

September 16, 2007 Review

Comments

Greetings from the Kresge Business School Library, where I have learned that courtesy is no longer expected. The noise level is commensurate with what I recall of the school cafeteria as opposed to a library. No effort is made to whisper, limit conversation or otherwise attempt to maintain a quiet environment for fellow users.

Back to news of note.

The week to come will have many interesting data points. There is of course the Fed cut (no cut = things so bad that a decision was made to stand against inflation and simply allow the markets to tank; 25 basis points and a message that “we are on the job” is what I expect. That way a sell off could be met with an emergency cut and seems to provide the “best case” scenario for holding onto whatever belief in the Fed might remain. A 50 basis point cut will spark a huge initial rally in equities that will be sold by the end of the week and more likely on Wednesday morning at the latest. Further 50 basis points will kill the dollar and blow gold through to new 20 year highs on its way to 4 figures). There also are 4 of the 5 investment banks reporting – we will see how clever their accountants have been in hiding loan and derivative losses by something much less than mark to market – should they come out with grim news, it will be an end game signal because there is no way they will do anything other than push the darkest side of grey in their numbers. We also have the sale of 5B in First Data bonds on Monday. This will be a tell on the appetite for LBO debt – my guess they will not sell out as presently priced and will need to go significantly higher on yield to move them. We will also see how well Hovian and others did with their weekend sales. Should they miss their 150K off sales goals it will tell you just how ugly things are in that industry. We also have the EC ruling on MSFT to see the status of monopoly in Europe. Bad news should hit other players such as INTC. We will also be watching the ongoing meltdown in Northern Rock. As with the Bear Stearns funds in June, one can rest assured that this is NOT a one off story and that the short term debt markets remain very prone to a meltdown.

On the other hand, the Investors Business Daily has a weekend banner headline that there will be no recession and there are plenty of upgrades on Wall Street to chose from. You can still get in on RIMM under 90 and GOOG, AMZN and other disasters waiting to happen are still very popular.

As always,

We will see . . .

Credit

- Sept. 15 (Bloomberg) -- Northern Rock Plc branches around the U.K. had lines of customers stretching outside their doors seeking to withdraw deposits for a second day after the Bank of England authorized emergency funding to the mortgage lender. A line extended about 40 meters (120 feet) from the Golders Green branch in north London

today, where as many as four police officers helped keep order. Clients also stood outside outlets in Kingston and Sheffield in England and Edinburgh in Scotland, images broadcast by television networks showed. "I have been saving for years, and I don't want to lose it," said Jacqueline Porte, who had advanced 25 feet toward the entrance to the Golders Green branch in three hours. "I don't want to be with a bank that hasn't been careful." [as with Bear Stearns in June – THIS is a very big deal with likely ongoing ramifications and the likelihood the problems are wide spread, not just at this institution]

Northern Rock Experiences Second Day of Withdrawals

<http://www.bloomberg.com/apps/news?pid=20601087&sid=apN38ZPrEbX8&refer=home>

- Sept. 15 (Bloomberg) -- The Federal Reserve may need to double its benchmark interest rate to at least 10 percent by 2030 to contain inflation, sparking a political showdown that could challenge its independence, former Chairman Alan Greenspan said. [I bet Bernacke really wishes Greenspan would simply go away. No matter your bias, this type thing is completely uncalled for right now – i.e. with a rate cut likely and plenty of matters pressing in 2007. Seems very much like Greenspan can't stand to not be the center of attention] Slowing productivity and rising wages abroad will probably cause U.S. consumer prices to climb in the next quarter century, Greenspan wrote in his book, "The Age of Turbulence: Adventures in a New World," published by Penguin Press. His outlook includes a reversal of many of the trends that aided the success of his own tenure at the Fed. To keep inflation under 2 percent, "the Fed, given my scenario, would have to constrain monetary expansion so drastically that it could temporarily drive up interest rates into the double-digit range not seen since the days of Paul Volcker," Greenspan wrote. Volcker Example [Greenspan was the anti-Volker, catering to the whim of the day and repeatedly bailing out the private sector.] Volcker was Greenspan's predecessor, and faced criticism from members of Congress as he lifted borrowing costs to rein in prices, sending the economy into a recession in 1980 and 1981. The economy will probably slow to a pace of under 2.5 percent on average from now until 2030, Greenspan forecast in the book. Consumer prices, which increased at an average annual rate of 3.1 percent during Greenspan's tenure, will likely climb by 4.5 percent or more a year in the future, he wrote. Ten-year Treasury yields may average 8 percent by 2030, he said. **Greenspan Sees Political Pressure on Fed as Inflation Picks Up**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aV9c2pZaxWkE&refer=home>
- Sept. 14 (Bloomberg) -- Northern Rock Plc got emergency funding from the Bank of England, the biggest bailout of a British lender in 30 years, after a freeze in money markets left the mortgage provider unable to finance itself. Northern Rock shares plunged as much as 26 percent to a six-year low after the company said today the central bank will provide an unspecified amount of credit. The Newcastle, England-based bank is the U.K.'s third-biggest lender by gross mortgages with loans worth 17.4 billion pounds (\$35 billion) as of June 30. **The rescue stoked concern among investors and depositors that other financial firms that rely on short-term credit rather than deposits may be vulnerable.** The Chancellor of the Exchequer Alistair Darling authorized the move, saying the Bank of England will step in as the lender of last resort "where institutions face short-term liquidity difficulties." "This is a set of circumstances that I've not seen in 25 years," [why anyone can claim to be surprised at this point is beyond me – the

reality is there has been abundant time to reign in risk and it is not being done] Chief Executive Officer Adam Applegarth said on a call with journalists. "It's a substantial program, it is at a penalty rate. The facility will provide a solid ground base." The Bank of England hasn't had to bankroll a major U.K. lender since the 1973 collapse of Cedar Holdings, which pioneered second mortgages, triggered a crisis of confidence that threatened to unravel the banking system. Bank `Solvent' **The move will `help Northern Rock to fund its operations during the current period of turbulence in financial markets," the Bank of England, U.K. Treasury and Financial Services Authority said in a joint statement. `Northern Rock is solvent, exceeds its regulatory capital requirement and has a good quality loan book."** [if all of this is true, why is the private sector not stepping up? The reality is that all is not well, there is no reason to believe that this "period of turbulence" will be limited in time or severity and there is a good likelihood that public funds are being frittered away. Unfortunately, we can get used to the last statement] "It leaves Northern **Rock desperately hoping that something comes along to restore confidence,"** said Colin Morton, who helps manage 14.4 billion pounds including Northern Rock shares at Rensburg Sheppards Plc in Leeds. "At the moment their funding costs are higher than what they get from people who are buying a house from them." **Credit-default swaps based on Northern Rock's debt rose 22.5 basis points to 152.5 basis points,** [wonder who the counterparties are on these – oh that is right there is NO way to KNOW] according to Deutsche Bank AG prices. `Freeze, Thaw' Northern Rock's origins date back to 1850, and the current company was formed from a merger between two building societies and the initial public offering of Northern Rock Building Society in October 1997. **The company has relied on borrowing in the money markets to control costs and grow faster than it would if it relied on its deposit base.** The amount that Northern Rock can borrow is capped by the collateral it is able to provide, CEO Applegarth told reporters. The interim dividend will be paid as planned on Oct. 26. The bank, which has 6,000 employees, this year won't replace all of the 15 percent of employees who typically leave annually, he said. **"Looking forward I can't see when the global liquidity freeze is going to end,"** [when the likelihood of repayment can be ascertained and that is no time soon] Applegarth said. "The thaw will only come when banks make it clear what they hold on their balance sheets." The Bank of England yesterday relaxed restrictions on financial institutions, encouraging them to lend more to each other as it tries to reduce overnight borrowing costs that are threatening to crimp economic growth. `Excessive Risk Taking' Yesterday's action by the U.K. central bank was its first to help credit markets since the subprime market collapsed. Governor Mervyn King has indicated the bank won't go as far as the European Central Bank and the Federal Reserve in helping banks cope with the credit rout because policy makers can't afford to "encourage excessive risk taking." **Commercial banks, which agree to hold a specific amount of money at the Bank of England at the end of each month long maintenance period, can now undershoot that target by 37.5 percent to free up cash if needed. That compares with the usual limit of 1 percent. [assuming that is not a typo, how scary is that statement. AND just how awful is the underlying situation to require such an abdication of responsibility by the central bank?]** **Northern Rock Gets Emergency Bank of England Funding**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=a7WvTBECy164&refer=home>

