



ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT



Financial Markets Outlook: When Will It Be Safe?

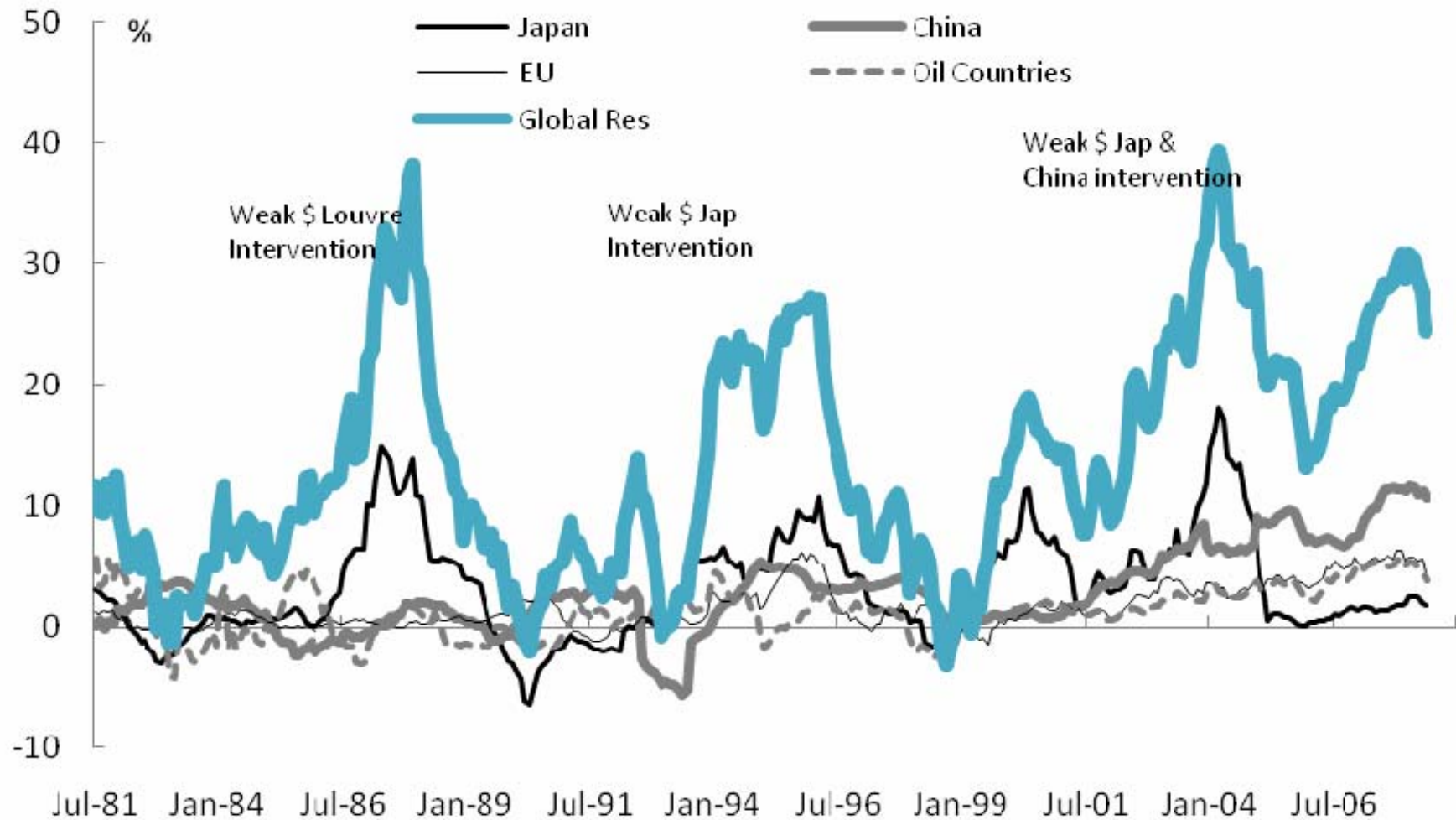
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Fig. 1: Key Issues of Focus

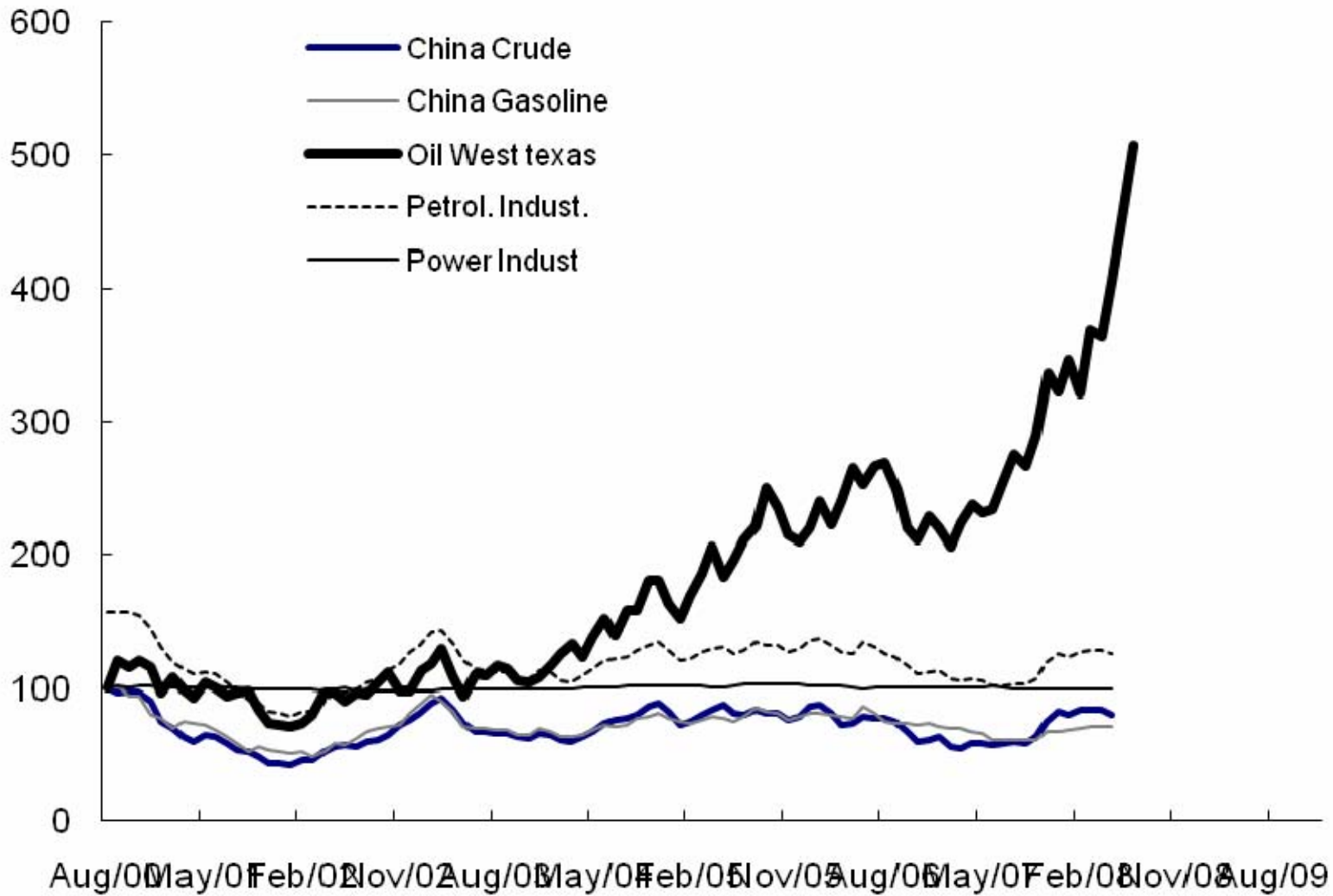
- The current situation arose out of 3 key distortions, resulting in a financial crises that was all too predictable, and a stagflation risk.
- **Distortion No. 1:** Global Liquidity bubble. Exchange rate regimes & energy price controls in Asia/Oil producers.
- **Distortion No. 2** Low rate policies in USA and Japan.
- **Distortion No. 3:** regulatory distortion explain why the bubble settles on subprime.
- How it plays out from depends on how these 3 distortions unwind.

