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Central Bankers See More Pain For Banks Ahead

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LONDON -- Central bankers past and present warned on Tuesday of more pain to come for the U.S. economy and that banks worldwide could take several months yet to reveal full losses from U.S. subprime mortgage lending.

Former Federal Reserve Chairman Alan Greenspan and billionaire investor George Soros said the downturn in the U.S. housing market had yet to take its full toll on growth.

Bank of England Governor Mervyn King said banks would take some considerable time to flush out total losses related to mass defaults on U.S. mortgages lent to people ill-equipped to pay.

"We have several more months to get through before the banks have revealed all the losses that have occurred, and have taken measures to finance their obligations that result from that, but we're going in the right direction," King told the BBC.

Banks, particularly in the United States, have come clean about huge losses tied to the subprime mortgage sector.

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The head of U.S. banking giant Citigroup quit on Sunday, taking the blame for expected losses of \$8-11 billion before taxes, on top of \$6.5 billion it wrote off three weeks ago.

Charles Prince's departure came five days after Merrill Lynch & Co ousted its chief executive, Stanley O'Neal, following an \$8.4 billion write-down there.

Citigroup has named veteran financial expert Richard Stuckey to head a new team managing its subprime mortgage portfolio, according to an internal memo seen by Reuters, a move taken positively by the U.S. stock market.

Banks in Europe have been hit too. Britain suffered its first full-blown bank run since the 19th century in September when the Bank of England had to step in to offer Northern Rock funding as "lender of last resort".

King said the decision to offer emergency funding to Northern Rock was taken because of worries over systemic risk.

Greenspan told a forum in Tokyo that high inventories of unsold homes presented a major risk to the U.S. economy and that he was not sanguine about how quickly the glut could be reduced.

"We still need to accelerate the rate of inventory liquidation, and that will mean bringing housing starts down and sales up. We have a long way to go," said Greenspan, who was answering questions via video link from Washington.

Soros said in a lecture at New York University that the U.S. economy was on the verge of a serious correction.

"I think we are definitely in for a slowdown that I think will be a bigger slowdown than (Federal Reserve Chairman Ben) Bernanke is seeing," he said.

Markets were first gripped by a credit crunch in August when interbank lending dried up as banks realised they did not know which of them was dangerously exposed to shaky U.S. home loans.

With precarious U.S. mortgages bundled up into complex financial products and sold on around the globe, uncertainty about where the exposure lies remains intense.

Money markets tightened on Tuesday, reflecting renewed jitters — London interbank offered rates for dollar deposits posted their biggest increase since late September as talk of further bank writedowns continued to fan credit concerns.

MASSIVE NUMBERS Bill Gross, chief investment officer at the world's No. 1 bond fund PIMCO, told CNBC Television the Fed could not afford to let U.S. housing prices fall sharply and would need to cut rates aggressively, perhaps to 3.5 percent.

It has already slashed rates by 75 basis points to 4.5 percent in an effort to limit damage to the broader economy from the housing market slide and resulting liquidity crunch.

Estimates of eventual total losses vary but all the figures put forward are staggering.

JPMorgan thinks the financial services industry is sitting on \$60 billion in undisclosed losses. Gross characterises the subprime crisis as a "\$1 trillion problem".

Greenspan said about \$900 billion of subprime mortgages had been securitised into fixed-income instruments, and the excess level of unsold homes was driving price declines that are eroding the value of the securities backed by those mortgages.

"The critical issue on the whole subprime, and by extension the whole financial system, rests very narrowly on getting rid of probably 200,000-300,000 excess units in inventories in the United States," he said.

Stock markets rose modestly, after Monday's Citigroup-led sell-off, but experts were loath to predict a prolonged rally.

"There's lots of uncertainty about the (bank) sector after the Citi writedowns, which gives the impression we haven't seen the end of it," said Philippe Gijssels, strategist at Fortis Bank in Brussels.

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