and student loans. Libor rates are also used to set the terms of more than \$500 trillion in "derivatives" contracts such as interest-rate swaps, which companies all over the world, including U.S. mortgage guarantors Fannie Mae and Freddie Mac, use to protect themselves against sudden shifts in the difference between long-term and short-term interest rates.

When banks want to borrow money, they contact banks directly or phone a loan broker, such as ICAP PLC in London. Much of the interbank lending takes place between 7 a.m. and 11 a.m. London time. In broker speak, a bank might ask for a "yard" -- one billion in a designated currency. Brokers communicate with bank clients by phone or through desktop voice boxes, which are faster. At ICAP, brokers track bids and offers by looking up at a big whiteboard above the trading floor, where a "board boy" posts information. The actual rates at which banks borrow from each other are known only to the lenders and borrowers, and possibly to their brokers.

Every morning by 11:10 London time, "panels" of banks send data to **Reuters Group PLC**, a London-based business-data and news company, on what it would cost them to borrow a "reasonable amount" in a designated currency. The dollar Libor panel, for example, consists of 16 banks, including U.S. banks **Bank of America Corp.** and **J.P. Morgan Chase & Co.** and U.K. banks **HBOS PLC** and **HSBC Holdings PLC**. Reuters uses the reported borrowing rates to calculate Libor "fixings." To reduce the possibility that any bank could manipulate an average by reporting a false number, Reuters throws out the highest and lowest groups of quotes before calculating averages.

Justin Abel, global head of data operations for Reuters, said in a statement that his company's role is solely to calculate fixings based on the information provided by banks. "It is their data alone we distribute. Reuters is purely the facilitator," he said.

Wary of Lending

The global financial crisis that began last summer has made it more difficult for banks to package and sell all kinds of loans as securities, as well as to issue bonds and short-term IOUs to investors. Increasingly, banks have turned to the interbank market to borrow cash. But their mounting losses on mortgage securities and other investments have raised fears that a major institution could go bust. That's made banks increasingly wary of lending to one another.

BANK 3-MO. RATE

HBOS 2.75000%

Credit Suisse 2.74000

Bank of America 2.73000

J. P. Morgan Chase 2.72000

HSBC 2.72000

Bank of Tokyo-Mitsubishi 2.72000

Barclays 2.72000

Norinchukin Bank 2.72000

Royal Bank of Canada 2.71750

Lloyds 2.71000

Westdeutsche Landesbank 2.71000

Rabobank 2.71000

UBS AG 2.71000

Royal Bank of Scotland 2.70500

Deutsche Bank 2.70000

Citigroup 2.70000

Calculating Libor

A look at how Tuesday's London inter-bank offered rate was calculated:

Between 11 and 11:10 a.m. London time, the 16 banks at left report the rates at which they borrow from other banks.

**Tuesday's 3-month
U.S. dollar Libor:
2.71594%**

The two center quartiles are averaged, and the day's Libor rate is published at about 11:30 a.m. GMT.

Sources: British Bankers' Association;
Reuters

Such jitters have made many banks unwilling to extend loans to each other for more than one week. As a result, the rates they quote for loans of three months or more are often speculative, because there's little to no actual lending for that time period, brokers say. "It amounts to an average best guess," says Don Smith, an economist at ICAP, the London broker of interbank loans and derivatives.

These bank problems are proving costly to other kinds of borrowers around the world. One way to measure the rough cost is by comparing the three-month Libor rate with an interest rate that doesn't reflect worries about banks' financial health -- such as

the yield on a three-month Treasury bill, which is backed by the U.S. government. The gap between the two stood at 1.58 percentage points Tuesday, and has averaged 1.39 percentage points since the crisis began in August. In the five years before the financial crisis started, it averaged only 0.28 percentage points.

Citigroup's Mr. Peng believes banks could be understating even those abnormally high Libor rates. He notes that the Federal Reserve recently auctioned off \$50 billion in one-month loans to banks for an average annualized interest rate of 2.82% -- 0.1 percentage point higher than the comparable Libor rate. Because banks put up securities as collateral for the Fed loans, they should get them for a lower rate than Libor, which is riskier because it involves no collateral. By comparing Libor with that indicator and others -- such as the rate on three-month bank deposits known as the Eurodollar rate -- Mr. Peng estimates Libor may be understated by 0.2 to 0.3 percentage points.

