The Finance Round-Up: November 16th 2007

Posted by Stoneleigh on November 17, 2007 - 6:00pm in The Oil Drum: Canada
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According to Gregory Peters, head of credit strategy at Morgan Stanley:

> There's a greater than 50 percent probability that the financial system will come to a grinding halt. You have the SIVs, you have the conduits, you have the money-market funds, you have future losses still in the dealer's balance sheet in the banks [..] That's all toppling at once.

Financial institutions are acknowledging that the losses could reach over $400 billion, and that is before an additional several hundred billion dollars worth of residential real estate enters foreclosure, leading to additional losses in the derivatives market of many times that figure due to leverage.

Over the next few months, major impacts will be felt.

First, the gargantuan bond insurance industry is teetering on the brink of the abyss, with rating agencies threatening downgrades of 14-18 notches (from AAA to deep junk). That could leave trillions of dollars of bonds uninsured, and therefore no longer able to borrow a triple A credit rating independent of their true worth. Those bonds would lose much of their value, and many large investors, such as pension funds, would be obliged by law to sell anything below investment grade.

Secondly, US accountancy rules changed November 15, affecting the upcoming financial year. "FASB 157" dictates that banks and securities firms can no longer hide their worst assets as Level 3, which allowed them to be kept off balance sheet. Trade in classes of commercial paper theoretically worth more than entire countries will have to be valued using observable inputs for the first time (where possible), rather than mark-to-make-believe.

In addition, as of January, banks can no longer indemnify their auditors for signing off on accounts they cannot verify, leaving the auditors potentially liable over the virtually unquanitfiable exposure of their clients to the derivatives market. Auditors are therefore likely to make every effort to verify valuations where evidence of true value can be found.

A cascading failure of financial institutions is all too possible.

Downward Spiral of Deep Junk

> The bond insurance industry has guaranteed more than $1 trillion of bonds issued by U.S. cities and states as well as bonds backed by mortgages, credit cards and other assets, and the guarantee allows borrowers to use the insurers' AAA rating. A loss of confidence by investors in the insurers' credit quality threatens the survival of the industry and the price of the thousands of bonds it guarantees.

Because of the "guarantee", god only knows what kind of garbage got rated as AAA. In return for the "guarantee" , companies like Ambac collect a fee. When times are good they keep collecting fees. When the proverbial * hits the fan, the guarantee is worthless. Is this a viable business model?

What we do not know is how much of that "AAA" paper banks are holding is really deserving of "AAA" status as opposed to being rated "AAA" because someone "guaranteed" it.

[MBIA, Ambac Downgrades May Cost Market $200 Billion]

The crisis of confidence in bond insurers that bestow top credit ratings on debt sold by borrowers from the New York Yankees to Citigroup Inc. may cost investors as much as $200 billion.

The AAA ratings of MBIA Inc., Ambac Financial Group Inc. and their five smaller competitors are being reviewed by Moody's Investors Service and Fitch Ratings. Without guarantees, $2.4 trillion of bonds may fall in value and some issuers would get shut out of the capital markets.

``We shudder to think of the ramifications,'' said Greg Peters, head of credit strategy at New York-based Morgan Stanley, the second-biggest U.S. securities firm by market value. ``You have politicians, taxpayers, municipalities, states. It just opens up a Pandora's box. That is a huge destabilizing force.''

For more than 20 years, the safety of insurance has eased the way for elementary schools, Wall Street banks and thousands of municipalities to sell debt with unquestioned credit quality. Now, mounting downgrades on insured bonds backed by assets such as mortgages are raising doubts about the stability of the guarantors. Armonk, New York-based MBIA, the world's largest, has a 28 percent probability of default, and Ambac's is 40 percent, prices of derivatives show.

[Next Phase of the Crisis: The Great Ratings Debacle]

The big three rating agencies have forever issued stellar, triple-A ratings to four specialized insurance companies — Ambac, MBIA, CIFG, and FGIC.

These are the companies that insure bonds and other credits from default.

Traditionally, they covered mostly tax-exempt municipal bonds. If a city or state defaulted, they'd step in and make good on the payments. But few cities or states defaulted.

So the muni default insurance seemed to work. And no one ever talked seriously about downgrading bond insurers like Ambac or MBIA.

But in recent years, in tandem with the housing bubble, the bond insurers have also insured massive amounts of mortgage-backed securities and other CDOs, a large percentage of which are in default ... or soon will be.

So this time the default insurance is not working. It's an unbridled disaster. And the triple-A ratings of bond insurers are about to collapse.

This is no trivial matter. It directly impacts $2.3 trillion worth of municipal bonds, mortgage-backed bonds, plus asset-backed bonds packed with credit card and auto loans — the same kind of securities that are now collapsing....

....Many years ago, the rating agencies engineered a cockamamie system whereby thousands of local governments and other bond issuers could simply buy the default insurance from an Ambac or an MBIA and automatically claim the insurer's triple-A rating as their own.

As long as bond insurers like Ambac or MBIA were triple-A ... then ... the thousands of tax-exempt bonds and CDOs they insured were also triple-A.

It didn't matter if the bonds really merited just a double-A ... or a single-A ... or a triple-B. It didn't even matter if they were pure junk (double-B or lower).

All that mattered was that they had the insurance. And like magic, the Fairy Godmother agencies — Fitch, Moody's and S&P — transformed all of Cinderella's mice into dashing coachmen: Every single one of the thousands of states, cities, towns and CDO issuers that bought bond insurance waltzed away with a triple-A rating.

Any Credibility Left At Fitch?

Fitch said it will spend the next six weeks reviewing the capital of insurers including MBIA Inc., Ambac Financial Group Inc., CIFG Guaranty and Financial Guaranty Insurance Co. to ensure they have enough capital to warrant an AAA rating. Any guarantor that fails the new test may be downgraded within a month unless the company is able to raise more capital, New York- based Fitch said today in a statement.

CIFG and FGIC, the bond insurer whose owners include Blackstone Group LP, have the highest probability of suffering erosion in the capital because of the falling value of CDOs, Fitch said. Ambac has a "moderate probability" and MBIA is at "low" risk, Fitch said.

"Fitch recognizes that financial guarantors view maintenance of their 'AAA' ratings as a core part of their business strategies, and management teams will take any reasonable actions to avoid a downgrade," the statement said.

Please read that last sentence again.

Fitch is explicitly admitting that it is making rating decisions not on merit alone, but on perceived implications of what a rating change might do to the company being rated.

Countrywide Pleads For No Debt Downgrades

Given that Fitch is implicitly admitting that it is making rating decisions not on merit alone, but on perceived implications of what a rating change might do to the company being rated (see Any Credibility Left At Fitch?) what does Countrywide Financial have to lose by pleading downgrade could weaken business?

Countrywide (CFC), the largest U.S. mortgage lender, said in a U.S. regulatory filing on Friday, that if its credit rating dropped below its current lowest rating, this would "severely," limit its access to the public corporate debt market and that could have repercussions on its business.

A below investment-grade rating also would mean Countrywide would face more restrictive terms and higher rates when it renegotiated or refinanced its existing borrowings, the company said in a U.S. Securities and Exchange Commission filing.