- Sept. 13 (Bloomberg) -- The Bank of England relaxed restrictions on financial institutions, encouraging them to lend more to each other as it tries to reduce overnight borrowing costs that are threatening to hurt economic growth. The move is the first by the U.K. central bank to help credit markets since the U.S. subprime mortgage market collapsed. Governor Mervyn King yesterday indicated the bank won't go as far as the European Central Bank and the Federal Reserve in helping banks cope with the credit rout because policy makers can't afford to "encourage excessive risk-taking." "Today's operations do not represent an underwriting of risky lending but a logical move to help the efficient functioning of the U.K. money markets," said Philip Shaw, chief economist at Investec Securities in London. The Bank of England also added a net 3.9 billion pounds (\$7.9 billion) to money markets in its weekly market operation today. The overnight rate for pounds fell 3 basis points to 5.87 percent after the announcement. It rose as high as 6.5 percent on Aug. 13. The three-month London interbank offered rate, or Libor, declined 1 basis point to 6.89 percent, still near its highest since 1998. The Bank of England's benchmark is currently at 5.75 percent. **Bank of England Relaxes Deposit Rules to Spur Lending**
<http://www.bloomberg.com/apps/news?pid=20601068&sid=aJIRJYeeseWA&refer=economy>
- Sept. 12 (Bloomberg) -- Bank of England Governor Mervyn King said the bank won't amend its system for financing commercial banks by changing its collateral rules or making longer-dated loans **because that would encourage risky behavior in future.** "The provision of such liquidity support undermines the efficient pricing of risk by providing ex-post insurance for risky behavior," King said in written testimony to the U.K. Parliament's Treasury Committee. **"That encourages excessive risk-taking, and sows the seeds of a future financial crisis."** The Bank of England is under pressure from commercial banks to follow the European Central Bank and the U.S. Federal Reserve and do more to help credit markets shaken by the subprime crisis. While the U.K. central bank will offer extra money this week to reduce overnight rates, it has refused to take action to ease three-month borrowing costs. Increasing defaults on U.S. subprime mortgages have pushed up credit costs around the world and widened the gap between three-month money market rates in the U.K. and the benchmark central bank rate to the highest in at least two decades. The ECB, the Fed and other central banks have loaned financial institutions more than \$400 billion since the crisis started to help lower lending rates. The Fed on Aug. 17 cut the rate at which it loans money directly to banks and dropped its bias toward fighting inflation. "Flexible Tool" **King said central banks should only act when there are "economic costs on a scale sufficient to ignore the moral hazard in the future."** [wow, a responsible banker who can actually look beyond the next 15 minutes – hope he never wants a job here, that attitude would never cut it] At the same time, "interest rates are a flexible tool and can be adjusted quickly when necessary."
- Sept. 10 (Bloomberg) -- Wall Street is getting no benefit from the biggest bond market rally in five years. Lehman Brothers Holdings Inc. faces higher borrowing costs today than it did in June, even after the steepest quarterly drop in U.S. Treasury yields since

2002 pushed interest rates down for everyone from Procter & Gamble Co. to AT&T Inc. Investors are so leery of Bear Stearns Cos. that its 10-year bonds trade at a discount to Colombia, the South American nation that's barely investment grade. Goldman Sachs Group Inc. is being punished with a higher yield than Caterpillar Inc., the heavy-equipment maker. **Bond buyers view the nation's largest securities firms as no safer than taking a flier on subprime mortgages. That's a nightmare scenario for the industry's chief executive officers, who relied on cheap financing for leveraged buyouts, real estate lending and proprietary trading** to produce record profits -- and paychecks of \$40 million or more for themselves. **Wall Street Credit Costs Soar on Spread to U.S. Rates**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=a8d.vtWFDdxw&refer=home>

- Sept. 10 (Bloomberg) -- Banks and companies need to refinance almost \$140 billion of commercial paper in Europe by the end of next week and may push up yield premiums on corporate bonds, according to Deutsche Bank AG, Germany's biggest bank. **"This could be a pivotal seven to 10 days,"** Jim Reid, a credit strategist at Deutsche Bank in London, wrote in a note to investors today. **"This will inevitably lead to wider corporate spreads, especially in high yield."** Borrowers are paying the highest costs in six years for commercial paper, IOUs maturing in 270 days or less, because of losses from assets related to subprime mortgages. The yield in the U.S. has soared to 6.33 percent for 30-day debt from 5.48 percent on Aug. 9. Almost \$60 billion of the commercial paper due this week and next is owed by conduits, firms set up by banks and companies to invest in longer-term assets, according to Reid. The debt is backed by bonds including asset-backed securities, as well as car loans, mortgages and trade receivables. The remaining \$80 billion of commercial paper is unsecured. **"Limited Appetite" "Banks have a very limited appetite to hold bonds on their balance sheets given other, more pressing demands for their capital in the short term,"** Deutsche Bank's Reid said in a telephone interview today. HBOS Plc, the U.K.'s largest mortgage lender, was forced on Aug. 21 to commit to refinancing about \$35 billion of asset-backed commercial paper sold by its Grampian Funding LLC unit. Bank of America Corp. estimates that about 59 percent of the \$230 billion of asset-backed commercial paper in Europe comes due this month. The peak will be Sept. 17 when the equivalent of \$48 billion matures, Bank of America analysts in London led by Raja Visweswaran wrote in a report. The credit markets are likely to remain "unsettled" until then, the report said. **Banks' "increasingly bloated balance sheets will not be good news for overall market liquidity,"** Deutsche Bank's Reid said in the note. The U.S. commercial paper market shrank for a fourth week, declining by \$54.1 billion, according to the Federal Reserve in Washington. That included a drop of \$31.3 billion in asset-backed commercial paper. **Debt Market in 'Pivotal' Test as \$140 Billion Matures**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aiVeSRn2c7XY&refer=home>

