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# ECOMENTARY™

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## As the recession deepens, probabilities change…for the worse!

A few weeks ago, I asked some friends who are professional forecasters and economic commentators to offer their estimates of the likelihood of the events listed below. The "stimulus" bill has passed and will be signed today and the US Treasury policy menu with regard to financial institutions has been "sketched" while getting definition in the weeks to come. The economy continues to deteriorate and signs from the rest of the world corroborate the spread of this shock. The just concluded G-7 meetings showed that the Finance Ministers are worried, have no uniform policy menu and continue to look to the US for leadership. It is time to recalibrate our estimates of policy changes to come. The prospects look bleak indeed.

- Feds are creating an "Aggregator Bank" to purchase impaired level 3 assets: (size of TARP funds; FED lending?)
- The banks decide which assets they will sell into the bank
- The banks largely dictate price at some reasonable mark up above where the asset is marked
- There is no dilution of bank equity holders from the government's intervention
- The government does not attempt to exert any locus of control over banking activities
- There is a move to accrual accounting (away from mark to market) for what is left in level 3 assets.

What Other Measures do you deem likely in the following areas?

- US becoming a member of the Board of the recipient Banks ( those aided by the TARP)
- US insisting on Lending Growth performance measures
- US insisting on compensation governance
- US insisting on compositional targets on lending

What's interesting about this list is that now the "worst" outcome appears the most likely outcome. 'Worst' in this context means the disappearance of the private financial system in the U.S. at least in the form we have known it. Start first with the "Aggregator Bank" which has now been replaced with a two step sequence beginning with the "stress testing" of individual banks and the creation of a private-public investment structure (as yet unspecified). If you go down the list, it is a foregone conclusion that it will be the Government that decides which assets the banks will sell; the Government will decide how the pricing of these toxic assets will occur; there will be dilution of bank equity holders; the Government will exert a locus of control in terms of executive compensation, lending targets and future asset composition of the banks. Should we call this nationalization? "A rose by any other name…"

Banks and highly paid bank executives are now featured as needed scapegoats for legislators reviewing our financial malaise. It is hard to muster a great deal of sympathy when their risk control process failed so badly. The recent House Financial Services Committee hearings featured leading bank executives as defendants in a kangaroo court that was most notable for the ignorance of economic and financial matters displayed by Committee members. In fact, many legislators know better than they appeared. They use these hearings to vouch their solidity with the folks back home needing an object for their ire at the state of the economy and their own personal economic misfortunes. Without naming names, the interrogation by two California representatives was totally Hollywood. Their "hand-raising" stunt was fully consistent with the legislative folly in Sacramento where the California state budget impasse continues. "Showtime: makes representative democracy appear totally inept in the face of a crisis. Imagine what a quasi-nationalized financial system will look like when it is subject to the supervision of such legislators who are constantly playing to the crowd?

The issue is "where do we go from here?" It will not be the first time that an Administration finds that its chief enemy is a Congress dominated by its own party. Pogo was right. "I have seen the enemy. It is us!"

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