[Fitch Downgrades $37.2B Of CDOs, Slashing AAAs to Junk]

Fitch Ratings downgraded Monday the credit ratings of $37.2 billion of global collateralized debt obligations, with more than $14 billion worth of transactions falling from the highest-rated AAA perch to speculative-grade, or junk, status.

The rating agency said more than 60 CDO transactions are still on watch for potential downgrade, with a resolution due on or before Nov 21.

[CDO Dominoes Are Falling]

Here is a summary of the CDO ratings scam.

- The S&P is only downgrading the Carina CDO because it has to.
- Why does it have to?
- Because by State Street's selling, we will find out what those assets are really worth.
- The S&P knows the answer is "not much" as evidenced by downgrading garbage it rated as AAA all the way to CCC-
- The rated value of assets by Moody's, Fitch, and the S&P are one thing. What those assets are really worth on the open market are another thing.
- The difference can be as much as 18 notches.

Previously I asked is there Any Credibility Left At Fitch? You can now ask the same question of the S&P and Moody's.

[Fingers of Instability, Part XII]

The next shoe to drop is Municipal Bombs er Bonds, and the credit default swap "CDS" market. Dominoes so to speak. Muni Bond insurers are in freefall as the credit rating agencies downgrade their prospects.

These firms are in freefall, as are all the other bond insurers. Anyone who is holding bonds insured by these dead men walking might want to consider calling your broker before the real stampede out of these SAFE and "insured" holdings begins. As credit ratings of the insurers are slashed, many holders of these bonds will be forced to sell. Muni bond funds, institutions and pension funds have covenants' which force them to do so.

Not far behind this unfolding tragedy is the credit default swap markets as these "OVER THE COUNTER" derivatives soar in price, and the parties to them are injured in unfolding CDO (collateralized debt obligations) and housing market disruptions. Insurance is not good if the counterparty to them is insolvent and the growing liabilities from the sub prime debacle is impairing their future ability to meet obligations outside those commitments. When the credit default markets crumble there will be real trouble that dwarfs current problems!

Credit pain is gain for a select few

All of these instruments rely on confidence for their very existence. Commercial paper could exist only if brokers believed SIVs were valued properly, and SIVs could exist only if their managers believed their underlying CDOs were valued right, and CDOs could exist only if their managers believed the underlying loans were properly valued, and so on.

Confidence is the heart and soul of credit markets, as unlike stocks, no promises of future growth will suffice -- only streams if cold, hard cash will do.

Now it turns out that slowly emerging at this time were a group of hedge-fund managers running their money in a style known as "credit arbitrage" who came to believe that these towers of debt were houses of cards just waiting to be pushed over. But how? There are no straightforward ways to short-sell these kinds of instruments.

The method that they hit upon: Destroy confidence, which was already beginning to ebb due to the rising rate of defaults far downstream in the underlying loans. According to Brian Reynolds, chief strategist at boutique brokerage M.S. Howells, the credit-arbitrage fund managers figured they could shake confidence, and make boatloads of money, by playing in the $70 trillion market for "credit-default swaps," or CDSs -- a set of securities that are issued by financial institutions as a kind of insurance policy on debt.

The CDS market thus became a key battleground between the arbitrage fund hit squads and the bankers. The arbitrage funds bought the credit-default swaps on the investment banks that issued the CDOs and shorted investment banks' stocks, two actions that created the impression of vulnerability among other market players. It's a bit like taking out a life insurance policy and buying a headstone for a sick relative. Someone might get the impression that your uncle's prospects aren't good.

You might wonder how there could be $70 trillion in CDS money out there, and the reason is pretty interesting. Imagine that you are at horse race at which the winner can earn a $10 billion prize, which in this case would be the amount a CDS would pay off in the event of a bank default. In the stands, however, are bettors with access to huge lines of credit that are betting up to $1 trillion among themselves on the outcome of the race. It doesn't matter that the most a CDS holder could ever win is $10 billion, because the betting -- or trading of the derivatives -- is a completely separate game.

[Private mortgage insurers dragged down as delinquencies rise]

> As the housing market crumbles, homeowners are worried about mortgage payments and sellers are worried about slumping prices – but the companies that insure their loans are worrying about their very survival in the face of billions of dollars in claims.
>
> Insurers like industry leader MGIC Investment Corp. are predicting they won't turn a profit for at least a year. The uncertainty is sending stocks downward and raising questions about what happens if loans go bad and the insurers behind them are out of business....
>
> ....If the insurers do run into trouble, the risks for the industry are huge. About 10 percent of the total loan market has private mortgage insurance, according to the Mortgage Insurance Companies of America. There was $776 billion in private mortgage insurance in force as of September, the trade group reported.

[Hot Potato]

> Something to keep in mind: these days a lot of mortgage insurance works on the same "representation and warranty" business that everything else in mortgage-land does. The insurer does not necessarily or even usually underwrite the loan file itself prior to issuing a certificate; it "delegates" this to the lender. However, that means that the insurer can refuse to pay if it believes that the lender knew or should have known that the loan did not meet the insurer's requirements. The insurer generally doesn't find this out unless 1) the file is subject to routine QC audit or 2) the worst happens and a claim is filed.
>
> So it's another episode of Finding Out Later, and the MIs don't want to hold the bag for it.

[Subprime Losses May Reach $400 Billion, Analysts Say]

> Losses from the falling value of subprime mortgage assets may reach $300 billion to $400 billion worldwide, Deutsche Bank AG analysts said.
>
> Wall Street's largest banks and brokers will be forced to write down as much as $130 billion because of the slump in subprime-related debt, according to a report today by New York- based credit analyst Mike Mayo. The rest of the losses will come from smaller banks and investors in mortgage-related securities.
>
> Citigroup Inc., Merrill Lynch & Co. and Morgan Stanley led more than $40 billion of writedowns as record U.S. foreclosures plundered asset prices. Estimates are rising with Lehman Brothers Holdings Inc. last week predicting losses linked to U.S. mortgages may reach $250 billion over the next five years. Zurich-based Credit Suisse Group in July forecast $52 billion of costs related to mortgage-backed securities.

Banks' balance sheets will hit fan in January

> If you think banks have trouble now, just wait until they report financial results in January.
>
> That's when the balance sheet will really hit the fan.
>
> The problem involves a rule passed a couple of years ago that will put the banking industry's outside auditors in peril if they sign off on results that they really can't verify.
>
> And right now there is nothing verifiable - or even understandable - about the banking industry's exposure to derivatives.
>
> The auditors' dilemma was caused by a rule change that now prohibits banks from indemnifying auditors against mistakes.
>
> All other kinds of companies can hold their auditors blameless in the event of errors that might generate investor and government lawsuits.
>
> And sometimes that's the only way the accountants will give a nod to the company's books.
>
> But a rule enacted in February 2006 by the Treasury Department, Federal Reserve and the Federal Deposit Insurance Administration now prohibit banks from doing that.