- Sept. 10 (Bloomberg) -- Treasury investors basking in the biggest rally in four years have reason to fear for their profits: **The largest owners of U.S. government debt are heading for the exit.** The dollar's slump to a 15-year low against six of its most actively traded peers is turning the gains into losses for international bondholders, prompting China, Japan and Taiwan to sell. Overseas investors own more than half of the \$4.4

trillion in marketable U.S. government debt outstanding, up from a third in 2001, according to data compiled by the Treasury Department. **``The support that Asia has shown in buying U.S. Treasuries has been a major supporter of keeping long-term interest rates lower than where they probably would be,**" said Gary Pollack, who oversees \$12 billion as head of fixed-income trading in New York at the private wealth management unit of Deutsche Bank AG, Germany's biggest bank. ``This could put some upward pressure on yields in the United States." **Treasury Rally May Falter as Overseas Holders Flee Dollar Drop**
http://www.bloomberg.com/apps/news?pid=20601087&sid=aNgW4Fu_8.tI&refer=home

Commercial Real Estate

Commodities

- Sept. 12 (Bloomberg) -- Wheat prices surpassed \$9 a bushel for the first time as a drought in Australia cut production, pushing global stockpiles toward a 26-year low. Australia's wheat crop may fall to 18 million metric tons from a prediction of 23 million tons in a U.S. report today. Reserves of the grain in Canada, the world's second-largest wheat exporter, plunged 29 percent at the end of July from a year earlier, Statistics Canada said yesterday. Increasing demand from Egypt to India and weather damage to crops from Canada to Australia have driven up global prices by 81 percent this year. Users including Sara Lee Corp. and PT Indofood Sukses Makmur, the world's biggest producer of instant noodles, are responding by raising prices, fueling inflation. **Wheat Price Rises to Record \$9 a Bushel on Global Crop Concerns [with oil also at a new high, I sure am glad there is no inflation to worry the Fed as they once again bail out unconscionable Wall Street behavior.]**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aDPaX6EqPeVU&refer=home>
- Sept. 7 (Bloomberg) -- OPEC, the producer of 40 percent of the world's oil, may reject consumer calls to increase supplies and lower prices from \$76 a barrel on concern energy demand will falter as U.S. economic growth slows. Oil ministers for Algeria, Iran, Libya, Qatar and Venezuela said in the past week they support keeping the quota at 25.845 million barrels a day until December. OPEC President Mohamed al-Hamli, who is also the United Arab Emirates oil minister, said yesterday markets are ``adequately supplied." The Organization of Petroleum Exporting Countries will meet Sept. 11 at its Vienna headquarters to determine production targets for the fourth quarter, when heating fuel sales peak. **OPEC May Reject Calls for More Supply With Oil at \$76**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=ahIufnL7JaR0&refer=home>

Currency

- Sept. 17 (Bloomberg) -- Currency traders are concluding that there's nothing the U.S. economy can do that Canada's can't do better. Much better. The U.S. and Canadian dollars, which traded in tandem 94 percent of the time since 2000, decoupled in May and now have diverged for the longest stretch this decade, according to data compiled by Bloomberg. While the worst housing slump in 16 years threatens to slow U.S. growth, record oil prices and rising costs for copper and zinc are boosting Canada's exports and allowing the government to balance its budget. Energy accounted for 19 percent of Canada's exports this year, compared with 12 percent in 2002, government data shows. "Canada is in a very strong position," said John Taylor, chairman of New York-based FX Concepts Inc., which manages \$12.1 billion in currencies. "Its economy has significantly diverged from the U.S., and it's got all those things the world needs. My longer-term bias is that the Canadian dollar would be stronger than the dollar." Canada's currency, nicknamed the loonie after the image of the national bird on the one-dollar coin, has risen 3.7 percent against its U.S. counterpart since June 12 amid growing speculation that losses related to U.S. subprime mortgages would prompt the Federal Reserve to cut interest rates. Of the 16 most traded currencies, none has done better than the loonie this year. It gained 13 percent, climbing to a 30-year high of 97.30 U.S. cents on Sept. 14. The currency rebounded from a low of 61.80 cents in January 2002. **[I recall the exchange rate being about 65-70 cents to the dollar when I was in Canada in 2001. I believe that the current trend will continue.]** Canada Dollar Dominance Shows Break With U.S. Economy, Markets
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a6uPcUFdLnao&refer=home>
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- Sept. 15 (Bloomberg) -- The dollar fell to an all-time low versus the euro as traders bet the Federal Reserve will cut borrowing costs at least a quarter-percentage point next week. The U.S. currency declined for a second week against the euro for the first time since July. A government report yesterday showed slowing retail sales growth, suggesting the housing slump is starting to affect the rest of the economy. The Fed will meet on Sept. 18. "The U.S. economy is slowing, and the pace of consumer spending growth has slipped somewhat, and that's dollar negative," said Jay Bryson, global economist with Wachovia Corp. in Charlotte, North Carolina, who previously analyzed currencies at the Fed. "The Fed will cut rates by 25 basis points and make sure they can act again if necessary." The dollar weakened 0.8 percent to \$1.3875 per euro from \$1.3768 on Sept. 7. The U.S. currency fell to an all-time low of \$1.3927 on Sept. 13. The dollar snapped a two-week losing streak and gained 1.8 percent versus the yen, to 115.36 from 113.38 a week ago. **Dollar Declines to Record Low Versus Euro Before Fed Meeting**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=atIuIRZqjnII&refer=home>
- Sept. 12 (Bloomberg) -- The dollar fell to a record low against the euro as investors bet the U.S. interest-rate advantage over Europe will narrow amid the housing market slump. The currency declined for a sixth day, the longest losing streak since April, after the National Association of Realtors yesterday cut its home sales forecast, reinforcing speculation the Federal Reserve will lower its benchmark rate next week. "The

fundamentals for the dollar remain poor because the Fed's the only major central bank that's likely to cut interest rates," said Adam Cole, head of global currency strategy at RBC Capital Markets in London. **Dollar Falls to Record Low Against Euro on U.S. Housing Slump**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=ad3KX7yVdhJo&refer=home>

Diversification

Derivatives

Housing

- **[this is included to demonstrate how ridiculous “investors” are – the builders have called the bottom for more than a year. Prior to that the builders said there was no bubble and things would always be great. Compare this assessment to reality and/or the S & P call]** Sept. 14 (Bloomberg) -- Hovnanian Enterprises Inc. Chief Executive Officer Ara Hovnanian said **the U.S. housing market is near the bottom** and won't recover until 2009. The shares rose 9.7 percent. Hovnanian, whose family has been building homes since 1959, said a three-day sale starting today may help boost revenue in the company's slowest markets, including California and Florida. The builder, based in Red Bank, New Jersey, **hopes to sell 1,000 homes this weekend, Hovnanian said in an interview. [let's see – the “bottom is in” and oh by the way we have houses we are trying to sell this weekend. The astounding thing is it worked at least on Wall Street for a day]** New home sales have fallen 37 percent from their peak two years ago as buyers back out of contracts, wait for prices to decline further or find mortgages difficult to secure. Hovnanian's stock has lost almost three-quarters of its value this year on concern the two-year-old housing decline may extend into next year. **“The bottom is very near [based on what sport? – reality – there is no way to know when “the bottom is in” but there is currently NO evidence that would indicate it is other than this dope trying to pump things to sell houses this weekend]** but I think it's going to stay along the bottom for a while before a recovery," the 50-year-old Hovnanian said today. Moody's Investors Service, Standard & Poor's and the National Association of Realtors said this week the housing decline will extend into next year as tighter loan standards and falling prices cut demand. The company's sale, dubbed the “Deal of the Century,” will be held in 18 states including California, New Jersey, New York, Arizona, Ohio and Illinois. **Hovnanian is offering discounts of up to almost \$150,000 on homes.** Discounts Planned Buyers will “realize unprecedented savings” with incentives of up to \$100,000 in some California developments and more elsewhere, the company said in statements issued this week. At its Vinsanto development in Phoenix, Hovnanian is offering \$5,000 toward closing costs; gift cards worth \$250 to \$500 for Home Depot Inc., Target Corp. and Ashley Furniture; a 42-inch plasma TV; a garage upgrade package with epoxy flooring; and free landscaping and an appliance package with refrigerator, washer and dryer, according to its Web site. Prices there start at about \$150,000 Pulte, Ryland Pulte Homes Inc., the third-largest homebuilder by revenue, advertised in the Chicago Tribune a three-day offer starting today for zero interest, principal, mortgage insurance and tax payments for six months for homes bought at its developments in suburban Chicago. Ryland Group Inc., based in