Other Benchmarks

In one sign of increasing concern about Libor, traders and banks are considering using other benchmarks to calculate interest rates, according to several traders. Among the candidates: rates set by central banks for loans, and rates on so-called repurchase agreements, under which borrowers provide banks with securities as collateral for short-term loans.

In a report published in March by the Bank for International Settlements, economists Jacob Gyntelberg and Philip Wooldridge raised concerns that banks might report incorrect rate information. **The report said that banks might have an incentive to provide false rates to profit from derivatives transactions. The report said that although the practice of throwing out the lowest and highest groups of quotes is likely to curb manipulation, Libor rates can still "be manipulated if contributor banks collude or if a sufficient number change their behaviour."**

Write to Carrick Mollenkamp at carrick.mollenkamp@wsj.com⁴
http://online.wsj.com/public/article_print/SB120831164167818299.html

Bankers Group Reviews Libor Amid Manipulation Concern (Update2)

By Ben Livesey

April 16 (Bloomberg) -- The British Bankers' Association will speed up the review of the process by which money-market rates are set daily amid concern that some contributors are providing misleading quotes.

The global credit squeeze has raised concern lenders have been manipulating the so-called fixing process to prevent their borrowing costs from escalating, the Bank for International Settlements said in March. Participants have complained about whether banks are submitting accurate information, said [Angela Knight](#), chief executive of the London-based BBA.

The association, which held its annual board meeting today, said it will ban any member deliberately misquoting lending rates. The rate serves as the basis for many interest-rate derivatives, including swaps that switch between fixed and floating-rate payments, which totaled \$382.3 trillion in the second half of last year, according to the International Swaps and Derivatives Association.

“At the heart of the problem is that this credit crisis has crystallized why we are referencing so many securities to an uncollateralized reference rate and not a market price,” said [Francesco Garzarelli](#), director of macro and markets research at Goldman Sachs Group Inc. in London. “That is why the panel is being solicited to provide better quotes. Libor is a rate that has lost some of its reference value in the current crisis.”

The BBA asks 16 member banks every morning to say how much it would cost them to borrow from each other for 15 different periods in currencies including dollars, euros and pounds. It then calculates averages, known as the London interbank offered rates, or Libor, which are used as benchmarks for companies, lenders and investment banks around the world, including the \$1.21 trillion a day market for interest-rate swaps.

‘Ensure the Integrity’

The BBA represents lenders such as [HSBC Holdings Plc](#), Europe's largest bank by market value, [Royal Bank of Scotland Group Plc](#) and [Barclays Plc](#). Spokespeople [Patrick McGuinness](#) of HSBC, [Alistair Smith](#) of Barclays and [Carolyn McAdam](#) of RBS declined to comment.

Liquidity concerns, the cost of wholesale market borrowing and Libor rates were discussed at the board meeting. The BBA holds a review of its daily money market operations every year, concluding in June. The BBA didn't say when the review would be completed.

“This is about the need to ensure the integrity of Libor is absolutely right,” Knight said. “We are in this very difficult credit situation and this is the right and appropriate thing to do. We have had people contact us. We recognize the points that have been made. We need to open up and have a good look.”

The complaints to the association were reported earlier today by the Wall Street Journal.

'Severely Weakened'

"Libor will survive, although its credibility is severely weakened," Paul Calello, Credit Suisse Group's head of investment banking, said in a speech at the International Swaps and Derivatives Association annual conference in Vienna today. "Continuing to base an enormous amount of derivative contracts on an index with credibility problems is a serious issue we must address."

Money-market rates began surging last year as the fallout from the U.S. housing slump left banks wary of lending to all but the safest borrowers. The three-month dollar rate was at 2.73 percent today, the highest since April 3, according to BBA data. That's 48 basis points more than the Federal Reserve's target rate for overnight lending between banks, compared with an average of 11 basis points in the first half of last year.

Three-month Libor understates true lending rates between banks by between 20 and 30 basis points, according to an April 10 research note by Citigroup Global Markets Inc.