Fig. 2: Contributions to Global Reserves (%)



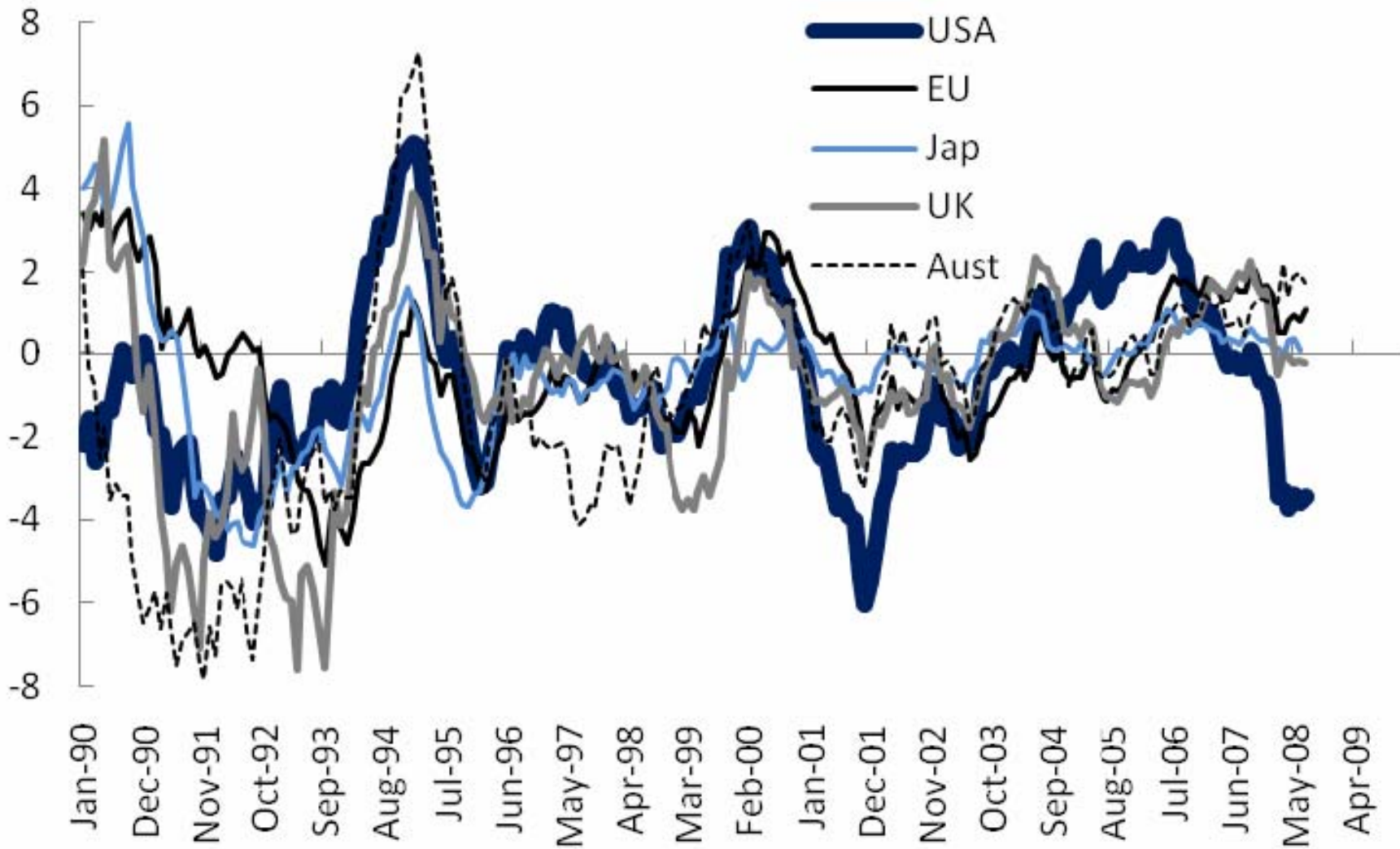
Source: Datastream

Fig. 3: Oil Price & China Domestic Fuels Costs



Source: Datastream

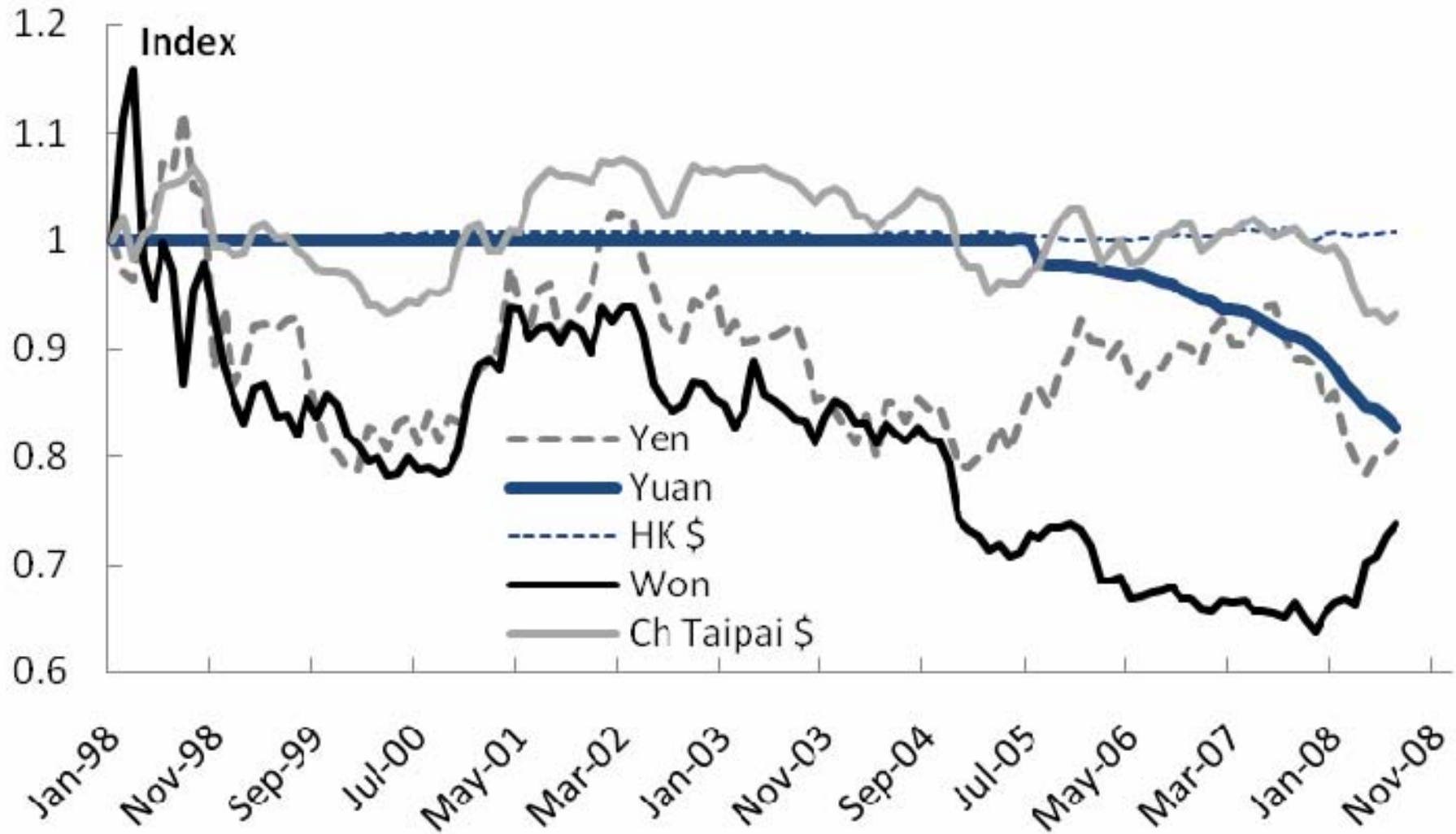
Fig. 4: MCI: Short rate, Exch. Rate, Oil, Bonds