Calabasas, California, ran an advertisement in today's Chicago Tribune offering a free finished basement and a plasma television to buyers who purchase now. At least five public homebuilders in the last three months have asked their banks for more lenient terms on loans because they are struggling to meet their earnings targets. WCI Communities Inc.'s lenders agreed last month to amend the terms of the company's credit lines to help avoid a default. Also negotiating new loans terms with creditors were Miami-based Lennar Corp., the biggest U.S. homebuilder by revenue; Bloomfield Hills, Michigan-based Pulte; Los Angeles-based KB Home, the fifth; and Irvine, California-based Standard Pacific Corp. **Hovnanian Chief Says Housing Bottom Is `Very Near'**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=ap5OqXj2qpnU&refer=realestate>

- Sept. 13 (Bloomberg) -- **U.S. homebuilders, forced to write down the value of land and liquidate inventories of unsold homes in the housing slump, are unlikely to see a recovery in 2008, Standard & Poor's said.** "We believe the recovery for large builders will lag that of the broader national housing market primarily because big companies invested more heavily in markets that experienced the greatest home price appreciation," James Fielding, a director in New York-based Standard & Poor's real estate companies group, said in a report issued today. Foreclosures are rising the most in areas homebuilders have focused on, including Florida, California, Nevada and Arizona, contributing to growing inventories of unsold homes, S&P said. Stricter lending standards resulting from the collapse of subprime-mortgage companies and concerns about falling home prices are constraining demand, the rating service said. Despite the negative outlook for 2008, homebuilders will eventually be able to clear existing inventories as prices fall to more affordable levels, S&P said. While undercapitalized homebuilders with limited liquidity may fail, companies that entered the decline with solid balance sheets will be competitive during the expected recovery, S&P said. The rating agency didn't name any companies in the report. **U.S. Housing Recovery Is Unlikely in 2008, S&P Says**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=ajsCUhtRw26g&refer=realestate>
- Sept. 11 (Bloomberg) -- The National Association of Realtors reduced its home sales forecast for the ninth time this year and said the housing slump will extend into 2008. **Existing home sales will fall 8.6 percent in 2007, exceeding the 6.8 percent drop estimated a month ago.** New-home sales probably will decline 24 percent on top of an 18 percent fall in 2006, the Chicago-based trade group for 1.3 million real estate brokers said today in a statement. **Realtors Cut Forecast, Say Slump Will Extend to 2008**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aZhCyZiEFjqk&refer=home>
- Sept. 7 (Bloomberg) -- Beazer Homes USA Inc. shares fell 13 percent after the homebuilder received notices of default from a bondholders' group for failing to file a quarterly report with regulators. **Beazer Shares Fall After Receiving Default Notices**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=aVU1CBk0BgL8&refer=realestate>

Housing Finance

- Sept. 10 (Bloomberg) -- Anna Morita, a neuropsychologist in the San Francisco Bay Area with near-perfect credit, was certain she could get the loan of her choice to buy an \$880,000 three-bedroom house. Morita, 34, with more than \$300,000 for a down payment and a credit score of 825 out of a possible 850, was banking on a 30-year loan with interest-only payments for 10 years. That mortgage became too expensive when her lender quoted a rate of 7.6 percent. She's now applying for another mortgage. From buyers who can't afford costly loans to homeowners who can't find a buyer, the mortgage market is a mess. Home-loan defaults are at record levels and analysts predict property prices in the most-expensive metropolitan areas of New York, California and Washington, D.C., will fall in the next year in the broadest decline since 1995. Prices already have dropped in a third of U.S. markets tracked by the Chicago-based National Association of Realtors. **“No place will be immune,”** said Ken Rosen, chairman of the Fisher Center for Real Estate and Urban Economics at the University of California in Berkeley. **“Inventory is increasing and the demand side is falling off. The psychology has become negative.”** **New York, California Metro Home Prices May Decline**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aMG3vdK3Qt2k&refer=home>
- Sept. 8 (Bloomberg) -- Countrywide Financial Corp., the biggest U.S. mortgage company, plans to cut its workforce by 10,000 to 12,000 in the largest round of firings since the industry's contraction began last year. New U.S. home loans probably will drop 25 percent in 2008 from this year's levels, forcing the company to eliminate as much as 20 percent of its staff, Calabasas, California-based Countrywide said in a statement yesterday. More than 15,000 jobs have been lost this week amid the worst U.S. housing slump in 16 years. IndyMac Bancorp, the second-biggest mortgage company, National City Corp. and Lehman Brothers Holdings Inc. cut staff. At least 100 mortgage companies have sought buyers or halted lending since the start of 2006, and foreclosures in the second quarter rose to a record, according to the Mortgage Bankers Association in Washington. **Countrywide May Fire as Many as 12,000 as Mortgage Demand Wanes**
<http://www.bloomberg.com/apps/news?pid=20601208&sid=ah7emxcVIod4&refer=finance>
- Sept. 7 (Bloomberg) -- U.S. homebuyers canceled a third of contracts last month to buy homes that depended on mortgage brokers to find them financing, a survey of the loan arrangers found. Borrowers who qualified for loans at the lowest interest rates, so-called prime-conforming loans, canceled contracts most commonly because they no longer wanted to buy, the survey found. Subprime borrowers were unable to get mortgages because lenders wouldn't approve them, failed to honor prior financing commitments or stopped making loans, according to the survey of 1,744 mortgage brokers. Almost half of broker clients who sought to refinance adjustable-rate loans last month couldn't, the survey found. Lenders are cutting back the types of loans they offer, raising rates on some of the mortgages they do offer, or are filing for bankruptcy, as investors avoid certain mortgage bonds. **Home Sales, Refinancing Crimped by Mortgage Slump, Survey Finds**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=aRbpGbK7IKzY&refer=real-estate>

