

## Economic Views for Investors

by Roger Nightingale

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American banks have registered huge increases in profits

The surge in profits announced by US banks last week was hardly a surprise. The Government had deliberately constructed an environment that allowed them to make spectacular returns, and thereby repair their balance sheets. Most importantly, they were encouraged to engage in round-tripping: borrowing from the Treasury cheaply and lending back to it expensively! Additionally, they were offered the facility to dispose of their toxic assets at prices well in excess of those available in the market place. And who provided the funds in each case to square the circle? The taxpayer, of course. He picked up the tab for the interest rate differential and also for the overpayment for assets.

It's the predictable corollary of official policy

The profits declared by the banks hadn't been *earned*, of course, merely *transferred*. They were the result, not of business acumen, but of regulatory prerogative. Accordingly, there was no justification for anything being distributed to shareholders or executives. The monies had been extracted from retailers and industrialists, from consumers and pensioners. It was they who'd been obliged to make sacrifices previously (unemployment in some cases, impoverishment in others); it was they who deserved rewards now.

Morally, it's the taxpayer who should get the benefit

Would they get them? Not a chance. The unspeakable bankers would scoop the lot. And their chums in high places (in the Treasury, the SEC etc.) would protect them while they did so. If an explanation were to be sought, it'd be claimed that generous rewards for bankers were a necessary part of the process of rebuilding equilibrium!!!

It'll be much the same in the UK; perhaps worse

A similar tragi-comedy is likely to be played out in Britain in the months ahead: banks will declare huge profits; journalists will make fatuous criticisms; spokesmen for Government and Opposition will talk empty nonsense; and bankers will carry on as before. Not many will ask the key question. Not many will ask whether it was necessary or desirable that the taxpayer bailout the bad banks.

Nationalisation was an expensive farce

Only the eccentric will claim that low interest rates were solution enough. That there was no good reason to nationalise the banks; none at all to saddle generations of future taxpayers with mountains of enervating debt. The judgment of those who made the relevant decisions—Brown and Darling, King and Macpherson—may not be called immediately into question, but, in years to come, it will be. History will savage them.

It might have prejudiced London's longer term position in the world

Posterity is likely to judge that it would have been better to have allowed the bad banks to fail and the good ones to succeed. It'll ridicule the assertion that the City's status was enhanced by the actions of the "feckless four." It'll argue that the preservation of a bunch of banking delinquents who seemed to know how to gear up in favourable circumstances, but not how to gear down in bad ones was detrimental to London's standing in the financial world. It'll be said that the authorities were driven, not by Augustan logic, but Caledonian politics.

What if there were to be another phase of the crisis next year?

The trouble is that the crisis may be far from over. It's true that exceedingly easy money seems to have stabilised the economy, but there is an anxiety that the relief might be only temporary. If the liquidity were to be withdrawn, it's possible the economy would collapse again. And, if it were to be maintained, it's possible (probable even) that the bankers would misbehave once more.

Do we have confidence in the authorities? Sadly, no!

What would they do next year if they found themselves with a huge potential to lend, but a dearth of reliable borrowers? In the past, in such circumstances, they've always sought out to unreliable borrowers. And, lending to them, they've sown the seeds of the next crisis! Could they avoid that mistake this time? Very unlikely.

What's required is Glass Steagall, with teeth

What the authorities should have done last year, and what they might still do next, is prohibit banks from engaging in complicated activities. Banks should stick to money transmission. The tricky stuff should be the exclusive reserve of those intellectually and psychologically equipped to handle it. We could all sleep more soundly in our beds at night if we knew the bankers were under lock and key.

Equities still cheap

Near term, the stock market is going to rise briskly. But there's uncertainty about the world in the second half of next year. Let's be aggressive buyers of stock for a few more months, but review the situation in 2010.

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