U.S. Banks, Brokers May Face $100 Billion in Additional Write-offs

> Recent rule changes by the Financial Accounting Standards Board make it more difficult for companies to avoid putting real-world market prices on their hardest-to-value securities, known as Level 3 assets.
>
> As Easy as Level 1, 2, 3...
>
> Level 1 assets are easy to price using mark-to-market accounting, you have all probably heard that term. This is where an asset's worth is based on a real price. For instance IBM... check the quote on the NYSE that's the "mark to market" price.
>
> Level 2 assets use something called "mark-to- model", but I call it Mark-to-Maybe. This is an estimate based on "observable inputs" which is used when no actually price quotes are available. An example might be a private transaction between two banks. They're saying "Maybe" this is what its worth.
>
> Then there's Level 3 asset values, which are based on "unobservable" prices. This is basically the banks' own "assumption" as to what the
> assets are worth. This is what's been called "Mark-to-Make-Believe" accounting. Because it's all just Fantasyland pricing... pure guesswork on the part of these Wall Street firms who of course are looking to cover their butts with the most generous valuation they can dream up.

[Rule change sounds alarm on Wall Street]

> The new rule from the US Financial Accounting Standards Board - known as FASB regulation 157 - comes into force on Thursday. It affects the Level 3 tier of assets that are currently valued according to in-house models, or 'mark-to-make-believe' in the words of Bob Janjuah, credit chief for the Royal Bank of Scotland.
>
> Mr Janjuah says the FASB rule change could lead to a further $100bn of writedowns as banks are forced to come clean, with total losses climbing as high as $500bn across all forms of distressed credit. The top six banks alone have $365bn of assets in Level 3.
>
> Although Level 3 assets are thinly traded, a series of ABX indexes give a rough guide to the market value of some $1,200bn sub-prime mortgage securities. These show that the lowest grades of 2006 vintage debt are worthless; BBB grades are down to just 18 cents on the dollar. AA grades are trading at around 60 cents, and AAA are near 85 cents.
>
> Moreover, much of the entire $3,000bn global market for collateralised debt obligations is under strain. Merrill Lynch has declared a 30pc writedown on its holding of CDOs, offering a glimpse into the true values.
>
> Few of the banks have admitted to losses on anything like the scale suggested by market prices. UBS is still booking its US mortgage debt at 90 cents on the dollar.
>
> While nobody knows what lies under the Level 3 rock, the new rule could spell trouble. Citigroup has $128bn of assets in this category, or 205pc of its tangible equity. The figures for other banks are: Morgan Stanley $88bn, (275pc); Goldman Sachs $72bn (212pc); and Lehman Brothers $35bn (194pc).

[Carina: CD-Oh-No]

> - The Carina CDO Ltd. liquidation event is a hallmark move toward risk aversion where the holders are saying We no longer are willing to accept the risk of potential cash flow impairment.
> - They are saying We just want to get whatever price we can get for the securities.
> - Now, the important risk for us going forward is that this is not a capitulation event, as equity market participants perceive, but a kickoff event precipitating increased risk aversion across the spectrum, not to mention the creation of "observable inputs" in pricing.
> - The new SFAS 157 provisions that firms have implemented require firms, whenever possible, to use "observable inputs" in pricing their Level Three assets.
> - Forced sales, at distressed prices, create "observable inputs"; the result will be revaluation down the line and risk aversion that begets still more risk aversion.

The Truth Will Set You Free

> The amount of losses that financial institutions have already recognized - $20 billion – is just the very tip of the iceberg of much larger losses that will end up in the hundreds of billions of dollars. At stake – in subprime alone – is about a trillion of sub-prime related RMBS and hundreds of billions of mortgage related CDOs. But calling this crisis a sub-prime meltdown is ludicrous as by now the contagion has seriously spread to near prime and prime mortgages. And it is spreading to subprime and near prime credit cards and auto loans where deliquencies are rising and will sharply rise further in the year ahead.
>
> And it is spreading to every corner of the securitized financial system that is either frozen or on the way to freeze: CDOs issuance is near dead; the LBO market – and the related leveraged loans market – is piling deals that have been postponed, restructured or cancelled; the liquidity squeeze in the interbank market – especially at the one month to three months maturities - is continuing; the losses that banks and investment banks will experience in the next few quarters will erode their Tier 1 capital ratio; the ABCP and related SIV sectors are near dead and unraveling; and since the Super-conduit will flop the only options are those of bringing those SIV assets on balance sheet (with significant capital and liquidity effects) or sell them at a large loss; similar problems and crunches are emerging in the CLO, CMO and CMBS markets; junk bonds spreads are widening and corporate default rates will soon start to rise. Every corner of the securitization world is now under severe stress, including so called highly rated and "safe" (AAA and AA) securities.
>
> The reality is that most financial institutions – banks, commercial banks, pension funds, hedge funds – have barely started to recognize the lower "fair value" of their impaired securities. Valuation of illiquid assets is a most complex issue; but starting with the November 15th adoption of FASB 157 the leeway that financial institutions have used so far for creative accounting will be much more limited. Valuation of illiquid assets is a most technical issue. But new regulations will limit the ability of financial institutions to put "illiquid" asset in "level 3" securities, i.e. securities where the lack of market prices allows them to use dubious "valuation models" and "unobservable inputs" to value such assets.

Credit and Financial Markets Losses: $100 billion or $200 billion? Or
most likely $500 billion?

> New reliable estimates suggest that using these market prices – rather than level 3 model gimmicks - will lead to losses of another $100 billion on top of hundreds of billions of subprime losses. And some market participants are already talking –quite realistically – about total losses from this credit disaster in
> the $500 billion range.
>
> Indeed, losses of the order of $500 billion are actually quite
> reasonable and likely once you account for all the losses from
> subprime, near-prime, prime mortgages, CDOs, CLOs, failed LBOs, auto
> loans, credit cards and other consumer credit, commercial real estate
> loans, a variety of asset backed securities, level 3 asset value
> recognition at market values, and other financial market losses.

Subprime alone is now estimated to lead to losses as high as $238 billion based on a mark to market analysis.

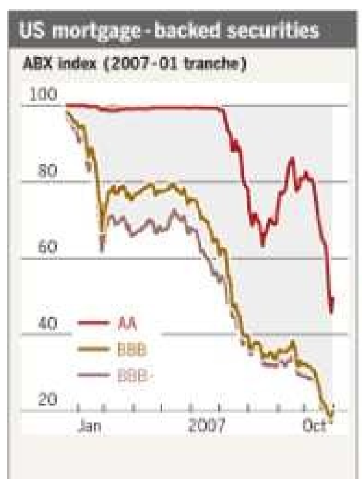
[Banks Face $100 Billion of Writedowns on Level 3 Rule]()

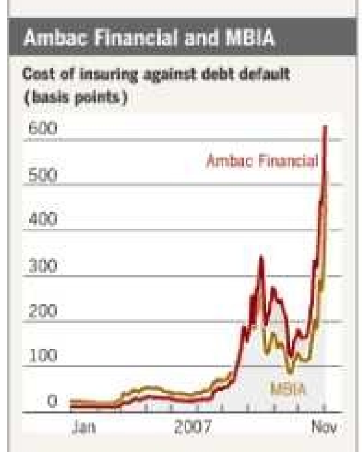
Citigroup Inc., which this week said losses from subprime assets may be $11 billion, has 105 percent of its equity in Level 3 assets, Janjuah wrote. The New York-based bank fell 4.8 percent to $33.41, a four-and-a-half year low.

Merrill Lynch & Co., which wrote down $8.4 billion of subprime mortgage debt and other debt securities, has Level 3 assets equal to 38 percent of its equity ``and may well come out of all of this in the best health,'' Janjuah said. Merrill, the world's largest brokerage, fell 4.2 percent to $53.99....

