

Brown and Darling have bitten the bullet - and set the world an example

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Will Hutton

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Yet Britain has produced a well thought-through, bold and comprehensive plan to put its financial system on a sounder footing - well ahead of any other government. Messrs Brown and Darling for once deserve some congratulation. There is every chance they will find themselves lionised at the IMF meetings in Washington this week as the one government that has finally risen to the occasion.

Big money is on the table. I estimated the cost of the package of measures that I recommended in the Crisis Watch column on these pages yesterday as between £350bn and £400bn, including up to £50bn of new capital for the banks - which I thought at the limits of the possible. The overall price tag on the actual measures is £500bn.

The proposed recapitalisation of the eight banks is vital - and it is conspicuous that it goes well beyond what any other government has contemplated. It will leave British banks as the most solidly capitalised in the world, even if it is a confidence shaker that the deficit in their capital was allowed to grow so big. The obvious concern is that without a "bad bank" to buy their toxic loans - the one omission from the package and importantly used by Sweden in its 1992 rescue plan, on which this is closely modelled - taxpayers' money will be immediately used to fund write-offs, so sending the banks back to square one. And the means of getting capital into the banks - preferred equity - has very little capacity to offer a compensating upside gain for the taxpayer because preferred equity share prices are more or less fixed, unless, like Warren Buffett's investment in Goldman Sachs, the government has warrants.

A "bad bank" has the merit of both removing the risk of further write-downs against the replenished capital, and also allowing the toxic debt to be partly or even fully recovered in better times - saving the taxpayer cash. On the other hand if the government succeeds in preventing a bank going bankrupt and the disastrous domino effects that would create, while its other interventions work the amount of toxic debt might stay limited.

The most eye-catching, eye-popping element of all is the up to £250bn of government guarantees for lending in the interbank market. This is targeted at what has emerged as the heartland of the problem - the de facto bank run, in which the big banks had completely lost confidence and stopped lending to each other. The guarantee is a double whammy. It will allow them to lend to one another again without fear, and to use guaranteed loans to finance maturing asset-backed securities - and on a huge scale. Barclays can now comfortably refinance the £28bn of its securities falling due next year; RBS its £18bn.

Given all this - along with the doubling in size of the Bank of England's special liquidity scheme and the coordinated cut in interest rates by Britain, the US and the EU - it is serious that the FTSE 100 closed the day more than 200 points down. One problem is that it will take time for the guarantee to open the interbank market, where the London interbank offered rate only eased a tiny fraction yesterday. Another is that the British action has exposed the inadequacy of what is proposed elsewhere - and thus the gigantic scale of both the problem and what has to be done by other governments, confirmed by the sombre pronouncements by the IMF and chair of the US Federal Reserve.

The American decision not to support Lehman Brothers is now turning out to be the fulcrum on which the crisis has turned. It is not just that Lehman had \$110bn of senior bonds that are now virtually valueless; it had written an estimated additional \$440bn credit default swaps on top which it cannot honour - a large part of which will come due at the end of this week. Wall Street is transfixed, as are the Asian markets. Nobody knows where these losses will end up. It has suddenly become obvious that the Paulson plan cannot simultaneously handle this together with the fallout of the sub-

prime crisis. And in addition there is the impossible challenge of financing trillions of dollars of asset-backed securities which are maturing when the world's interbank markets are shut. Britain may have invented a way to allow its banks to do this, but banks in other countries need the same help, along with the same chance to recapitalise themselves.

This will dominate the discussions at the IMF/World Bank annual meetings this weekend. Britain has bitten the bullet and partially nationalised its banking system. Other countries, notably the Americans, need to follow our lead - and to do so fast. Incredibly, it may have fallen to Gordon Brown to show the world how to avert a slump.

Will Hutton has written a weekly column for more than 15 years: six years at the Guardian and nine years at the Observer.