'Prevailing Fear'

"The most obvious explanation for Libor being set so low is the prevailing fear of being perceived as a weak hand in this fragile market environment," wrote Scott Peng, head of U.S. rates strategy at Citigroup in New York.

Eurodollar futures contracts, which are based on traders' expectations for three-month dollar Libor, rose today amid concern that rates may increase at tomorrow's fixings as banks exercise more care when giving quotes, said Ian Lyngen, an interest-rate strategist at RBS Greenwich Capital in Greenwich, Connecticut. The implied yield on the contract expiring in June climbed 12 basis points to 2.68 percent.

"The risk is that there are calls coming down from the highest level of the 16 different banks associated with the Libor process saying this better not be us and if it is, it better not be us tomorrow," said Lyngen. "We might find out tomorrow" if estimates of Libor's inaccuracy were correct.

Money markets would benefit from increased transparency and "trimming," or the discarding of extreme rates quoted by participating banks, the Basel, Switzerland-based BIS said in a study released in March with its quarterly report. The system still worked as it was meant to do when rates started rising last year, it said.

<http://www.bloomberg.com/apps/news?pid=20601102&sid=aZHPJf06Z5t8&refer=uk>

Libor credibility questioned as credit crunch deepens

By Peter Taylor

Last Updated: 12:49am BST 17/04/2008

The British Bankers' Association has brought forward a review into how it sets the pivotal London Interbank Offered Rate amid mounting concerns over the credibility of the measurement.

The association yesterday revealed it was re-assessing how it calculates Libor - a benchmark measurement that filters through the economy, affecting mortgage and other interest rates across the lending system.

Despite widespread concerns that Libor has blown out to levels significantly above base rates, economists fear banks are understating the rates at which they are prepared to lend to each other, downplaying liquidity problems.

advertisement

Pressure for an overhaul of the Libor calculation process is escalating after a report last week, *Is Libor Broken?*, by Citigroup interest rate strategist Scott Peng, who said the inter-bank rate "touches everyone". "We believe the current liquidity crisis has damaged the inter-bank market, resulting in Libor sets that at times deviate significantly from real inter-bank lending rates," he said.

- **The financial crisis in full**

Paul Calello, chief executive of investment banking at Credit Suisse, yesterday joined a growing chorus questioning Libor reliability.

"Continuing to base an enormous amount of derivative contracts on an index with credibility problems is a serious issue we must address," he told a banking conference.

Credit Suisse rate strategist William Porter said Libor had a "huge incumbent advantage" the British Bankers' Association (BBA) was in danger of losing. "There's no underlying transaction actually done at Libor, so it is inherently subjective, and yet it fixes the interest rates on a large proportion of the world's interest-rate contracts."

The BBA calculates a range of Libor figures in various currencies for borrowing periods ranging from overnight to 12 months, based on an average of inter-bank rates offered by a panel of 16 banks each morning.

A BBA spokesman said Libor rates were "self-checking because they are rates within the market", though they were verified by a committee of "practitioners and experts".

While an annual review had been scheduled for mid-year, it had been brought forward and started several weeks ago. The outcome would be announced "in due course", he said.

Though lower inter-bank rates reduce consumer borrowing rates across the credit system, the fear is that the banks are understating their real borrowing costs to avoid drawing more attention to their funding woes.

Another economist, who declined to be named, said: "No one's going to call each other's bluff because, as an industry, I think they don't want to admit the problems that there are out there with funding. It's like a mutual thing: I'll pretend you're thin if you pretend I'm six feet tall."

The significance of Libor, which has far more impact on "coal face" rates than central bank rates, has grown since the liquidity crisis took hold last year and the gap between inter-bank rates and central bank rates has widened. While the Bank of England cut base rates last week to 5pc, the three-month sterling Libor yesterday stood at 5.9244pc.

In his report, Mr Peng said the importance of Libor, the most popular floating-rate index in the world, had "evolved far beyond its humble roots as an inter-bank lending rate". "Libor touches everyone from the largest international conglomerate to the smallest borrower in Peoria: it takes centre stage in every interest rate swap."
<http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/04/17/cnlibor117.xml>

Best of the Dog