Source: Datastream/Thomson Financial

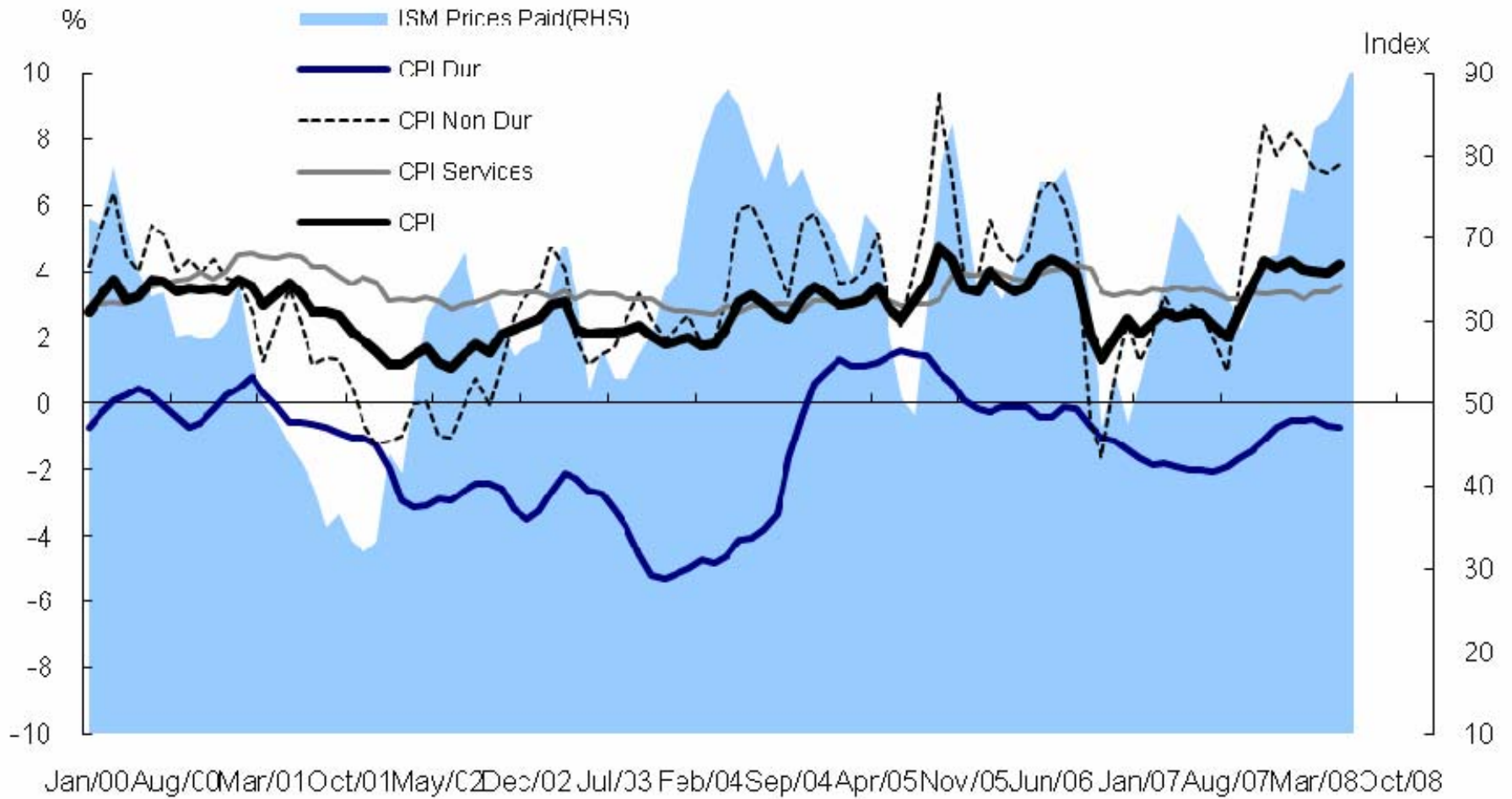


Fig. 5: Asian Exchange Rates: More Flexibility?



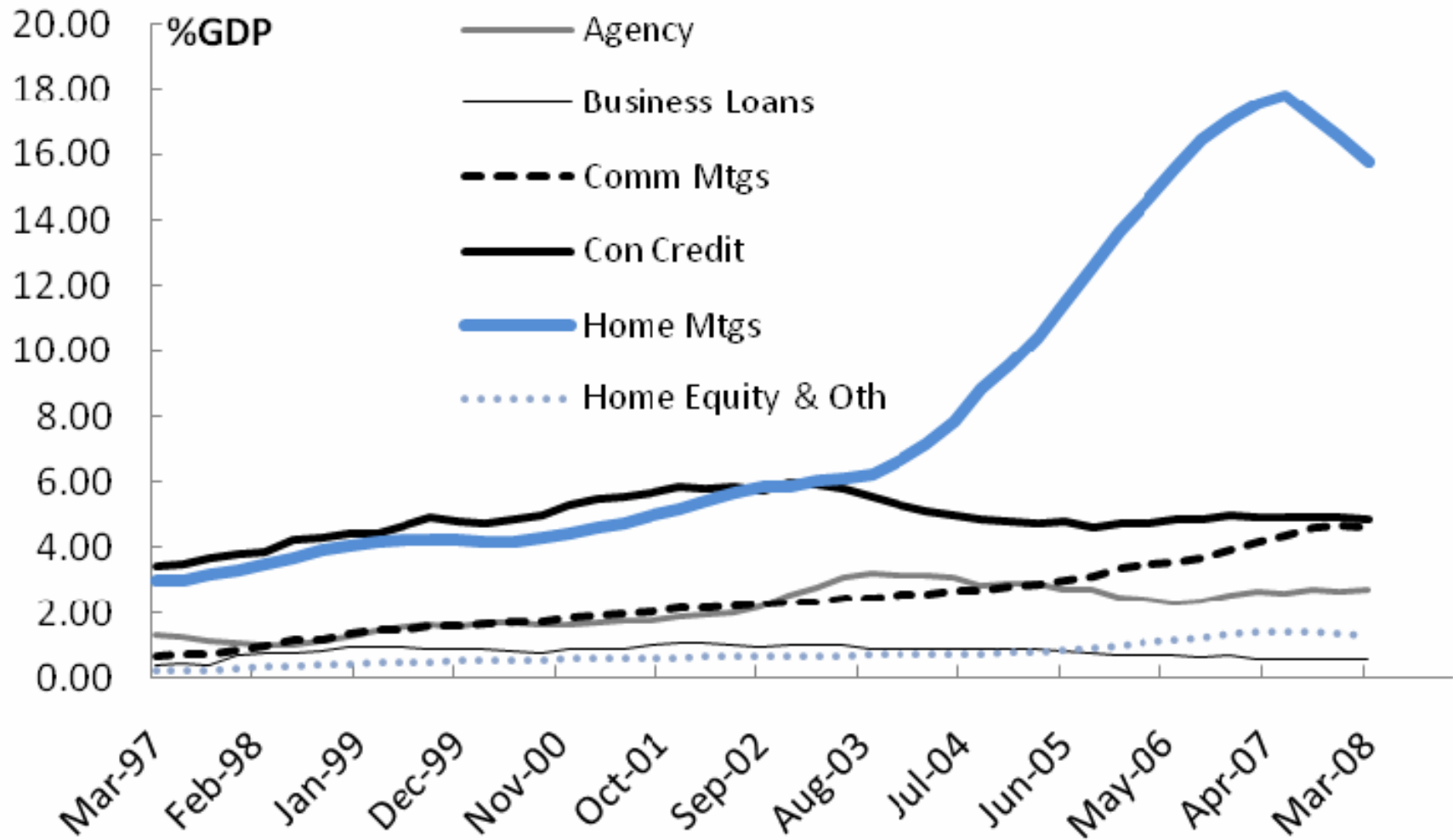
Source: Datastream, OECD

Fig. 6: US Inflation Pressures



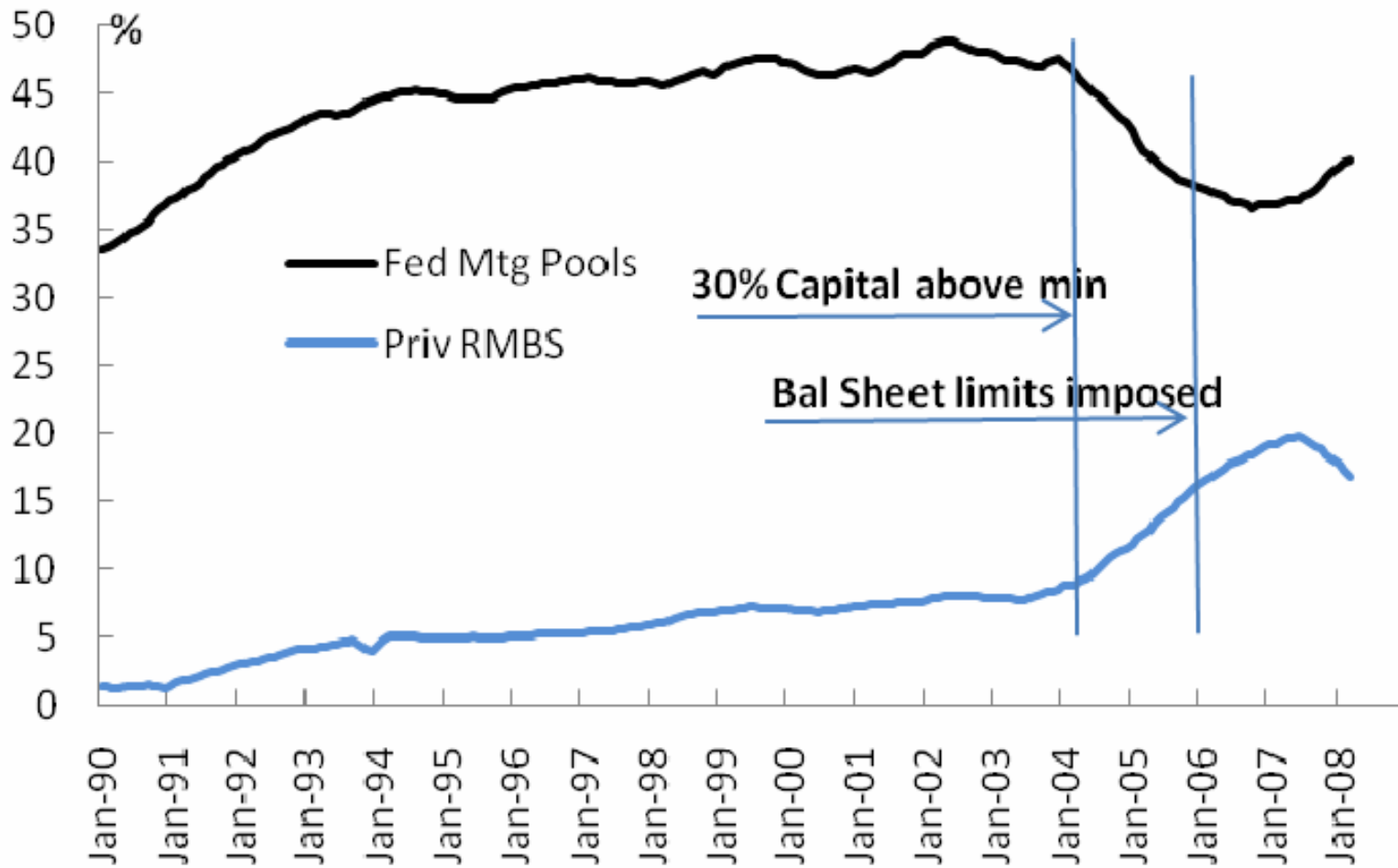
Source: Datastream, OECD

Fig. 7: RMBS versus Other Securitised Assets (% GDP)