....ABX indexes, which investors use to track the subprime-bond market, are showing ``observable levels'' that would wipe out institutions' capital if the benchmark's prices were used to value their Level 3 assets, according to Janjuah.

[What's the subprime damage to banks?]()





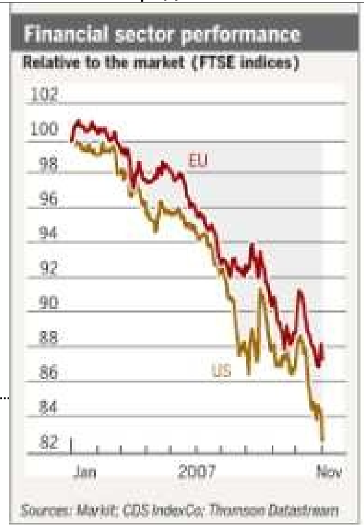
However, when it comes to working out the impact on banks, the task becomes even harder. For in recent years, banks have not simply been acquiring subprime loans, they have been repackaging them into complex "asset-backed securities" (ABS) that can be difficult to value. The Bank of England, for example, suggests that on the basis of industry data some $700bn-worth of bonds backed by subprime loans are now in circulation in the world's financial system, with another $600bn of bonds backed by so-called "Alt A" loans, or those with slightly better credit quality.

Moreover, these bonds have then been used to create even more complex
securities backed by diversified pools of debt, known as collateralised debt obligations (CDOs). According to the Bank's calculations, for example, some $390bn of CDOs containing a proportion of mortgage debt were issued last year – though the precise level of the subprime component varies.

The multi-layered nature of these complex financial flows means it is hard to assess how defaults by homeowners will affect the value of related securities.

In recent weeks, some credit rating agencies have indeed started to downgrade their ratings of debt: Moody's and

S&P, for example, downgraded about $100bn of mortgage-related securities last month. But most analysts think that this "downgrade" process is still at a very early stage – and in tangible terms, that means that subprime defaults have not yet delivered tangible losses for many security investors. "Most CDOs have yet to see many downgrades and there have been almost no actual defaults of the ABS bonds within the CDO portfolios," points out Matt King, analyst at Citigroup. "[But] all that is about to change."



[Goldman Held Bigger Level 3 Share Than Citi, Merrill]

Goldman Sachs Group Inc. held a bigger proportion of hard-to-value assets at the end of the third quarter than Citigroup Inc. and Merrill Lynch & Co., two of the firms hardest hit by subprime mortgage losses.

Goldman's Level 3 assets, for which market prices are so scarce that companies use internal models to gauge their value, accounted for 6.9 percent of the New York-based firm's $1.05 trillion total at the end of August, according to a filing with the U.S. Securities and Exchange Commission. Citigroup classified 5.7 percent of its assets as Level 3 on Sept. 30 and Merrill reported 2.5 percent.

Investors have grown wary of banks and brokerages with difficult-to-sell securities on their books, after profits at Citigroup and Merrill were crippled by at least $19 billion of writedowns, mostly from bonds backed by home loans to borrowers with poor credit histories. While Goldman officials say the firm won't report an ``extraordinary'' drop in its subprime holdings, investors remained skeptical, pushing its shares down 15 percent this month through yesterday in New York Stock Exchange composite trading.

[Auditors set for tough talks with clients]

Similar to the international accounting standards followed in Europe and elsewhere, it is aimed at simplifying and standardising "fair value" accounting, where assets and liabilities are booked at market price. Some companies, notably banks, took advantage of the option to introduce FAS 157 a year ago, including Goldman Sachs, Lehman Brothers, Citigroup, Merrill Lynch and JPMorgan.

At the top of the bucket hierarchy is Level One, involving assets with prices quoted in active markets, such as mainstream stocks. Level Two contains less-traded securities and uses prices for assets very like the one being valued.

At the bottom lurks Level Three, assets with "un-observable inputs", meaning their value is calculated via a series of assumptions. Most collateralised debt obligations end up here....

....Auditors are gearing up for tough year-end conversations with their clients.

Fannie Mae's fuzzy math

> Investors might want to take a closer look at Fannie Mae's latest earnings report. Lost in the unsurprising news of the mortgage lender's heavy losses was a critical change in the way the company discloses its bad loans -- a move that could mask that credit losses that are rising above levels that the company predicted just three months ago.
>
> Without the change in disclosure, an important yardstick for credit losses that Fannie Mae (Charts) provides to investors would have looked much worse than it did in financials filed last week.
>
> Fannie Mae's potentially misleading disclosure comes at a crucial time for the company. Fannie Mae was severely penalized last year for overstating earnings and for a lack of oversight. As part of its punishment, the amount of home loans that Fannie Mae can make was limited.
>
> But now influential members of Congress, including Senator Charles Schumer, want Fannie Mae's watchdog, the Office of Federal Housing Enterprise Oversight (OFHEO), to temporarily lift the portfolio limits on the company and its rival Freddie Mac. Legislators want both lenders to buy more subprime mortgages to help stave off foreclosures.
>
> Fannie Mae already holds a substantial amount of risky mortgages in its $2.4 trillion mortgage book -- and the recent shift in how it discloses a much-watched credit yardstick disguises just how quickly bad loans may be rising.

The U.S. Credit Crunch of 2007: A Minsky Moment

> Throughout the summer of 2007, more and more financial-market observers warned of the arrival of a Minsky moment. In fact, "We are in the midst of [such a moment]," said Paul McCulley, a bond fund director at Pacific Investment Management Company, in mid-August. McCulley, whose remarks were quoted on the cover of the Wall Street Journal, should know about a Minsky moment: he coined the term during the 1998 Russian debt crisis (Lahart 2007).
>
> McCulley may have originated the term, but George Magnus, senior economic advisor at UBS, a global investment bank and asset management firm, offers perhaps the most succinct explanation of it. According to Magnus, the stage is first set by "a prolonged period of rapid acceleration of debt" in which more traditional and benign borrowing is steadily replaced by borrowing that depends on new debt to repay existing loans. Then the "moment" occurs, "when lenders become increasingly cautious or restrictive, and when it isn't only overleveraged structures that encounter financing difficulties. At this juncture, the risks of systemic economic contraction and asset depreciation become all too vivid" (Magnus 2007, p. 7).

Wall Street's money machine breaks down

Two things stand out about the credit crisis cascading through Wall Street: It is both totally shocking and utterly predictable.

Shocking, because a pack of the highest-paid executives on the planet, lauded as the best minds in business and backed by cadres of math whizzes and computer geeks, managed to lose tens of billions of dollars on exotic instruments built on the shaky foundation of subprime mortgages.

Predictable because whether it's junk bonds or tech stocks or emerging-market debt, Wall Street always rides a wave until it crashes. As the fees roll in, one firm after another abandons itself to the lure of easy money, then hands back, in a sudden, unforeseen spasm, a big chunk of the profits it booked in good times.

"The fee engine becomes so huge that these products take on a life of their own," says Tiger Williams, CEO of Williams Trading, a leading financial services firm for hedge funds. "Everyone rationalizes that it's safe because they're making so much money. But it's far from safe."