- Sept. 7 (Bloomberg) -- Citigroup Inc., the largest U.S. bank, curtailed lending to mortgage companies, according to two people with knowledge of the decision. The bank's First Collateral Services unit won't accept new clients for "warehouse" credit lines, which provide cash to mortgage banks so they can fund home purchases and refinancings, the people said. They declined to be identified because they don't want to hurt relationships with New York-based Citigroup. First Collateral, based in Concord, California, still lends to existing customers, the people said. Citigroup's decision may make it harder for some home lenders to survive. More than 100 have sought buyers or halted operations since the start of 2006 as U.S. foreclosures climbed to a record in the second quarter. Loss of warehouse credit may have led to all of this year's 15 bankruptcy filings, said Ronald Greenspan, senior managing director for FTI Consulting Inc., a Baltimore-based firm that advises creditors. "Our decisions are based on our continued evaluation of the current and evolving market environment," Citigroup said in an e-mailed statement that didn't confirm the decision. Brad Knapp, listed as president of First Collateral on the unit's Web site, didn't return a call seeking comment. **Citigroup Unit Won't Take New Mortgage Bank Clients**
<http://www.bloomberg.com/apps/news?pid=20601208&sid=aLU8dXZYK.Po&refer=finance>

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Macro Economic

- Sept. 14 (Bloomberg) -- **London house prices fell the most since 2004 this month after five interest rate increases in a year and turmoil in financial markets sapped buyers' confidence**, according to a Rightmove Plc report. The average asking price for a home in the U.K. capital declined 2.5 percent from August to 384,439 pounds (\$774,000), according to Britain's biggest real-estate Web site. The reading is taken from a survey conducted from Aug. 12 to Sept. 8. For the U.K. as a whole, prices fell 2.6 percent, Rightmove said. Growth in London property values is faltering after the collapse of the U.S. subprime mortgage market triggered losses in securities linked to the loans and spurred banks to raise lending rates. The turmoil is piling pressure on consumers, already finding it costlier to pay loans after the Bank of England raised its key rate to a six-year high in July. "We've reached the peak of the current boom," Miles Shipside, commercial director of Rightmove, said in an interview. "Affordability is stretched, and people are concerned about global financial markets and their ability to take on greater commitments." **London Rightmove House Prices Fall Most Since 2004**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=aGUTrqoewzIM&refer=real estate>
- Sept. 15 (Bloomberg) -- China will need to follow the fifth interest rate increase this year with further tightening to curb the fastest inflation since 1996 and damp speculation in stocks and real estate, economists and analysts said. "The economy is really showing some signs of overheating, which it didn't used to before," said Dariusz Kowalczyk, chief investment strategist at CFC Seymour Ltd. in Hong Kong. "This makes them nervous enough to be more aggressive in their monetary policy." The benchmark one-year lending rate will increase to a nine-year high of 7.29 percent from 7.02 percent, starting today, the central bank in Beijing said yesterday on its Web site. The rate has risen from

6.12 percent on March 17. A trade surplus that reached a record \$161.8 billion in the first eight months of this year has flooded the economy with cash, pushing up consumer prices at twice the central bank's target pace. The benchmark CSI 300 Index for China's yuan-denominated A shares has quadrupled in the past 12 months as investors seek better returns than those on offer at banks. House prices in 70 major cities rose 8.2 percent in August from a year earlier. "This is doing nothing to help stem the flow of money into the booming A-share market," said Glenn Maguire, chief Asia economist at Societe Generale SA. "There'll likely be one more move on lending rates this year. Deposit rates will also go up because with inflation rising, real interest rates are negative."

China Needs More Rate Increases to Curb Inflation, Speculation

<http://www.bloomberg.com/apps/news?pid=20601068&sid=aUKzLr6EyB3w&refer=economy>

- Sept. 10 (Bloomberg) -- This time, when the U.S. sneezes, the rest of the world may well catch a cold. Global economic growth looks likely to slow markedly in the months ahead as further weakness in the U.S. infects Asia and Europe. That would represent a shift from the last 18 months, when the world economy proved immune to a U.S. slowdown and grew at an annual clip of more than 5 percent. **What's different now is the U.S. slump is starting to spread from the domestic housing market to consumers** who buy imports from companies such as Toyota Motor Corp. And the sudden increase in borrowing costs that followed the collapse of the subprime-mortgage market is now showing up overseas, raising the price tag on credit worldwide. "It will be a much bigger deal this time," says Raghuram Rajan, a former chief economist for the International Monetary Fund who's now a professor at the University of Chicago. "I don't see growth falling off a cliff, but it will slow." **Global Growth Threatened as U.S. Contagion Spreads**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aEM9on7P5400&refer=home>
- Sept. 10 (Bloomberg) -- Japan's economy contracted at almost twice the pace forecast by analysts in the second quarter, hardening speculation the central bank will refrain from raising interest rates this year. The economy shrank at a 1.2 percent annual rate in the three months ended June 30 as business spending slumped, the Cabinet Office said in Tokyo today. The result was less than the government's initial estimate for a 0.5 percent expansion. Bond yields fell to the lowest level since February last year and the benchmark Nikkei 225 stock average slumped more than 2 percent. Any rebound in growth depends on the severity of the housing recession in the U.S., Japan's biggest export market. "A move by the Bank of Japan is out of the question," said Takehiro Sato, chief economist at Morgan Stanley Securities Japan Ltd. in Tokyo. "A cloud is hanging over the domestic and global economy." **Japan's Economy Contracts a More-Than-Expected 1.2%**
http://www.bloomberg.com/apps/news?pid=20601087&sid=aX1_OROLdBo4&refer=home
- Sept. 9 (Bloomberg) -- Federal Reserve Bank of Philadelphia President Charles Plosser said there is an "underlying stability" [change it to past tense and the statement has

veracity, certainly not the case today however] in the U.S. economy and officials need not always cut interest rates in response to turmoil in financial markets. "Disruptions in financial markets can be addressed using the tools available to the Federal Reserve without necessarily having to make a shift in the overall direction of monetary policy," Plosser said yesterday at a conference in Waikoloa, Hawaii. Plosser said while the housing slump has lowered forecasts for the expansion and there is "considerable uncertainty" about the outlook, **he expects economic growth to return toward trend later in 2008.** [ignore the man behind the curtain] **The drag from housing will "gradually" ease, concluding sometime next year.** [based on WHAT information can he make this claim?] Economy's `Stability' **"It is important to understand and appreciate this underlying stability of the economy** [agreed, too bad you do not have a clue] in the face of temporary disturbances as we seek to assess monetary policy," Plosser told the Pennsylvania Association of Community Bankers convention. Still a `Stigma' **Plosser noted that the Fed has already taken several steps to ease stress in financial markets, including injecting cash into the system and cutting the rate for direct loans to banks.** [that have had very little impact] There's still a "stigma" attached to borrowing from the Fed's discount window, and the central bank is working to improve the situation, he said. **The Philadelphia Fed president said the Fed's goal is to help markets operate in an orderly manner, and not to insure individuals or firms from losses or failures.** [Absolutely correct. Had that policy been followed by Greenspan there never would have been a Real Estate bubble] That echoes other officials' concern about refraining from a bailout for investors who made bets that went bad. Officials' Remarks **A day before the employment report, four Fed district bank chiefs in separate remarks declined to endorse a rate cut.** Kansas City Fed President Thomas Hoenig and Dennis Lockhart of the Atlanta Fed said **they hadn't seen sure signs of a housing spillover into the broader economy.** St. Louis Fed President William Poole and the Dallas Fed's Richard Fisher **said the effects of the turmoil so far were unclear.** [the picture is about to become very clear] **Plosser Says Fed Rate Cut Not Always Needed to Soothe Markets** [posting this on Sunday and wondering what the week will bring. The Fed should not in fact cut. The Fed should have allowed the economic cycles to work in the past. The current severity of the problem is the miss-pricing of risk as a result of prior Fed bailouts. With all that said, these comments are a little nutty. I suspect when this goes out next weekend, we will see markets MUCH lower] <http://www.bloomberg.com/apps/news?pid=20601087&sid=aun1ssvumPyM&refer=home>