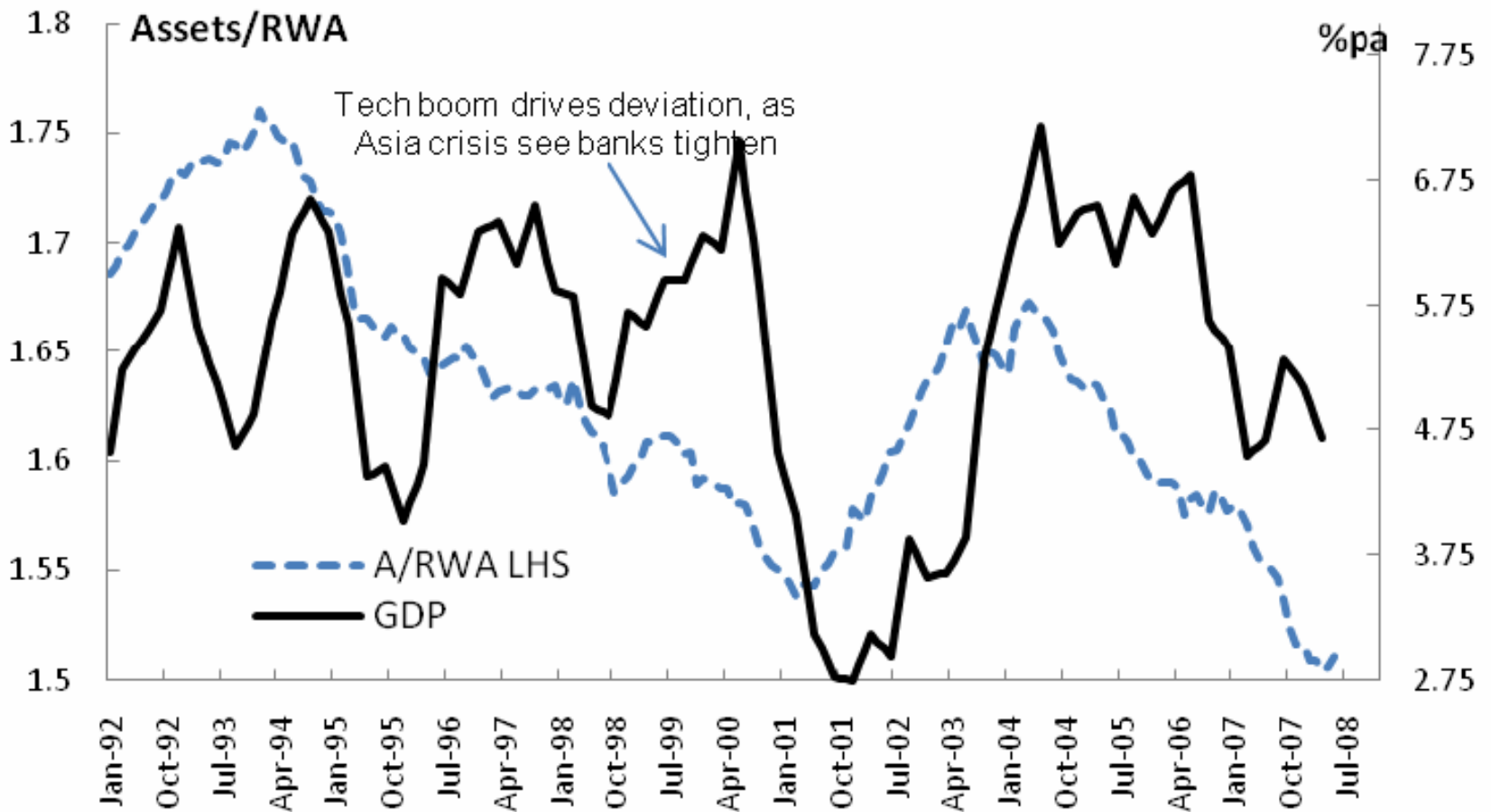
Source: Federal Reserve, Datasteam, OECD.

Fig. 8: Fed Mortgage Pools versus Private RMBS, (% Total Mortgages)



Source: Federal Reserve, Datastream, OECD

Fig. 9: US GDP & (Total Assets)/(RWA)



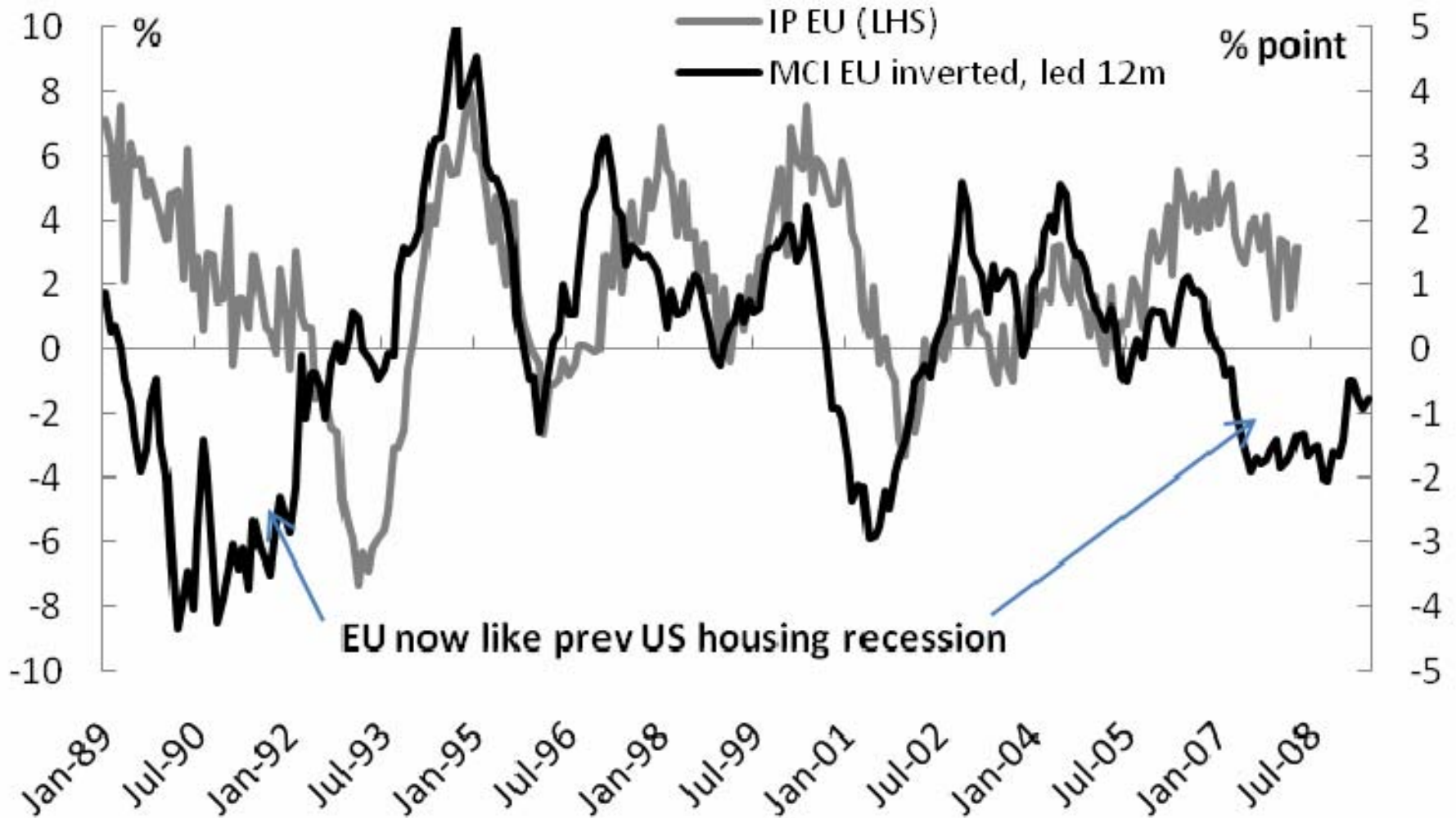
Source: Datastream, OECD.