Peak Money

In any case, finance for the purpose of deploying capital has prevailed as reality among people who use the implements of the dinner table, but something weird has happened to it in recent years. It has entered a stage of grotesque, hypertrophic metastasis that now threatens the life of the industrial organism it evolved to serve. Its current state can be understood in direct relation to the run-up to peak oil (peak fossil fuel energy, really, since coal and gas figure into it, too). The oil age, we will soon discover, was an anomaly. Many of the things that seemed "normal" under its regime will turn out to have been rather special. And as the beginning of the end of the oil age becomes manifest, these special things are starting to self-destruct pretty spectacularly.

For one thing, finance in the past twenty years has evolved from being an organ serving a larger organism to taking over the organism, becoming a kind of blind, raging dominating parasite on its former host. Or to put it less hyperbolically, it has become an end in itself. That is what they mean when they say that the financial sector has been "driving" the economy. A feature of this ghastly process has been the evolution of financial instruments into ever more abstract entities removed from reality-based productive activities. Stocks and bonds were understood to represent direct investment in enterprise. Sometimes the enterprise was a failure, and sometimes the people running it were swindlers, but no one doubted that common stock represented the hope for profit in a particular venture like making steel or selling laxative chemicals.

The new "creatively-innovated" financial "derivatives" of recent years are now so divorced from any real activities or product that often the people trafficking in them don't understand what they're supposed to represent. I'd bet that more than half the people in the New York Stock exchange any given day could not explain the meaning of a credit default swap if a Taliban were holding their oldest child over a window ledge across Wall Street.

War of the Housing Worlds: 3 Reasons why the Bubble Spread

> If anything this housing market has as much to do with human nature and mass psychology as it does with actual economics and market fundamentals. There is now an economic war in the housing industry. What can be done to ameliorate a decade long binge on credit and living beyond our means? Any good debt counselor will tell you that the first thing you need to do is cut up all your credit cards. Well we are at the point in the housing road where we have to decide if products such as sub-prime loans need to be "cut up" and never allowed in the market ever again. Those in the housing complex would argue that sub-prime has a niche and most folks will use them for financially prudent ends.
>
> Well as the case in mass hysteria shows, not everyone is going to use certain information in a logical way. In fact, a large percentage will not especially when you have lenders pushing people into riskier loans that have higher kickbacks. This is another way to fix the industry; legislation is now trying to stop brokers from steering people into certain loans. This is a good start. If anything, before this mess is over we will return to localized lending in a few years and doing things as they were once done. Local lenders having a piece of the action and understanding the market dynamics of their respective areas and having a piece of their own financial skin in the game.

Financial Manias and the Trade of a Lifetime
(free registration required, PDF file to download)

"Alarmingly high" risk of systemic shock seen

> Investors may not be prepared for the real possibility of a further downturn in the financial sector, and the risk of a systemic shock to the system is "alarmingly high," analysts at Morgan Stanley said on Friday in a report.
>
> "Over the past several weeks, we have worked ourselves into a full-fledged bearish lather," analysts, including Greg Peters, said in a report.
>
> "At the root of our near-term negativity is the alarmingly high potential for a systemic shock, as well as concerns on the financial system and economic environment due to the derailment of the securitization process," they said....
>
> ....By passing on loans, banks have been able to free up capital for further lending, which has been a key factor in the ability of consumers to obtain loans. Now, as demand for the repackaged debt dries up, banks in turn have less capacity to lend and the cost of borrowing is also set to rise.

Mortgage Loan Losses Pose Risk of Systemic Shock, Peters Says

> There's a greater than 50 percent probability that the financial system ``will come to a grinding halt" because of losses from mortgages, Gregory Peters, head of credit strategy at Morgan Stanley, said.

The world's biggest banks and securities firms have written down at least $45 billion in the value of assets linked to subprime mortgages for the third quarter after borrowers with poor credit histories failed to keep up with payments. Structured investment vehicles have defaulted on debt, forcing lenders including Legg Mason Inc. and SunTrust Banks Inc. to prop up their money-market funds to cushion them from possible losses.

``You have the SIVs, you have the conduits, you have the money-market funds, you have future losses still in the dealer's balance sheet in the banks,'' Peters said in an interview in New York. ``That's all toppling at once.''

The risk of systemic shock from the current subprime meltdown is quite large in the near term, Peters said. ``It's an overarching concern that we have,'' he said.

OECD warns subprime turmoil not yet over

The full global impact of the U.S. subprime mortgage market crisis has yet to be felt although more information is needed to determine its full extent, OECD Chief Angel Gurria said in a speech in Budapest on Thursday....

.... He said the greatest impact of the recent turmoil was on confidence in the banking sector, which has not returned to normal, and said the crisis had accelerated an ongoing slowdown in the pace of global growth.

"(The) greatest impact of subprime is on the confidence level, and multiplication of the impact on the whole financial system, which stopped giving loans to each other and to normalize this would take time," Gurria said.

The Wile E. Coyote Economy

Now if the problem here was just "subprime mortgages," Wall Street would take a lickin' and keep on tickin'. But as Hutchinson points out there's a ton of bad paper out there: securitized credit card loans, mortgages other than subprime, asset-backed commercial paper and more. The list goes on and on.

Wall Street and America's banks made a ton of money because the people who decided how much their assets were worth were the same people who owned the assets. And since their bonuses were based on how much those assets were worth, let's just say those assets were worth a lot. It takes a lot of "profit" to justify bonuses equal to the raises of 80 million Americans, after all.

Bernanke and the Fed are aware there's a problem, and their easing of interest rates and other actions like forcing loans on the banks have been an attempt to deal with the problem by providing "liquidity". But here's the problem: you can give the banks money, or lend it to them, but you have a hard time making them buy huge steaming piles of crap. This isn't the Long Term Capital fiasco where some trades went bad but there was good reason to believe that if you held onto the position and unwound it you might make money. The underlying instruments are probably crap and you will never make your money back if you buy them at face (or that's the fear, and it's well founded). Nor is it nearly as small as Long Term Capital fiasco was; the amounts of money involved today are magnitudes larger. So the banks, while making "good citizen" noises, are mostly not willing to take that money and bail out those of their colleagues and competitors who are holding onto reams of worthless paper (the membership of which includes some big banks as well, including Citigroup).

Because this issue extends beyond Wall Street and into banks, most of whom were eager to get in on the easy and big money they saw securities firms and hedge funds earning, the consequences are going
to be very, very real for ordinary people. When the banks have to take large write-downs the amount of money they will have available to lend to businesses and possibly even to consumers will also decline. Bernanke may make interest rates low, but if this cascade continues, and there's no reason to believe it won't, there simply won't be the money to lend. (As an aside, this is exactly the reason why Great Depression lawmakers forbade banks to get involved in securities businesses. Removing those laws set the stage for what is happening.)

The Super Mortgage Market Birth Story: CDOs, Mezzanine, Unrated Tranches, and a Touch of Greed

Everything was coming together since people had lost faith in the gods of technology. The decline in the technology sector came like a plague of locusts. Who would have thought that a company selling for 200 times earnings with no potential for revenue generation would go bankrupt? The masses demanded better returns. Hooked on 20 to 30 percent annual returns they needed a place to speculate and funnel their preciously earned dollars. What better way than to bet the house? Why limit a mortgage to the local bank who would scrutinize the area with a fine tooth comb, analyze the buyers potential ability to pay the note, and have an actual stake in the mortgage? Why do this when you can sell that same mortgage to our friend Tim who would chop it up like a Sushi chef, charge a hefty fee for his investment banks underwriting fee, and put it for sale at the worldwide buffet? The appetite was prime and all he was doing was providing the hungry with a meal. After all, it was demanded....