Retail

Retirement

- Sept. 14 (Bloomberg) -- Retail sales in the U.S. rose less than forecast in August, adding to concerns a softening labor market and a deeper housing slump will curtail demand. The 0.3 percent increase followed a revised 0.5 percent rise the prior month that was larger than previously estimated, the Commerce Department said today in Washington. Purchases excluding automobiles unexpectedly fell 0.4 percent. Declining home values, higher borrowing costs and the first drop in hiring in four years **may sap Americans'**

buying power. [or American's could continue to spend money they don't have, which is what has kept things afloat to this point.] A slowdown in spending, which accounts for more than two thirds of the economy, may prompt Federal Reserve policymakers to continue lowering interest rates after a projected reduction at next week's meeting. "With employment slowing down, the stock market struggling and home prices falling, the headwinds for the consumers are going to grow stronger," Scott Anderson, a senior economist at Wells Fargo & Co. in Minneapolis, said before the report. "Downside risks grew appreciably over the past month, and the Fed will want to start cutting rates as an insurance policy against recession." [certainly can't have any downturns in the economy without government meddling can we. Someone tell Scottie it is too late please] **Retail sales, which account for almost half of all consumer spending, were projected to rise 0.5 percent after an originally reported 0.3 percent increase in July, according to the median of 79 estimates in a Bloomberg News survey of economists. Forecasts ranged from 0.1 percent to 1.2 percent. [i.e. the number was so bad even the pessimist was too high],** Declines in purchases at building material merchants, clothing stores and service stations restrained the sales total last month. "The outlook certainly isn't for the consumer to crumble," Tim Rogers, chief economist at Briefing.com in Boston, said before the report. "Clearly, there are risks that weren't there even a few weeks ago, **but income growth is still supporting spending." [this has not been the case for years, what planet is Tim from]** "Most of the underlying fundamentals of the U.S. economy are pretty good," Rick Wagoner, General Motors Corp.'s chief executive officer, said in an interview. Detroit-based GM is the largest U.S. automaker. Early evidence suggests spending isn't deteriorating further this month. Retail sales at stores open at least a year during the seven days ended Sept. 8 rose the most in five weeks as consumers bought back-to-school clothing and supplies, according to the International Council of Shopping Centers and UBS Securities LLC. Consumers are spending at a "moderate pace," the trade group said Sept. 11. Fed Policy The slowdown in spending last month may make it easier for Fed policy makers to keep lowering interest rates if needed jumpstart the economy. Falling home values and the decline in payrolls signal the housing recession may wear down consumers in coming months, economist said. The Fed will probably cut its benchmark target rate by a quarter percentage point to 5.00 when they meet Sept. 18, based on the median forecast of economists surveyed by Bloomberg. Some businesses are calling for a bigger reduction to revive demand. "A significant rate cut of 50 points would be helpful," said GM's Wagoner. "A rate cut would certainly do a lot to shore up confidence" and "help avert a potential continued downslide in the U.S. economy." Consumer spending will probably grow at a 2.25 percent average annual pace in the final six months of the year, compared with a 2.55 percent rate from January through June, based on the median in a Bloomberg survey of economists Aug. 30 to Sept. 7. Quarterly gains averaged 3.7 percent in the last decade. Audi AG, Volkswagen AG's luxury brand, said U.S. sales will decline in the fourth quarter, in part because competitors will offer more incentives to spur sales. "We need to batten down the hatches, so to speak," Johan de Nysschen, Audi's U.S. chief, said in a Sept. 12 interview. "We think it's going to be stormy for a while." **U.S. Retail Sales Rise 0.3% in August; Drop 0.4% Ex-Autos**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aCOOrLNbImhFs&refer=home>

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- Sept. 11 (Bloomberg) -- Marsha Slotten's bad news came in April by e-mail, from a tipster warning that the company holding her retirement nest egg had collapsed. After racing in a panic to the office of Southwest Exchange Inc. outside Las Vegas, she found a locked door and a sign saying the staff was "in training." It never reopened. "I was devastated," said Slotten, 58, who said she was forced to cancel early retirement after the disappearance of \$2.74 million she made selling a strip mall. "I thought I knew what I was doing, but now my nest egg, my retirement plan, is gone." The real estate broker is among hundreds of investors who lost the proceeds of property sales because two companies went bankrupt during criminal investigations. The two were among thousands of mostly unregulated U.S. firms that hold money between commercial-property sales. Their collapse led to dozens of lawsuits and calls for regulation. The intermediaries are known as 1031 exchanges, named for a provision of U.S. tax law that defers capital gains taxes if the seller of a property buys another like it within six months. **Retirement Funds Vanish as Bankruptcies Hit Tax-Deferred Scheme**
http://www.bloomberg.com/apps/news?pid=20601109&sid=ary1hm_rkIgU&refer=home

Risk

Savings Rate

Tech

- Sept. 14 (Bloomberg) -- A ruling next week on Microsoft Corp.'s appeal of a record 497 million-euro (\$689 million) antitrust fine by the European Union may bolster three other EU probes. The European Commission in 2004 ordered Microsoft, whose software runs on about 95 percent of personal computers, to pay the penalty, disclose proprietary data and sell two versions of its Windows operating system. The Sept. 17 court ruling on Microsoft's appeal may affect investigations of Intel Corp., Rambus Inc. and Qualcomm Inc. and raise regulatory risks for Google Inc., according to lawyers and investors. "A loss by Microsoft would be an unhealthy precedent," said Michael Holland, chairman of Holland & Co., which oversees more than \$4 billion, including shares of Microsoft, Google and Intel. "If I was at Google, I would be of two minds about this: One is the parochial, 'we win if Microsoft loses,' but there's a larger systemic loss if Microsoft loses." The case puts both European Competition Commissioner Neelie Kroes's credibility and Microsoft's growth on the line, lawyers say. An EU victory would turn the Brussels-based agency, which is taking a harder line against monopolies than U.S. authorities, into the "global regulator of dominant firms," said Keith Hylton, a professor at Boston University School of Law. **Microsoft's Appeal May Boost EU's Monopoly Probes**
<http://www.bloomberg.com/apps/news?pid=20601204&sid=aDYdJdtMAHDU&refer=technology>