Fig. 10: Bank & Investment Bank Capitalisation, US versus Europe

(as of fiscal year-end 2007, in millions)

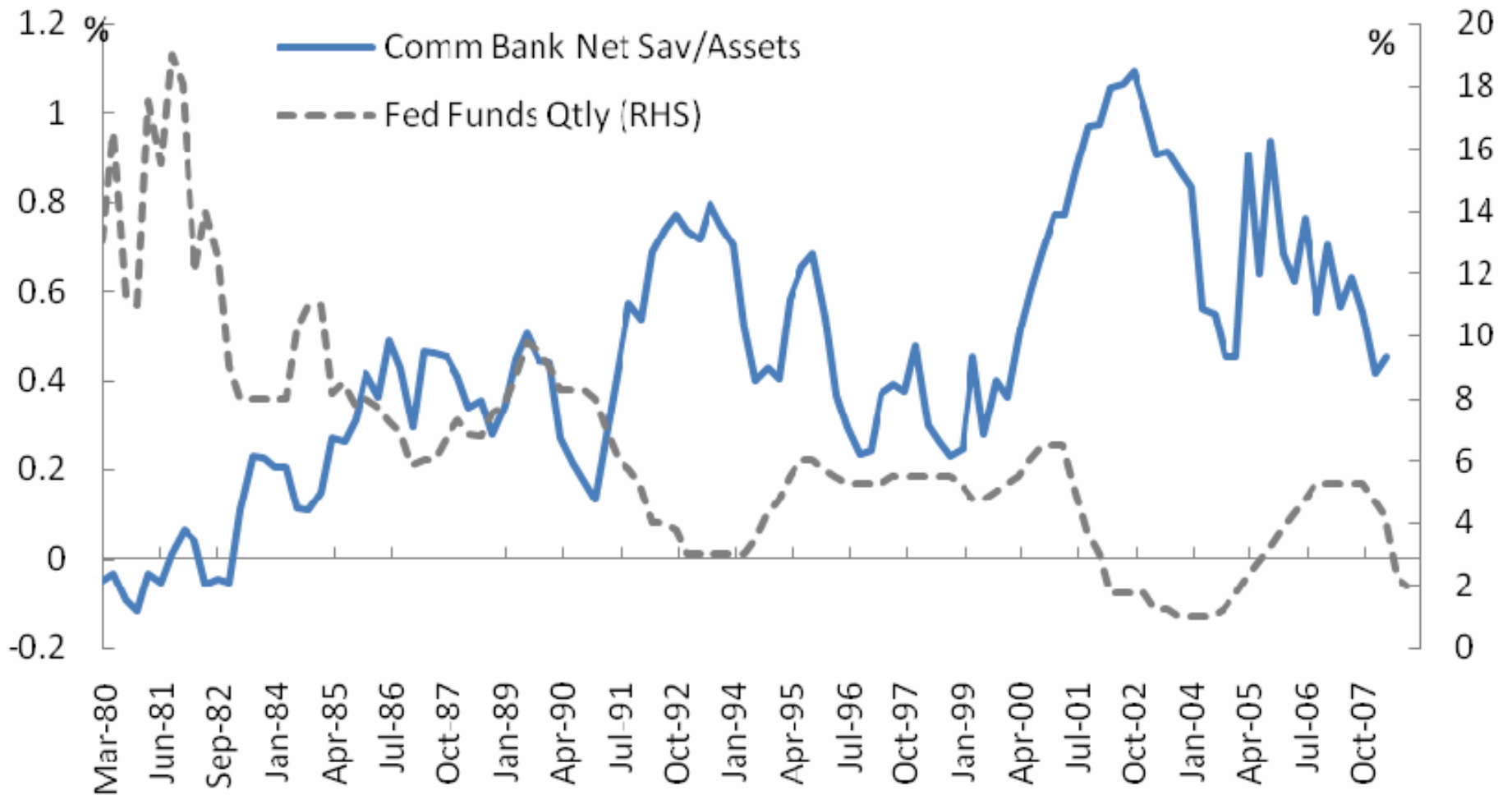
EUROPE	currency	Assets (A)	Tier 1 Cap. (B)	Leverage ratio (B/A)
Deutsche Bank	EUR	2,020,349	28,320	1.40%
Credit Agricole	EUR	1,414,223	28,000	1.98%
Commerz bank	EUR	616,474	16,333	2.65%
Barclays	GBP	1,227,361	27,408	2.23%
BNP Paribas	EUR	1,694,454	37,601	2.22%
UBS	CHF	2,272,579	32,811	1.44%
Societe Generale	EUR	1,071,762	21,616	2.02%
Credit Suisse	CHF	1,360,680	34,737	2.55%
HBOS	GBP	666,947	24,388	3.66%
Lloyds	GBP	353,346	13,952	3.95%
BBVA	EUR	502,204	20,659	4.11%
Santander	EUR	912,915	39,725	4.35%
RBS	GBP	1,900,519	44,364	2.33%
European total	Euro	15,673,605	351,950	2.68%
UNITED STATES				
Citigroup	USD	2,187,631	89,226	4.08%
US Bancorp	USD	237,615	17,539	7.38%
Wells Fargo	USD	575,442	36,674	6.37%
Bank of America	USD	1,715,746	83,372	4.86%
JPMorgan Chase & Co	USD	1,562,147	88,746	5.68%
Suntrust	USD	179,574	11,425	6.36%
Washington Mutual	USD	327,913	22,406	6.83%
BB&T	USD	132,618	9,085	6.85%
National City Corp.	USD	150,374	9,367	6.23%
Countrywide Financial Corp.	USD	211,730	8,754	4.13%
Goldman Sachs	USD	1,119,796	42,728	3.82%
Lehman Brothers	USD	691,063	23,103	3.34%
Merrill Lynch	USD	1,020,050	31,566	3.09%
Morgan Stanley	USD	1,045,409	32,074	3.07%
US total		11,157,108	506,065	5.15%
US Banks		7,280,790	376,594	5.88%
US Investment Banks		3,876,318	129,471	3.33%

Fig. 11: MCI Europe (Exch Rate, Short rate, Bonds, Oil), Inverted & Led 12m, vs IP



Source: Datastream, OECD

Fig. 12: Fed Funds v. Comm. Bank Net Saving as a % of Assets



Source: Federal Reserve, OECD



Fig. 13: Recapitalising Through Earnings:
 Fed Rate Cuts, Dividend Cuts & Time
 Required (to offset losses but not grow the
 balance sheet)

Earn. Rate p.a. Assets \$11.4trn. Dec 2007 (%)	Payout Ratio 0.5			Payout ratio 0.25			Payout ratio 0		
	Net Earn Rate % p.a.	Cap Build \$bn p/qtr	No. qtrs recap. \$83bn	Net Earn Rate % p.a.	Cap Build \$bn p/qtr	No. qtrs recap. \$83bn	Net Earn Rate % p.a.	Cap Build \$bn p/qtr	No. qtrs recap. \$83bn
0.6	0.30	\$8.55	9.7	0.6	\$17.10	4.9	0.6	\$17.1	4.9
1.1	0.55	\$15.68	5.3	0.8	\$23.51	3.5	1.1	\$31.4	2.6
1.5	0.75	\$21.38	3.9	1.1	\$32.06	2.6	1.5	\$42.8	1.9
2	1.00	\$28.50	2.9	1.5	\$42.75	1.9	2.0	\$57.0	1.5

