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Play Ball: The Real Season Is About to Begin

The Treasury's "new plan" reminds one that "opening day" is less than two weeks away, and this year day is night. The season begins with a night game April 5. If opening day follows opening night, have we reversed the Shakespearean dictum and it now follows that we are to be false to everyman? Seems so!

The Treasury's new plan begins with a hidden ball trick, perhaps two of them. First, the public does not know (and perhaps neither do the Fed or the Treasury) which of the "too big to fail" banks are truly insolvent. Perhaps there are more of them than we would want to know. Second, the original Paulsen plan impaled itself on the horns of the toxic asset pricing dilemma. If the Government bought the toxic assets at prices the (insolvent?) banks would be willing to sell them, the taxpayer would start in a big hole. If the Government tried to buy the banks at "market prices," the (insolvent) banks would not sell them. What's changed? The Geithner plan due to be unveiled today is inviting the private sector into the game. Why?

Hidden Ball Trick 1: Ecomentary rarely is in agreement with Paul Krugman, but his Op today in the **NYTimes** is directly on point. We still don't know which banks are insolvent, even if we know the biggies are too big to fail. If several of the biggies are insolvent, then the Geithner plan is a waste of time. If the object is to get the banking system back into a full lending mode, some sort of coercion will be necessary. Moving the toxic assets off these insolvent bank balance sheets at prices that can attract private, risk-taking buyers is a Sysyphean task. If the bank is already insolvent except if someone pays substantially close to the original purchase cost of the toxic assets, who is going to buy them? If they can move off the balance sheet in a freely negotiated sale, would they still be there? Not if a sale results in insolvency. What are we to make of the prospective sales to private buyers? Something is being hidden and it must be the price.

Hidden Ball Trick 2: If toxics are to move to private buyers, and insolvency would be the result, then the Government is going to have to plug up the hole in insolvent bank balance sheets. The Government may have to coerce the bank to sell the toxics with the threat that an unwilling bank is **not too big too fail.** Readers are invited to note that no announcements of the results of the **stress testing** have been made available. What is the size of the resulting hole in the balance sheets of insolvent banks that will have to be plugged?

Our guess is that the private sector is being invited to the party to cover up the real price and that further bail outs will occur for the otherwise insolvent banks. In the meantime, the stone the U.S. economy is rolling up the hill is a millstone. It will be around the neck of the U.S. credit system until the Government removes it. Call it what you will, but the new plan contains at least one or more hidden ball tricks. The paralysis that the Obama Administration has suffered in treating the insolvency issue is how to hide the fundamental pricing problem, or to put it more graphically, how big a loss will the taxpayer be saddled with when the toxic assets are removed.

Bluntly, if the Government wants credit to flow, it must 'plough the road,' which means removing the stones. That will result in some mighty big holes to fill if the road is to be useable.

One word of advice to the Government: if you want the private sector to take the fall for disguising just how much dead weight has to be removed from bank balance sheets, make sure you pay them sufficiently and don't threaten them with your newly enshrined "just wage" doctrine. The concealment strategy is contained in the huge incentives offered to lever up the trade with the Feds providing extremely attractive financing and downside guarantees. We are now back to the "Heads I win, Tails you lose strategy." The "you" is the taxpayer because of the guarantee. The "heads" will be the private investors---and possibly the taxpayer, but we don't know the terms. …***la même chose.***

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955 Mt. Moro Road, Villanova, PA 19085. tel (610) 527 5368 fax (610) 527 5068

Website www.ecomentary.com. Contact: munkb@ecomentary.com