....With the introduction of Gaussian copula models, which for purposes of our story dear reader only helped speed the CDO pricing process, the priming of the pump was in full force. Credit was now available to anyone who would be willing to pray to the Wall Street gods and believe in their new financial dogma. Many went on the pilgrimage to financial prosperity with eyes and arms wide open. They bought and sold, flipped and churned, and the market cheered with glory. Tim was happy for he had found a market larger than his small rural town, he had opened the market to the entire world.

Deep down a nagging whisper lurked in his mind. For Tim knew that even a few defaults would cause the perfectly structured Ponzi Scheme to fail; no one dare utter these words in prosperous times for the dogma of housing wealth was strong and deep. So many had bought the lie that was being sold and convinced themselves that a free lunch was possible. Not only was a free lunch possible but a free dinner as well so long as you were willing to play Tim's credit game. At a certain point in the game, the market sentiment shifted. Nature has a cruel way of showing humans that yes, we do answer to laws that man cannot control. The magnitude and the complexity of the market was no match for the weak foundations that it was built upon.

Bill Fleckenstein: Stage is set for a stock crash

> As I looked at my screens during Wednesday's rout in stocks, it occurred to me that our financial system was in the process of imploding. With credit contracting, many businesses in that arena are in the process of being destroyed -- and, without a financial system, there is no capitalism.
>
> Thus I wrote in my daily column on my Web site that day: "It seems to me that there's almost no chance of escaping a stock crash at this point."
>
> Then the sell-off spiraled viciously Thursday. It was led by technology, after Cisco Systems' admission that problems faced by the financial institutions that constitute its largest customers were impacting the company's business. Speculation expired as it finally dawned on tech-stock bulls that if the economy is weak, businesses will be hurt and stocks won't go higher.
>
> Thursday's sell-off was even more significant than Wednesday's because it was an indication of (a) dots being connected and (b) the speculative fever being broken. It was the last piece of the puzzle that I was looking for in signaling that a dislocation or a crash may be coming.
>
> I know I've talked about this fairly often and that it hasn't happened. Such events have an extremely low probability of occurring. But the stage has been set by the reckless policies pursued by the Greenspan Fed in the past decade and a half. These have enabled the risks to pile up while rewarding folks for ignoring them. The Fed's efforts to stave off small forest fires have guaranteed a gigantic one.

Talk of Worst Recession Since the 1930s

> Asked how he could conceivably give credibility to such an ominous forecast, Mr. Melcher observes: "I've never seen a market with more risk and what's significant is that risk is not yet priced in."
>
> Given his grim expectations, he says there is no equity market in the world he would play right now. "When the American market goes down, other equity markets around the world should follow," he says.
>
> As of now, his portfolio is pretty much devoid of stocks, save for an exchange-traded fund focused on leading companies in oil services, which he regards as an ongoing growth industry. The ETF, the Oil Services Holders Trust, trades on the American Stock Exchange under the symbol OIH. Although enthusiastic about the industry's growth prospects, Mr. Melcher says he would be reluctant to recommend oil services stock because he believes the price of oil could easily drop 50% in the recession he envisions.
>
> Another danger he sees for the market is the prospect of huge withdrawals of funds from America by foreign investors due to the falling dollar, the credit crisis, and a slowing economy.

[Monster Western credit crisis – prelude to a depression]

> The West (US,EU, Canada) is in the midst of a gigantic and spreading credit crisis that may well to lead it into a depression, if it is not fixed soon. So far, Central bank infusions (Over $1trillion worth in a few months since July!) have been the only thing that has stopped a massive bank liquidity crisis from shutting down commerce. But the damage to credit markets thus far is so huge, and worsening rapidly, that a very bad outcome seems assured. Gregory Peters of Morgan Stanley said there is a better than 50% chance of a systemic banking crisis that will hammer credit markets at this time.
>
> So far, equity markets have barely reflected this turmoil to the degree it should. That is going to rapidly change. Central banks have been doing backflips to stem the crisis, and I think, things are rapidly spinning out of control. They have barely been able to stem a collapse in interbank lending, which would halt credit markets. The damage a paralyzed credit system will do to our credit dependent economies is going to be staggering. It would appear that much of the crisis is hidden from view, but the way it will inevitably reveal itself will be in falling corporate earnings, and collapsing consumer and business spending. In a few short months, we will see if I am right. So far, stock markets have not priced in falling earnings that we expect to appear in coming months, as contracting credit markets constrain all manner of spending and investment.

[Carnage on Wall Street as loans go bad]

> the total losses facing the financial sector could amount to between $150bn and $450bn, and that many of the banks have hidden losses that have been concealed in off-balance sheet instruments like "structured investment vehicles (SIVs)".
>
> The big Wall Street banks and investment houses who are most exposed could find their profits, and much of their capital base, wiped out.
>
> To restore their profits, and indeed in some cases to remain solvent, they will be forced to sell off many assets and lay off many workers, as well as cutting the bonuses of their remaining staff and limiting their future lending.
>
> The size of the financial sector in the US economy - with banks making up 30% of the profits of all US companies last year - means that the effects will be felt both in the real economy and on the stock market.
>
> And with $2.8 trillion in distressed mortgage bonds, including $1.3 trillion in sub-prime bonds, there is enough distress to go around.

[Paulson on Super-SIV: "Anything Worth Trying"]

> - What is known is this:
>   1) The structure must be in place by the end of the year because the SIVs (structured investment vehicles) cannot currently obtain short-term credit to finance their higher-yielding investments.

2) As many as 60 financial institutions will be asked to participate once the structure and term sheet is released, perhaps sometime in the next week or two.

- Also becoming clearer, is that the intention of the Super-SIV is more psychological than functional.
- How so?
- Currently the standoff in credit markets is so severe that a freeze has occurred among institutions.
- There is simply no one willing to step in to bid for SIV assets.
- The purpose of the fund is to provide at least the appearance of a backstop in order to kick start trading.
- "This is something that is not a savior," U.S. Treasury Secretary Henry Paulson told the Times.
- "Anything at the margin that will speed up liquidity is worth trying," he added.
- Anything? What about accupuncture?

Paulson Announces Super-SIV Failure Already

Debt market are indeed deteriorating but comparisons to Long Term Capital management do not do this problem justice. This problem is orders of magnitude worse.

Now, Henry M. Paulson Jr., the Treasury secretary, is describing the proposal's benefits as helping "at the margin." In an interview on Thursday, before the latest agreement was made, he acknowledged that the proposed backup fund would not rescue troubled SIVs, only lead to a longer and more orderly demise.

"This is something that is not a savior," Mr. Paulson said, noting that he expected the fund to begin operating by the end of the year. "Anything at the margin that will speed up liquidity is worth trying."

This is an amazing admission of failure right as the agreement has been reached.

Credit Crisis to Credit Crunch

Banks which have write downs and losses have to raise capital to meet net cap requirements. One of the ways you can do that is by making fewer loans. Thus banks are tightening up their lending standards.