Source: Federal Reserve, OECD

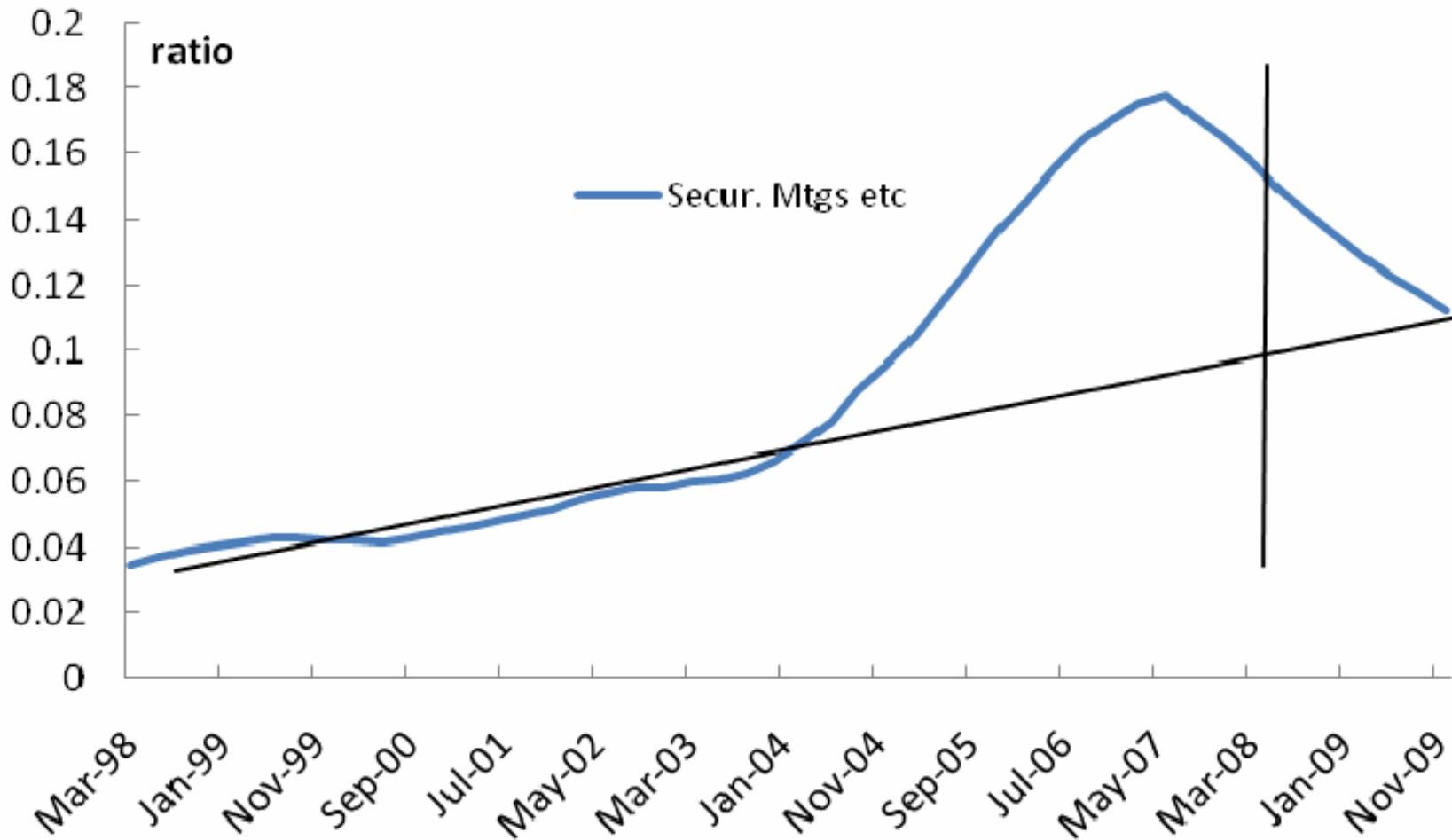


Fig. 14: Securitised Mortgages Cumulative Loss Model: Range Based on Recovery Rate

Quarter	CUMUL. \$bn LOSS @ RECOVERY RATE			
	0%	40%	50%	60%
Sep-07	75	45	37	30
Dec-07	155	93	77	62
Mar-08	254	153	127	102
Jun-08	347	208	174	139
Sep-08	429	257	214	171
Dec-08	505	303	253	202
Mar-09	575	345	287	230
Jun-09	635	381	318	254
Sep-09	697	418	348	279
Dec-09	769	461	384	308
Memo:	OFHEO House price fall 7% to 2009 Q4 Unemployment peaks at 6.4% Sep 09			

Source: OECD.

Fig. 15: Mortgage-backed Securities Stock/GDP



Source: Fedrreral Reserve, OECD



Fig. 16: Summary on Losses & Capital

- 2004 explosion of RMBS—excess capital & Fannie Freddie caps are causal.
- Ultimate losses \$380-\$460bn, US commercial banks about \$83bn. (IB's another \$23bn)
- Commercial bank capital required to stand still: \$83bn, & to grow balance sheet at 7% p.a. \$157bn.
- Less than 1/2 the capital raised so far.
- To recapitalise via earnings with dividend payout cut to 25% and a (back-to-all-time-high) 1.5% earning rate on assets is 3 quarters (to stand still) & to grow at 7% is 5 quarters.
- Problem is we are closer to the 1.1% earning rate and 50% payout, which is 5-6 quarters.



Fig. 17: Summary on Economic Effects

- It is not over, as not enough capital raised; and we have not factored in second round effects—from oil price rise, food price rises, any hedge fund losses, and from corporate bond defaults.
- About 1-1/2 to 2% GDP impact likely in USA.
- If we slip back to 0.75% earning rate & 50% payout, then we are looking at 10 quarters.

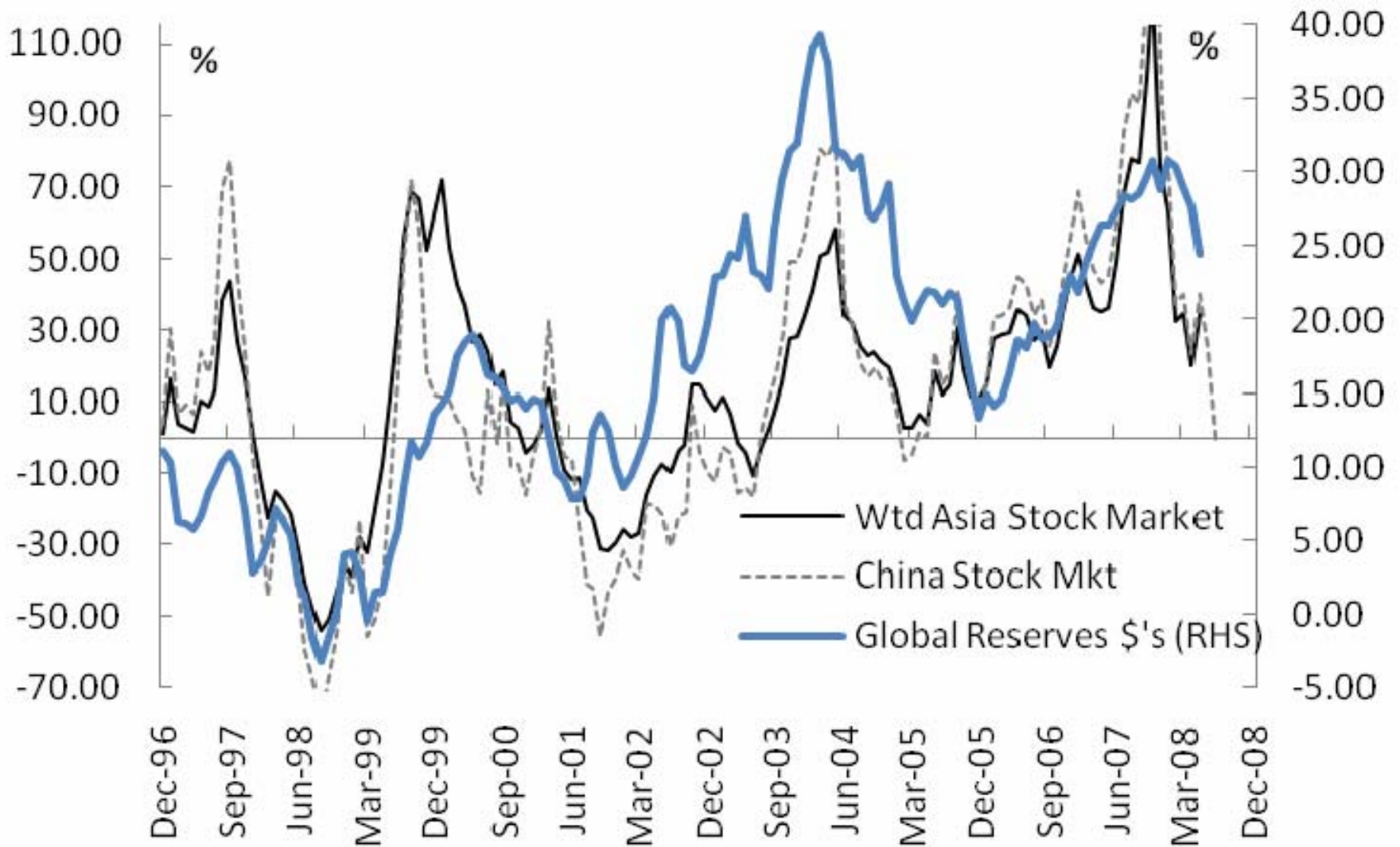


Fig. 18: Summary on Economic Effects

- **Europe: has subprime (UBS etc); is exposed to (asset bubble) Eastern Europe borrowing; has the largest issuance of equity structured products (by far—already banned in Norway); has banks that are massively less capitalised than their US counterparts; is only lagging behind the USA, (just as in early 1990s) with tight financial conditions.**