Wall Street

- Sept. 14 (Bloomberg) -- Merrill Lynch & Co., the biggest underwriter of collateralized debt obligations, signaled that the subprime-mortgage crisis may hurt third-quarter earnings. The New York-based firm said in a regulatory filing today that it made "fair value adjustments" for potential losses to date on unspecified holdings and financing commitments. Merrill fell 49 cents to \$74.65 as of 4:26 p.m. in composite trading on the New York Stock Exchange, making it the day's second-biggest decliner on the 12-member Amex Securities Broker/Dealer Index. Analysts expect the five largest securities firms will post losses on the declining value of subprime-mortgage and CDO holdings, as well as loan commitments to leveraged buyouts. Lehman Brothers Holdings Inc., the fourth-largest by market value, will be the first to report earnings, on Sept. 18, followed by Morgan Stanley, Goldman Sachs Group Inc. and Bear Stearns Cos. Merrill's disclosure "puts pressure on everybody else" to be "very frontal about this," said Frederick Lane, chairman and chief executive officer of Boston-based investment bank Lane Berry & Co. "It's not exactly news to people that there are balance sheet issues in these firms." **Merrill, which reports next month, is at risk because it participates as an investor, lender, counterparty and guarantor in markets tied to subprime mortgages. They include structured credit products, such as CDOs, and leveraged loans, according to the filing.** [this is not a sub-prime issue it is a structured finance and derivatives issue. Subprime was the start of it, not the overall issue.] **Merrill Says Fair Value Adjustments Made for Subprime**
<http://www.bloomberg.com/apps/news?pid=20601208&sid=aT3nJeyd64TA&refer=finance>
- Sept. 12 (Bloomberg) -- Old Lane LP, the hedge-fund firm acquired this year by Citigroup Inc., fell 5.9 percent in August, hurt by losses on debt and emerging-market securities. The drop left Old Lane, which oversees \$4.4 billion, with a 1.9 percent gain for 2007, according to a Sept. 7 report sent to clients. The return reflects performance across all of the New York-based firm's funds, according to the update from Jonathan Barton, managing director and a founding partner. Old Lane, run by Vikram Pandit, John Havens and other ex- Morgan Stanley executives, lost more than the average hedge fund last month, which declined 1.31 percent. It also trailed the average 6.2 percent advance for 2007, according to data compiled by Chicago-based Hedge Fund Research Inc. New York-based Citigroup, the biggest U.S. bank, paid about \$800 million for the firm in July and is closing its Tribeca Global Investments LLC hedge fund, which follows a similar strategy. "They've got some time to have some positive months that would more than offset the losses and put them back into contention for being a superb manager," said Geoffrey Bobroff, an independent investment consultant in East Greenwich, Rhode Island. **To have that, you have to take more risks, and it means becoming more aggressive."** [another in our ongoing series - your money at work] **Citigroup's Old Lane Hedge-Fund Unit Declined 5.9% in August**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=agYdpNiekpzM&refer=home>

- Sept. 7 (Bloomberg) -- Krispy Kreme Doughnuts Inc., the second-largest U.S. doughnut chain, fell the most ever in New York trading on a 12th consecutive quarterly loss and concern about whether it can meet terms of loans. Krispy Kreme dropped \$2.42, or 38 percent, to \$3.91 at 4:08 p.m. in trading on the New York Stock Exchange, the biggest decline since its initial share offering in April 2000. The chain said yesterday it may not meet some financial agreements in loans because earnings trailed its forecasts. [Krispy Kreme was a Wall Street darling five years ago. How did the "buy and hold" investors fare on this one?] **Krispy Kreme Shares Drop Most Ever After It Has Loss**
<http://www.bloomberg.com/apps/news?pid=20601205&sid=aU7skJ.Ibauo&refer=consumer>

I Disagree . . . and why

Article of the week:

Sept. 13 (Bloomberg) -- Alan Greenspan trusted his instincts. Ben Bernanke trusts the MAQS.

For the past several days, the MAQS -- a group of analysts in the Federal Reserve's Macroeconomic and Quantitative Studies unit -- have run a series of what-if scenarios on the U.S. economy that will play a critical role in next week's interest- rate decision.

The simulations will supplement the forecast handed to policy makers at the start of their Sept. 18 meeting and may determine the size of the rate cut almost universally predicted by Wall Street economists.

Bernanke has championed the team's work since becoming Fed chairman in 2006 because he wants to sift through models, projections and anecdotes before coming to conclusions. His approach contrasts with that of predecessor Alan Greenspan, who relied more on his own reading of conditions -- and as a result probably would have cut rates to insure against a recession long before the Sept. 18 Federal Open Market Committee gathering.

"Greenspan emphasized that, in response to a low- probability but high-cost outcome, the Fed should move aggressively," said Mickey Levy, chief economist at Bank of America Corp. in New York. "This Fed under Bernanke is more disciplined."

The FOMC will next week lower the overnight lending rate between banks to 5 percent from 5.25 percent, according to the median forecast of economists surveyed by Bloomberg News. The reduction would be Bernanke's first and may be followed by at least two more before year-end, federal funds futures suggest.

Greenspan said Bernanke is doing "an excellent job," according to excerpts from a CBS interview scheduled to air on the 60 Minutes program Sept. 16, a day before the publication of the former chairman's book, "The Age of Turbulence." He added that he had "no notion" of the threat subprime lending posed to the overall economy "until very late in 2005 and 2006," according to excerpts e-mailed by CBS today.

Subprime Reverberations

Calls for lower borrowing costs have been mounting since early August as the collapse of the subprime-mortgage market suddenly raised the cost of credit for companies and consumers. Pressure on Bernanke increased even more after a Labor Department report on Sept. 7 showed employers got rid of workers last month for the first time in four years.

Rather than resort to an emergency cut in the federal funds rate, Bernanke, 53, has waited for more data and a careful study of all the scenarios now under preparation by the staff.

The MAQS are in charge of the quantitative model of the U.S. economy known as FRB/US or "Ferbus." By adjusting for such things as higher financing rates for American companies or a sharp decline in home prices, the team provides policy makers a glimpse of possible outcomes.

Staff Playbook

The scenarios -- known at the Fed as "alt sims" or alternative simulations -- are especially important at next week's meeting because the vote will likely be cast on the dangers that the forecast is better or worse than reported, former Fed officials said.

"The FOMC will start by looking at the standard calculation" of how changes in home prices and credit spreads affect the outlook for employment and inflation, said Douglas Elmendorf, an assistant director of the Federal Reserve Board's research and statistics division from 2004 to 2007.

Policy makers will then ask, "Where do we see the risks arrayed around the baseline?" said Elmendorf, now a senior fellow at the Brookings Institution in Washington. "Alternative simulations are quite important, particularly because of the Fed's announced interest in risk management."

The methodical approach has some pining for the good old rapid-response days of Greenspan, who called six emergency rate meetings between 1992 and 2001. Five of those resulted in reductions as he sought to head off recession or ease gridlock in capital markets.

'Slow to Acknowledge'

Under Bernanke, "the Federal Reserve has been very slow to acknowledge what is one of the biggest busts in U.S. housing history," said Allen Sinai, president of Decision Economics Inc. in New York. "They've never even called it a recession."

The distinction between Bernanke and Greenspan, 81, has roots in their different resumes and competing views about managing risk and uncertainty. Greenspan was a business economist before he became Fed chairman in 1987 -- one of his offices was on Wall Street -- and he read the economy like an income statement. His decisions were often based on close readings of disparate data, and his methods defied quantification. Greenspan's memoirs of his years at the Fed will be released on Sept. 17, the eve of the rate decision.

Bernanke, a former head of the economics department at Princeton University, has spent most of his career in academia. His analysis is based on models, and he has greater confidence in forecasts and statistical methods.

Snap Judgments

Over time, Greenspan's "confidence in making snap judgments on less convincing evidence increased," said Ethan Harris, chief U.S. economist at Lehman Brothers Holdings Inc. in New York. "Bernanke has a more balanced approach to decision making, which means you combine business-economist skills with anecdotes, high-frequency indicators, with models and simulation exercises."