But there is another reason that lending standards are higher. Many banks no longer function as what we think of as banks in the "old days" of 20 years ago. Today a bank uses its capital to make a number of loans and then packages them up and sells them as a security to another investor. Banks are now originators of loans rather than long term lenders.

But the institutions which are the ultimate market are demanding higher quality loans, and thus originators are responding to the market demand. So far, there is little new CDO issuance, and no subprime securities to speak of. But standards are going to get tighter for all sorts of paper. Capital One informed us today that credit card delinquencies are up over a full percentage point from this time last year to 4.75%. Do you think that investors will buy credit card paper at the same terms as last year? The market for credit card asset backed securities is almost $700 billion. Rates are going to go up, and credit will be harder to get for those with less than pristine credit.

There is a distinct lack of confidence in the ratings of asset backed securities of all types. We do not have a liquidity crisis. We have a confidence crisis. As we see capital implode and confidence erode, we are facing the real possibility of a full blown credit crunch.

(By the way, this is not just a US problem. You can bet similar problems are going to crop up in institutions all over Europe.)

Toxic export: How America's risky subprime mortgages fouled the world's markets

But how did defaulting subprime borrowers in the U.S. end up causing havoc for a British bank that never lent a penny across the Atlantic?

The answer lies in the structure of the modern financial markets, experts say. Securitization --the repackaging and chopping up of loans and other assets into tradable slices -- has allowed risks to be spread across a more diverse set of investors around the globe. When functioning normally, the system is supposed to increase the availability of credit and spread risk, reducing the chance that a major financial institutional will collapse and cause a financial meltdown.

But it has also tied far-flung markets more closely together. That means a crisis in a niche market in one country can contaminate lots of other markets that at first glance have little to do with each other. Technology transfers information in seconds, giving the infection a more potent scope.

A month-long investigation by MarketWatch reveals how such a chain reaction, triggered by rising U.S. subprime-mortgage delinquencies unleashed turmoil among bankers, investors, depositors, policy-makers and regulators all over the world. Their stories -- told from the front lines -- illuminate the powerful linkages between seemingly disparate corners of the financial world, and the risks underlying them.

"The initial problem was in the U.S. in subprime, but the contagion played out globally," said London-based asset manager Dagmar Kent Kershaw of the M&G Investment Management, which oversees more than $400 billion. "In the current financial world, with the free transfer of information, you can't have one part of the world blowing up and not have that affect other regions."

King: the wrong target for Northern's rocks

In truth, listened to, or read, in full, Mr King's interview gives the most interesting account so far of the events that led to the first run on a British bank for 140 years. He also accepts a share, at least, of the blame.

The Bank, he admits, had not pressed hard enough for changes to Britain's inadequate investor protection scheme. That meant Northern Rock's retail deposits could not be transferred quickly to another institution once it was in trouble.

The result was a double-bind. Northern Rock could not be allowed to fail, but its financing needs were so large that any official help could not be hidden from the markets. A secret rescue was never a real option. For its part the Financial Services Authority had been too slow to identify the damage that would be done to Northern Rock by the collapse of the subprime lending market in the US....

....Mr King made mistakes. So too did Mr Darling. The FSA was fast asleep on sentry duty. The tripartite system they were operating was wholly inadequate to the task. But as we hurl the brickbats at imperfect officialdom, we should recall what got us here.

The Bank, Treasury or FSA cannot be blamed for the reckless behaviour of bankers who treated mortgage securitisation as the new alchemy; or for that of the Northern Rock directors who thought they had found a risk-free way to print money. The governor is surely right when he says that the role of the Bank of England "is not to do what the banks ask us to do".

British banks' value dives by £90bn in nine months

Nervous investors have wiped more than £90 billion off the value of Britain's eight leading banks in the past nine months on fears that they are heading for major credit losses, an analysis by The Times has found....

....HSBC, forced into its first profit warning by the credit crisis, is worth £11.8 billion less than it was in February. The UK's biggest bank and one of Europe's largest by assets, it still has a market worth of £100.7 billion. Other banks to fall foul of market nerves include Bradford & Bingley, the mortgage lender, Alliance & Leicester and Lloyds TSB. Valuations of these three have fallen by just over £10 billion in the past nine months.

Alex Potter, an analyst at Collins Stewart, has been bearish on the UK banking sector all year, although he retains a "buy" recommendation on Barclays. He said that if Barclays and other banks were on course to "materially miss consensus", they would have to notify the stock market formally.

"That said, there is a lot of fear out there," he added. "It is a pretty irrational market. People just go online and check out the credit indices. They see even decent triple A-rated paper is trading at pretty big haircuts."

Japanese banks' subprime woes widen

Mizuho Financial, Japan's second-largest bank, reported a 16.6 percent drop in first-half net profits to 327.06 billion yen (2.95 billion dollars) as it booked losses of almost 70 billion yen related to the US subprime loan crisis....

....Another Japanese mid-size player, Aozora Bank, said its net profit for the fiscal first half to September fell 20 percent to 42.75 billion yen, hit by losses arising from its investments in mortgage backed securities.

"Given the sharp declines in markets since mid-October, it may take some time before the subprime mortgage lending troubles settle down," chairman Kimikazu Noumi told reporters.

Japan's biggest bank Mitsubishi UFJ Financial Group (MUFG) last month warned it expects a 31.9 percent drop in net profits to 600 billion yen this year due to weak income, losses on subprime loans and problems at its credit card subsidiary.

Canada's Royal Bank to take subprime charge

Royal Bank of Canada said on Tuesday it will take a C$160-million ($167-million) after-tax charge in the fourth quarter on investments tied to the U.S. subprime mortgage market, making it the second Canadian bank in a week to write down exposure to this default-hit sector.

Commercial Real Estate Black Hole

Blackstone's chief operating officer Hamilton James said Monday the sagging private-equity market might not make a comeback until major Wall Street banks get a better handle on the credit crisis.

Mish comment: We might have a better handle on the credit crisis sometime on or around January 1, 2012 . That number was not plucked out of the air. It is based on historical new home sales, historical starts, and mortgage rate resets in conjunction with a consumer led recession.

"The mortgage black hole is worsening ... it is deeper, darker, scarier than what the banks originally thought," he said. "My sense is they don't have a clear picture of how this will play out, and their confidence is low."

Mish comment: You ain't seen nothing yet. Residential is nowhere near a bottom and commercial is staring over the abyss.

James believes the market for leveraged loans, which buyout funds use to finance deals, appears to be picking up after a crippling summer.

Mish comment: False hope springs eternal.

One-Third of Americans 'Concerned' That Subprime Mortgage Crisis May Affect Ability to Obtain Car Loans, Other Credit

As woes in the subprime mortgage market persist, a new survey indicates that Americans shopping for car loans and other forms of credit are beginning to get nervous.

The survey of 1,000 consumers was fielded in late October by market researcher Synovate of Chicago for GDEXAuto (www.gdexauto.com) – a new Web-based

> marketplace where auto dealers and financial institutions come together to securely package, buy and sell asset-backed debt.
>
> In response to the question – "Given the fallout in the subprime mortgage market, how concerned are you that your ability to obtain credit for something like a car loan will be affected?" – a significant portion of the population expressed fears about possible spillover from the subprime crisis. Fully one-third of the sample (33 percent) said they were "extremely" or "somewhat" concerned their credit may be at risk.