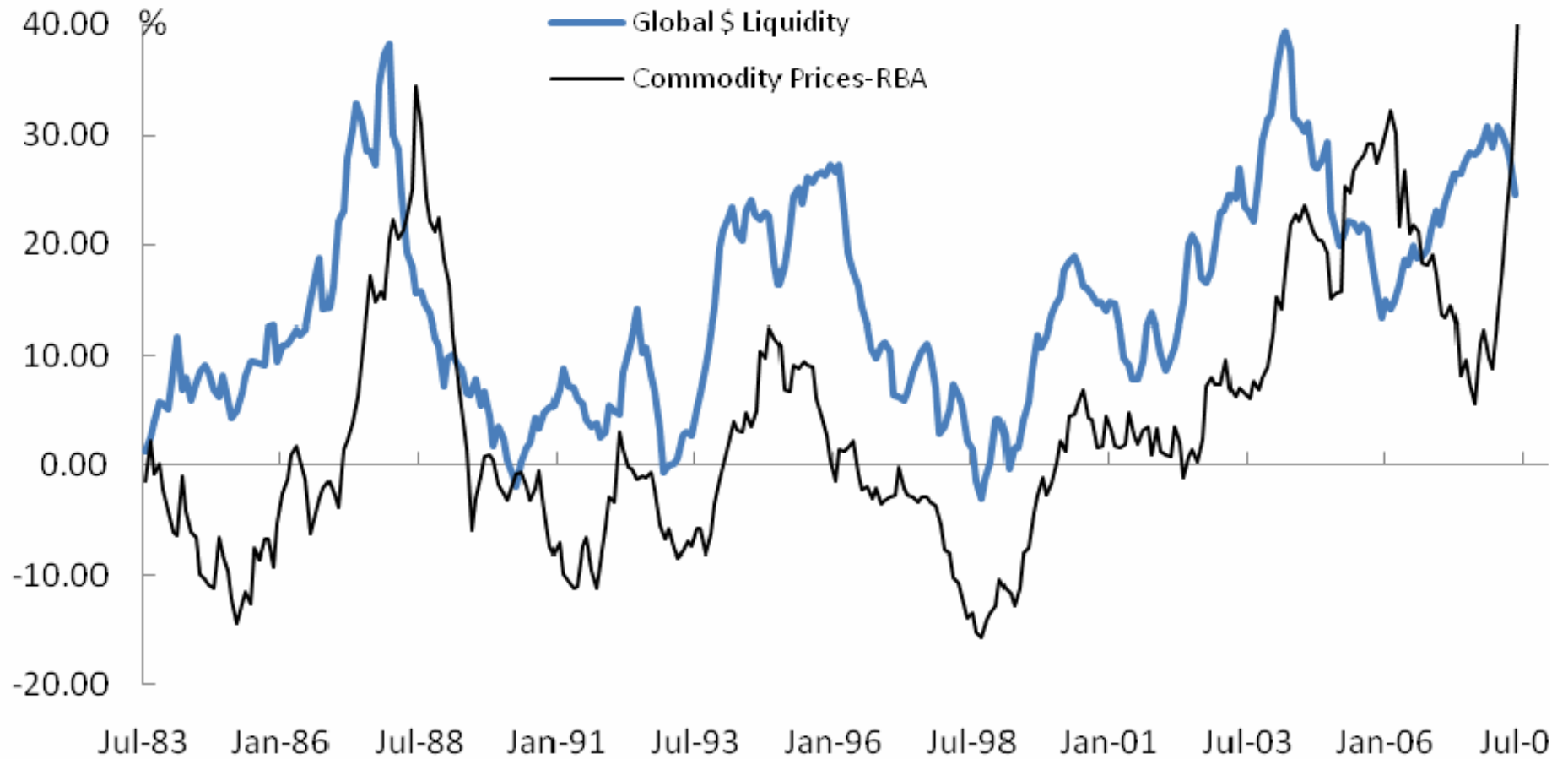


Fig. 19: Global Reserves vs. Asian Stocks (%)



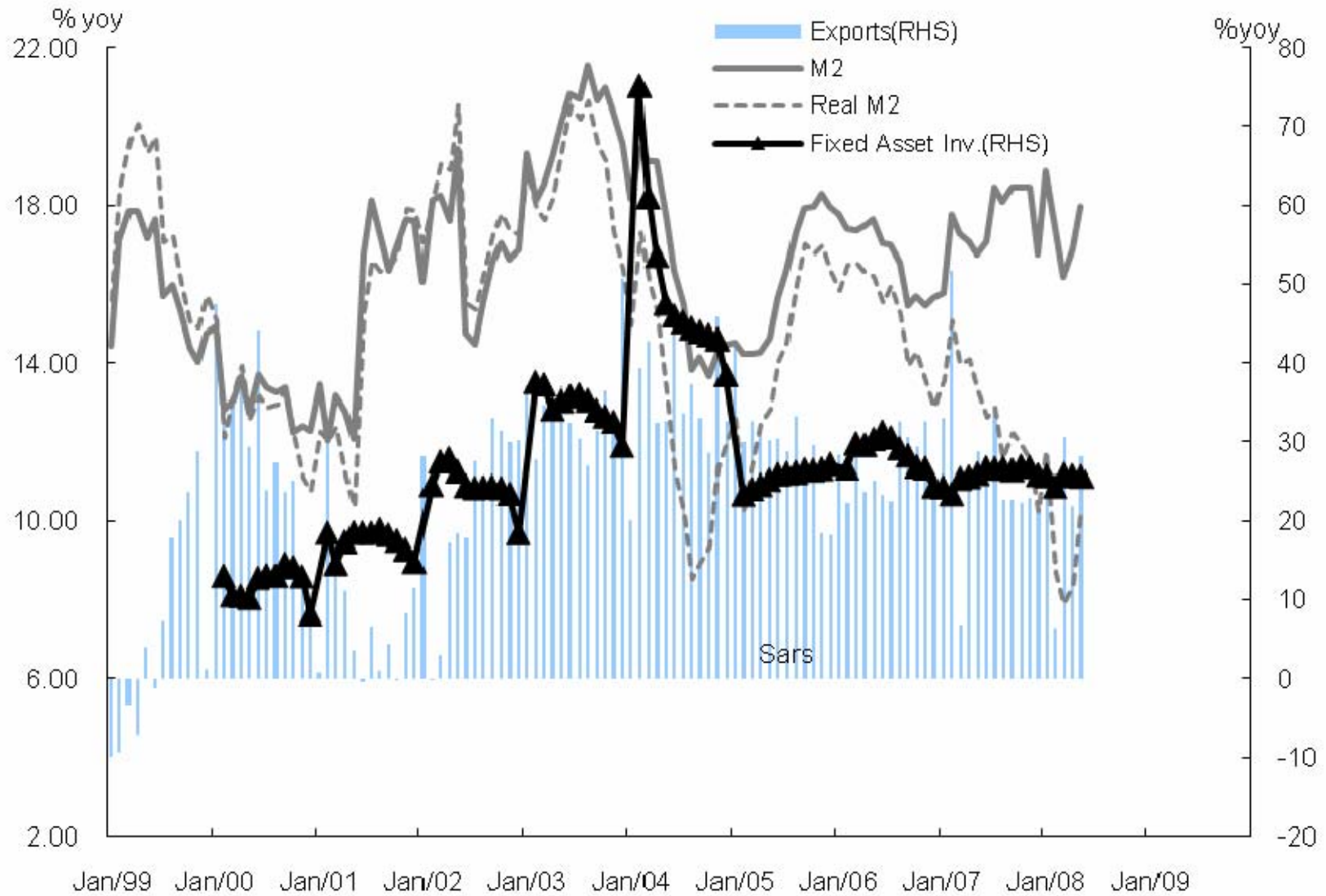
Source: Datastream

Fig. 20: Global Reserves vs. Asian Stocks (%)