Both approaches have risks. Greenspan cited uncertainty as "the defining characteristic" of the monetary policy landscape in an August 2003 speech. "Only a limited number of risks can be quantified with any confidence," he said.

The speech was critical of models, and elevated the role of judgment. He invoked theories of Frank Knight, a University of Chicago economist from 1927 to 1955, to explain his ideas of risk management.

Knight distinguished between risk and uncertainty: Risk is quantifiable, uncertainty is random. Managers "would try to turn those uncertainties into knowable costs," said Ross Emmett, a professor at James Madison College at Michigan State who has edited a collection of Knight's essays. "They would purchase insurance."

Greenspan's Preference

Greenspan's preference for insurance was most visible in the third rate cut of 1998, and the aggressive easing from 2001 to 2003 to offset a "minor" probability of deflation.

Both those moves have been reassessed by Fed officials and private economists, who acknowledge that the rate cuts were too aggressive. To use Greenspan's framework, the Fed "overpaid" for insurance against risks that turned out to be less severe.

"We did use the fed funds rate, and that may have been a mistake," former Fed Vice Chairman Alice Rivlin, who voted for the 1998 rate cuts, said in an interview last month. Referring to the Bernanke Fed, she added: "It might have been smarter to try what they are trying."

The third cut of 1998 took the federal funds rate to 4.75 percent in a quarter when the economy grew at a 6.2 percent annual rate, according to revised data. In 1999, the Nasdaq Composite Index surged 86 percent, only to lose 39 percent the following year, and another 21 percent in 2001.

Bernanke's Vote

Bernanke, as a Fed governor, voted to keep the federal funds rate below consumer-price inflation for three years from 2002 to 2004. The result was a different bubble -- housing -- fueled by the biggest mortgage binge on record. Americans borrowed \$2.8 trillion in home loans between 2004 and 2006.

“It was the Fed’s own lax monetary policy that permitted the problem to arise,” said Anna Schwartz, co-author of the 1963 book “A Monetary History of the United States, 1867-1963” with Nobel laureate Milton Friedman. “The responsibility is right at the door of the Federal Reserve.”

Statistical modelers such as Bernanke have their own icon to draw on: the 18th century British mathematician and Presbyterian minister Thomas Bayes. Unlike Knight’s apostles, Bayesians are more likely to quantify uncertainty by deriving probabilities. There is also a role for constant updating with new information to hone a forecast. Bayesian theory is used in hurricane tracking, for example.

Speeches suggest that members of the current FOMC are aware of the danger of overpaying for insurance again.

“Conditions can change quickly for better or for worse, especially in financial markets, so it’s hard right now to speak with a great deal of confidence about future economic developments,” San Francisco Fed President Janet Yellen said Sept. 10.

“A good example is the aftermath of the Russian debt default in 1998,” she said. “Many forecasters predicted a sharp economic slowdown as a result, but instead, growth turned out to be robust.”

Bernanke Spurns Greenspan’s Quick Fix, Seeking Data

<http://www.bloomberg.com/apps/news?pid=20601109&sid=aWSBqmhwbCFw&refer=home>

Sept. 13 (Bloomberg) -- Former Federal Reserve Chairman Alan Greenspan said he “didn’t really get” how the boom in subprime lending might hurt the economy, and endorsed his successor’s handling of recent market turmoil, CBS television reported.

Current Fed Chairman Ben S. Bernanke “is doing an excellent job,” Greenspan said in an interview on the 60 Minutes program, according to excerpts e-mailed by CBS today. The show is scheduled to air on Sept. 16, a day before the publication of Greenspan’s book, “The Age of Turbulence.”

The remarks come amid criticism among some investors that Bernanke has failed to be as forceful as his predecessor in responding to financial turmoil. Greenspan in 1998 cut interest rates three times after a Russian debt default rippled through global markets. Bernanke’s Fed has refrained from lowering its benchmark so far, relying on other tools to provide liquidity.

“I'm not certain I would have done anything different” than Bernanke, Greenspan said in the interview, according to excerpts released by CBS. “I'm not sure that's true,” Greenspan said when asked if he would act “dramatically and quickly now.”

The former Fed chief, who led the central bank for 18 years, said inflation is a bigger concern now than when policy makers cut the target rate for overnight loans between banks in 1998, CBS said.

“We were dealing in an environment back there where inflation was easing,” Greenspan said, according to the excerpts. “We could have acted without the fear of stoking inflationary pressures. You can't do that anymore.”

‘Vote of Confidence’

“Greenspan, given his significant legacy and stature, giving Bernanke an ‘atta-boy’ in this environment is a positive boost for Bernanke,” said William O'Donnell, head of U.S. rate strategy for UBS Securities LLC in Stamford, Connecticut. “It's a nice vote of confidence for Bernanke going into next week's meeting.”

The Federal Open Market Committee will lower the benchmark rate by a quarter percentage point, to 5 percent, when it meets Sept. 18, according to the median forecast of economists surveyed by Bloomberg News.

As chairman, Greenspan won admiration for steering the economy through a series of crises, pumping out money to help growth rebound from a stock-market crash in 1987.

Housing Bubble

After the 2001 recession, the Fed cut its benchmark rate to a four-decade low of 1 percent. That move, along with Greenspan's hands-off approach to regulation, have brought him under fire as this year's bursting of the housing bubble and the subprime mortgage crisis again threaten to sink the broader economy.

Greenspan said in the interview that he was aware of lax lending standards in the subprime market, in which borrowers have little or poor credit history. The admission comes a week after the death of former Fed Governor Ed Gramlich, who had pushed Greenspan to strengthen the central bank's oversight of banks during the record U.S. mortgage boom from 2004 to 2006.

“While I was aware a lot of these practices were going on, I had no notion of how significant they had become until very late,” Greenspan said in the 60 Minutes interview. “I really didn't get it until very late in 2005 and 2006,” as he was about to leave office.

Senator Charles Schumer of New York, a Democrat who chairs the congressional Joint Economic Committee, said in a statement that “Greenspan was one of smartest regulators this country ever had. If he missed it, then it should be a warning to the current regulators about the depth of this crisis.”

Greenspan Says He Failed to Foresee Subprime Rout

<http://www.bloomberg.com/apps/news?pid=20601068&sid=aOmrdfzHpajc&refer=economy>

UM EMBA

To our many new readers, this section is where I include items that might related to something we recently covered in class or any update to a case study (example, every now and then there is something interesting on SBUX).

And a note to all, the email “all MBAs” seemed to upset several. Please know that I sent the email in that fashion because there is no way to know who might have an interest in these materials and because I have a very strong belief that an immediate risk reward assessment is warranted for all of us. I felt the one shot email a good way to allow those with an interest to take a look with a very minimal intrusion to those who were not interested. Thanks to all of you who sent supportive emails and my apologies to all who thought it a poor judgment on my part. I view the merit of this site to be the sharing of news and not my commentary. We are all sufficiently talented to sift through materials made available. The function this newsletter and the website serve is to note information that varies with the “public line.” In closing, I will reiterate, there is and never has been an intention to use anyone’s email to create a distribution list. If anyone ever wants communicate with me, I pretty much appreciate anything anyone cares to send.