[Amid Housing Crisis, Reverse Mortgage Market is Booming]

> There is still one area of the mortgage industry that is beyond red-hot right now — worth covering because of how poorly the rest of the mortgage market is performing. Reverse mortgages are white hot, and a good number of loan officers have been looking into reverse mortgages as a way to keep afloat as the rest of their residential business has gone kaput....
>
> ....Reverse mortgages were once primarily a tool used to keep from foreclosing on an old retiree. But it appears that the drive for industry innovation has finally arrived to the grey-haired — reverse mortgage fundings have surged 41 percent through the end of September, according to HUD statistics.
>
> And what's been driving the growth in reverse mortgages? A group of investment banks, outfits like Lehman, that have decided they're willing to buy reverse mortgages so they can eventually securitize them. The emergence of a private party market has led to a proliferation of new reverse mortgage "products," so this market segment is no longer constricted to the arcane standards of someone like, say, Fannie Mae.
>
> Well that, and the fact that Granny and Gramps want to go to the Bahamas.

[Momentum building for steeper yield curve]

> This flight from risky assets has sparked a dramatic dip in short-dated bond yields. The sliding dollar and fears over inflation have prevented yields for long maturity notes and bonds falling as quickly.
>
> One of the most popular trading strategies in the bond market involves buying and selling Treasury notes and bonds that have different maturities. Longer-dated securities typically yield more than shorter-dated notes, as investors demand a higher return the longer they hold a bond that pays a fixed rate of return.
>
> This means that the yield curve – which plots the yields paid out by different bonds against the dates at which they mature – should naturally slope upwards. In recent days, the difference between short and long-dated bond yields has reached its steepest level since February 2005. Traders think momentum for a steeper curve is building.
>
> A steeper yield curve puts a floor under mortgage rates, potentially exacerbating existing problems in the housing market as borrowers struggle to refinance into new home loans.

[What's Wrong With Approved Appraiser Lists]

> That's actually why I find those emails quoted in the indictment to be so explosive. I have spent a lot of years learning to decipher coded language about regulatory-not-exactly-improprieties-but-perhaps-areas-of-concern and other corporate-speak ways of putting it that I'm utterly blown away by the unvarnished language being used here. You just don't accuse a major account like WaMu of out-and-out violation of safety and soundness regulation unless the conduct is egregious in the extreme, or you think it is clear that you are being lined up for bagholder duty, or both. It sure sounds to me like WaMu wanted to tell eAppraiseIT what to do, while having eAppraiseIT do the scut work plus the small matter of making all the relevant warranties in the utterly certain event it backfired. Mortgage market participants can be so amazingly short-sighted sometimes it's hard to believe, but somebody at eAppraiseIT seems to have figured out who the sucker at the table was. No doubt they wouldn't be on the receiving end of a civil suit from Mr. Cuomo if someone higher-up had listened to whatever internal employee called bull on this one.
>
> Why didn't they listen? Why doesn't any corporation ever listen? Because the WaMu account is huge, and nobody wants to stop a gravy train. The indictment also includes snippets of emails suggesting that WaMu dangled other business relationships outside the appraisal management function in front of First American if it rolled over. Which is more or less exactly what lenders to do appraisers all the time: offer repeat business if they play ball, or being kicked off the team if they don't.

[Redefining "Normal"]

> According to the country's large independent credit card issuer, among customers who are "at least three months late on their mortgage payments," some "70% are current on their credit cards."
>
> And the above-mentioned change in bankruptcy law is one major culprit behind this trend, the other culprit being the rising number of subprime-related foreclosures. In other words, the revised law makes forclosure-related bankruptcy easier on households than is credit card-related bankruptcy. The outlandish irony is that many of the banks and financial institutions hid hardest by the subprime debacle are the very institutions that pushed for and got the bankruptcy law changed in their favor. So they got the boost in credit-card profits they wanted, but, oops, those profits are dwarfed in many cases by the size of the write-offs from bad mortages and other subprime-related losses now piling up.

[Prisoners of Debt]

> In a financial version of Night of the Living Dead, debts forgiven by bankruptcy courts are springing back to life to haunt consumers. Fueling these miniature horror stories is

an unlikely market in which seemingly extinguished debts are avidly bought and sold....

....Consumer lawyers and even some longtime players in the bankruptcy-paper market say they're worried that the trading of canceled debt encourages unsavory efforts to collect on discharged debt. "What you are highlighting is a significant abuse in the industry," acknowledges William Weinstein, a former chief executive of B-Line and a pioneer in the debt-buying business.

Speaking generally and not about his former company, he confirms that some lenders and debt buyers simply hound consumers to pay debts that have been canceled, while others refrain from informing consumer credit bureaus when debts are eliminated. "The failure to accurately update credit reporting has allowed unscrupulous activity to prosper,"says Weinstein.

How to profit from a 'police state'

In the midst of a six-year war on terrorism, widening income inequality and a growing fear of immigrants, America has become something of a police state, according to a new study, with as much as 25% of our entire labor force focused on protection rather than production.

The evidence is all around us, from the 47% increase in U.S. workers classified as security guards since 2002 to the sharp advance in the number of men and women under arms in Iraq, Afghanistan and elsewhere.

And it's not just public police forces and shopping-mall rent-a-cops. During the raging brush fires in Southern California last month, it was revealed that many wealthy homeowners now hire private firefighters through their insurance companies.

The study by noted Santa Fe Institute and University of Massachusetts economists Samuel Bowles and Arjun Jayadev, called "Garrison America," suggests that one in four Americans are now engaged in "guard labor," which means they either provide security for people and property or impose work discipline at factories, farms and retailers.

China tightens foreign investment rules

China has released new rules to prohibit or limit foreign investment in key industries as it seeks to cool its overheated economy and clean up its damaged environment, state press reported Thursday.

In a wide-ranging directive published late Wednesday, China's key economic developmental agency identified sectors from real estate and financials to oil and rare metals as restricted or off limits to foreign capital.

Have Global Stock Markets Peaked on "Peak Oil?"

For the vast majority of Americans who usually don't follow trends in the crude oil futures market, the Global "Oil Shock" only caught their attention after gasoline prices suddenly jumped 25 cents a gallon at the pump this month, and about 80 cents more than a year ago. Last week, West Texas Sweet crude oil surged to an all-time high of $98.62 /barrel, and jolted the Dow Jones Industrials 4% lower towards the 13,000 level, zapping the value of investors' 401k accounts.

Guy Caruso, the head of the US Energy Information Administration, told reporters on Nov 12th, "We haven't seen the full pass-through of high oil prices yet. I would say what's in the pipe right now for gasoline is about another 20 cents."

The stunning rise in the price of crude oil, up 56% this year and up 365% in a decade, to within a whisker of the magical $100 /barrel level, has some traders wondering whether "Peak Oil" is finally here. If correct, is the spectacular bull-run for global stock markets, which is now 4.5-years old, building a major "rounding top" pattern? Until recently, high and rising oil prices didn't disturb the bullish psychology among global stock market operators. Instead, the spin surrounding rising oil prices described a positive story, an unprecedented boom in the world economy.

But historically, Global "Oil Shocks" have tipped the global economy into recession.