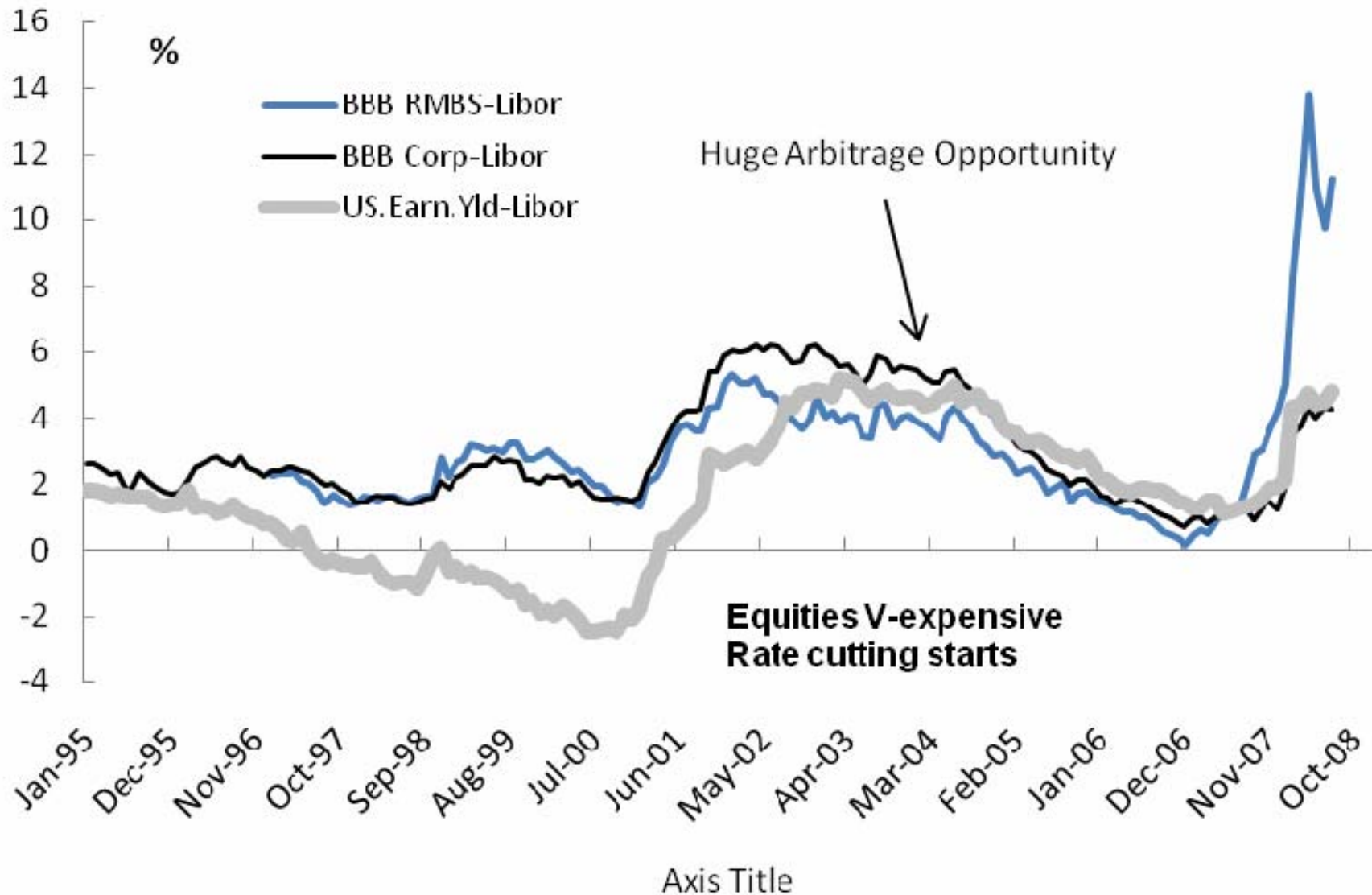
Source: Datastream

Fig. 21: Chinese Economic Indicators



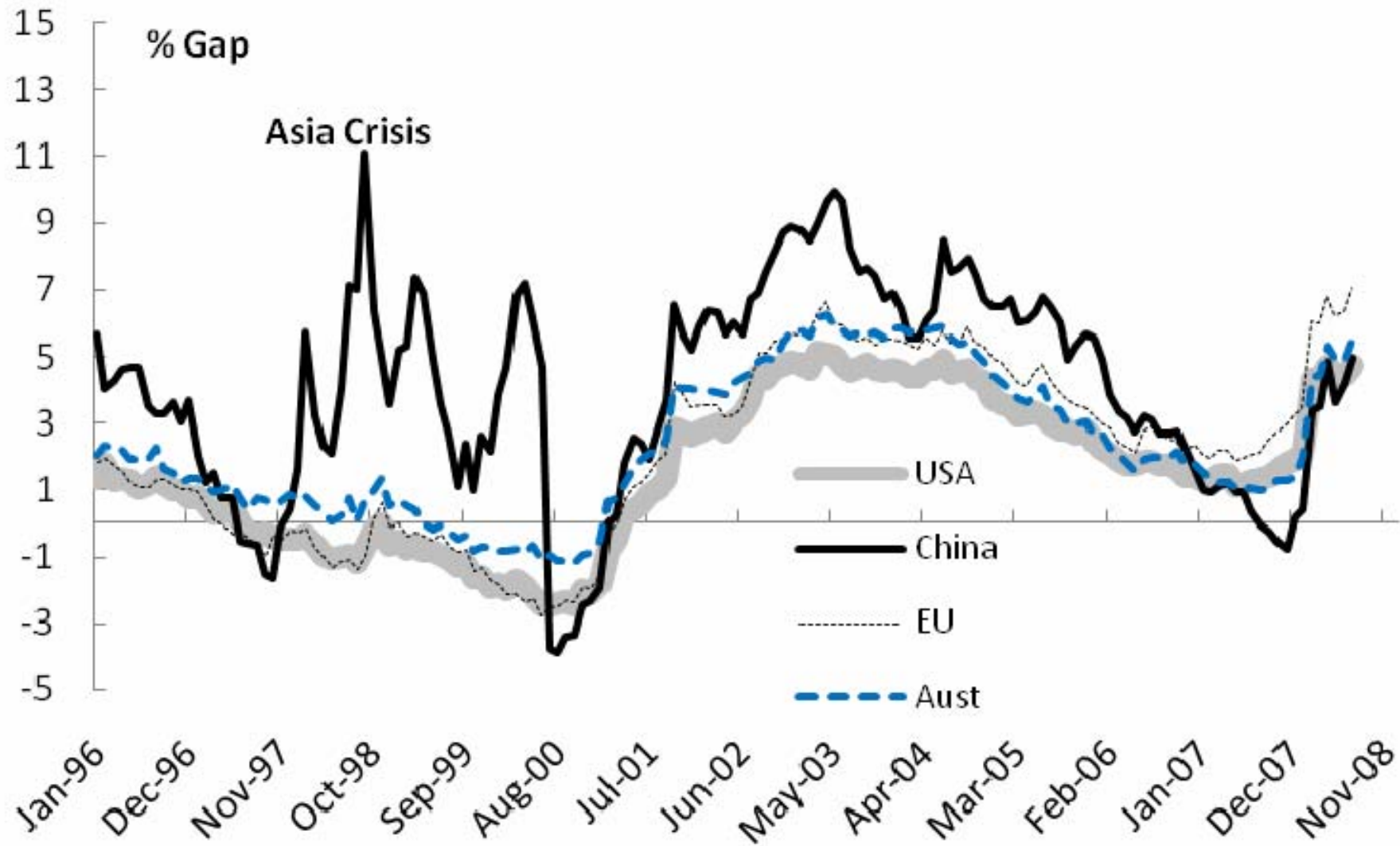
Source: Datastream, OECD

Fig. 22: Bond & Earnings Yield Gap To LIBOR



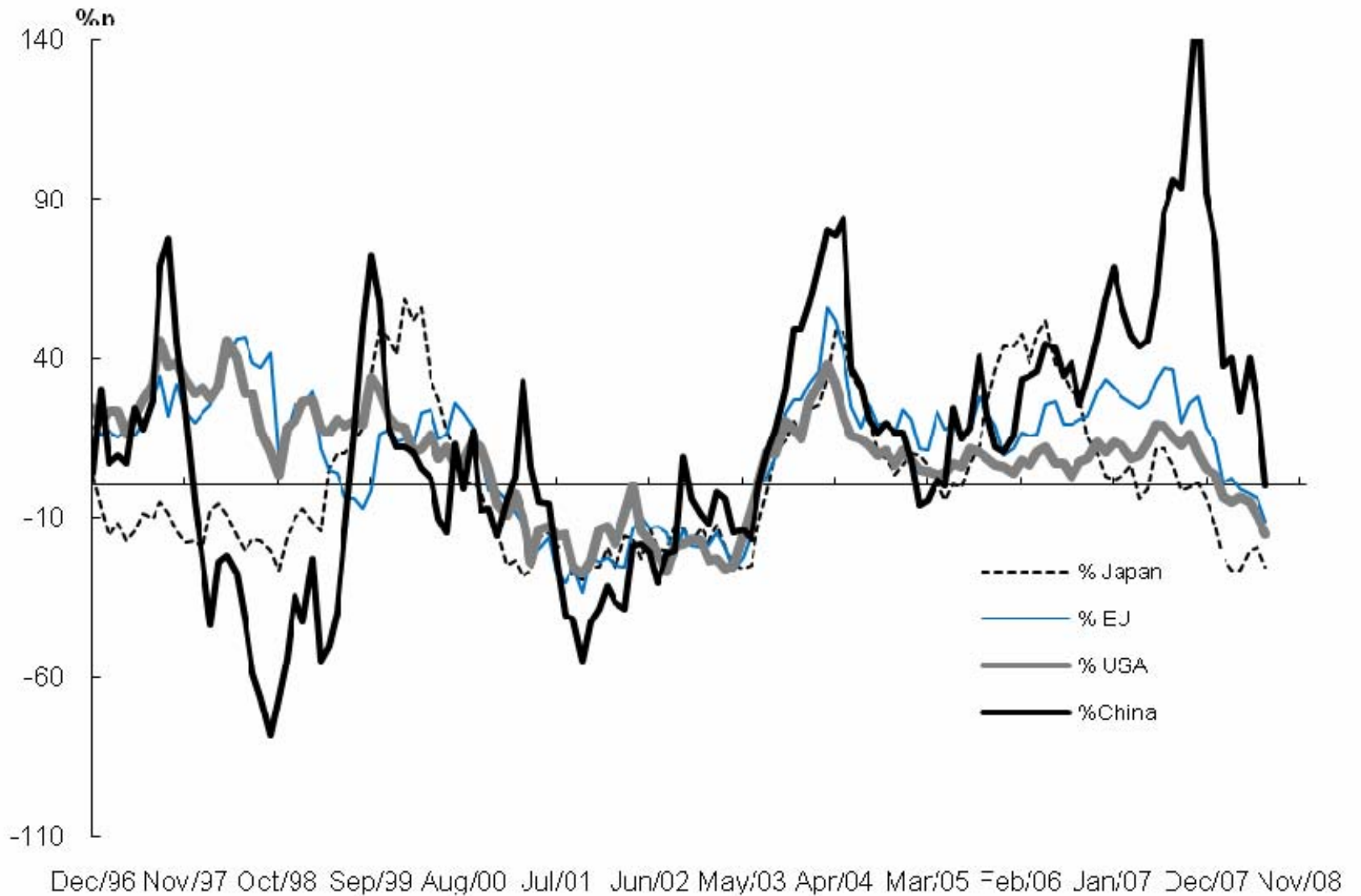
Source: Datastream/Thomson Financial

Fig. 23: Valuation: Earnings Yield LIBOR Gap



Source: Datastream/Thomson Financial

Fig. 24: Stock Market Performances: China & the Rest



Source: Datastream/Thomson Financial