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Economic News

FINANCIAL CRISIS

TARP agreed – relief?

Following compromises from all sides, the US Congress and the government this past weekend agreed on a bailout package (TARP, Troubled Asset Relief Program) for the financial sector, which is likely to be formally passed this week. The downward spiral in the financial sector is thus likely to be slowed, but only stopped at best. However, the package does not mean rapid support for the economy. The first reactions on the Asian stockmarkets were not exactly euphoric.

- The **core elements** of the bill are as follows: The Congress will release the total sum of US\$ €700bn in tranches. Once the first US\$ 250bn has been authorised the president can file a written request for a further US\$ 100bn. The remaining US\$ 350bn must be explicitly authorised by Congress. The US government will receive non-voting warrants from the companies benefiting from the programme. As a result, the taxpayers will participate in possible earnings. A new congressional committee is to supervise the programme. The Treasury Secretary is required to report to Congress on a regular basis. Severance package limits will be established for the heads of the participating companies. The US government can prevent the foreclosure of some of the mortgages that fall under the plan. Should the programme incur losses 5 years after its launch, the Treasury will draft a plan to recoup such losses for the taxpayer via taxation of the participating companies.
- **Macroeconomic evaluation:** This package of measures is an important, albeit painful, step towards bringing the downward spiral on the financial markets to a halt and easing market participants' risk aversion. Should it succeed, it will make a deep recession in the USA less likely. Nevertheless, financing conditions will remain difficult for business and consumers alike. However, we do not expect to see a quick turnaround on the US real estate market. House prices will probably continue to fall in the months to come. We do not expect the market to stabilise before H1 2009 at the earliest.
- The US government's aid programme should reduce the systemic risks facing the financial system itself. From the **equity market perspective**, however, this does represent a more far-reaching intervention by the government than hitherto expected. The explicit participation by the state in US banks receiving assistance, a new committee to replace the previously voluntarily measures, and the announcement that companies will be obliged to assume responsibility for further losses, imply clear limits. The division of the aid programme into three tranches will also limit the short-term positive impact on the stock markets, all the more so as this part of the solution had already been on the radar for the last few weeks. A political compromise has therefore meant that the "major breakthrough" has failed to materialise. Consequently, it is hardly likely to lend the equity markets sustainable support, all the more so as it does not bring the solution to the financial market crisis one step closer.

Georg Elsaesser
+49 211 826-7821
Georg.Elsaesser@westlb.de

Bastian Hepperle
+49 211 826-3145
Bastian.Hepperle@westlb.de

Holger Sandte
+49 211 826-7398
Holger.Sandte@westlb.de

- Furthermore, the US rescue package does not offer **Europe's equity markets** any significant advantages. The current fall-out of the tensions on the credit market (the emergency measures taken to save Fortis and Hypo Real Estate), far more tend to suggest that the crisis has yet to bottom out. In addition, there is an aid package for the US auto industry worth \$25bn, which European carmakers will undoubtedly regard as a competitive disadvantage.
- Accordingly, what would be the right **time to re-enter the equity market** with lasting success? While it is difficult to predict the exact timing due to the extreme uncertainty, it is obvious what conditions are required: first of all, the financial market crisis will have to be channelled so that market players can at least identify one clear direction. Subsequently, much will depend on how far market expectations regarding trends in margin and profit growth have been adjusted to the scenario of a global economic downswing. The consensus still anticipates high growth rates in corporate earnings and a sustained rise in profitability. There will be further potential for disappointments on the fundamental front as well as in the immediate future if the forecasts continue to be far more optimistic than the real economic conditions actually merit.
- **In conclusion:** risk perception currently remains exceptionally high across all risky asset classes. It is very difficult - if not impossible - to provide valid short-term forecasts due to the high level of volatility. The details of the US government's plans should provide little support, at least in the short term.

WestLB AG
Herzogstrasse 15
D-40217 Düsseldorf

WestLB AG
London Branch
Woolgate Exchange
25 Basinghall Street
London EC2V 5HA
United Kingdom

T: +49 (0)211 826 71841
F: +49 (0)211 826 6154

T: +44 (0)20 7020 2000
F: +44 (0)20 7020 4209

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