Reach of credit crunch grows ever wider
Nicole Bullock and Michael Mackenzie

GE's need to raise capital is a sign of things to come, say Nicole Bullock and Michael Mackenzie

The need for General Electric, long regarded as the gold standard of corporate credit quality, to raise $15bn in capital to quell concerns about its financial health is the starkest evidence yet that the credit crunch is hitting companies big and small.

"The markets are not taking any prisoners now and General Electric is not immune despite having triple A ratings," said Richard Hofmann, an analyst at CreditSights.

The recent credit freeze has created a "vicious circle," Mr Hofmann says, in which investor concerns about companies' ability to raise capital becomes self-fulfilling. The perception sends the prices of existing securities lower, which in turn makes new capital raising more expensive, even prohibitive.

GE's move shows that the freeze in the US and European capital markets is hurting corporate America and will imperil activity well into 2009. That increases concerns about the eventual extent of the damage to Main Street caused by the financial crisis, irrespective of what happens in Washington DC.

The credit crunch "will restrain economic activity for the next three quarters even with the approval of the [US government] bailout plan," said Jane Caron, chief economic strategist at Dwight Asset Management.

GE's fundraising, which included the sale of stock to Warren Buffett's Berkshire Hathaway, stemmed mainly from concerns surrounding its finance arm.

Operations like that, which rely on access to short-term funding in the capital markets, are being especially punished this week, says Dan Barrett at Tradition Asiel Securities, which tracks the equity and credit derivatives markets. Default protection on the financing arms of big industrial companies, including John Deere and Boeing, have risen on fears the upset in the financial markets could ultimately slow sales.

"Financing costs remain prohibitively high forcing these operations to offer credit at a potential loss or risk losing a potential sale," Tradition Asiel said in research this week. "We believe revenues or financing costs will ultimately be impacted and have a negative effect on earnings."

Since the bankruptcy of Lehman Brothers in mid-September, most parts of the debt markets have ceased to function. Recent bank failures and rescues in the US and Europe have only intensified the breakdown in trust between institutions and banks, halting lending in short term money and commercial paper markets.

While European companies rely less than their US counterparts on commercial paper, for those big companies that do rely on Euro-denominated paper, they too have seen supply retrench.

Some European companies have been able to secure funding in CP over the period of a month, and in rare cases three months, but one senior banker said an unusually high proportion of the trades being done were still just over one day.

Last week, the loss of confidence in the capital markets was so severe that companies weren't able to access commercial paper, very short-term debt that is typically available to the best-regarded companies. Companies also turned to credit lines to fill funding gaps.

AT&T, the American tele-coms giant, said it was unable to sell any commercial paper other than for overnight. At the same time, Goodyear Tire & Rubber was forced to draw $600m from

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its bank credit lines when it could not gain quick access to cash invested with Reserve Primary Fund.

Reserve Primary rocked the money markets by falling below $1 in net asset value. Known as "breaking the buck," such a loss has happened only once before in money market funds.

American companies are looking beyond the financial markets to boost capital and confidence in their finances. Goldman Sachs, for instance, got a shot in the arm from Warren Buffett.

In a sign that funding issues are indiscriminate, Sheldon Adelson, the chairman and chief executive officer of the Las Vegas Sands Corp, and his family, invested $475m in the company through a convertible bond issue to sidestep a technical default.

"While the credit markets are experiencing turbulence, our strategy remains alive and well and our business continues to march forward. Little of our fundamental business strategy has changed and this investment will strengthen our capitalization and liquidity position as we continue to execute our plans," Mr Adelson said.

Meanwhile, the short selling bans imposed by a number of global regulators has impaired the convertible debt market, a key sector for raising capital.

The combination of these policy decisions has only increased uncertainty for the fixed income market and contributed to the breakdown in trading and sky high risk aversion.

So far the massive injections of overnight and term liquidity into the banking system have failed to thaw the lending freeze.

Yesterday, benchmark London Interbank Offered Rates remained at highly elevated levels. Meanwhile, the latest Federal Reserve weekly data on commercial paper showed a decline of $95bn, taking the total drop to more than $200bn in the last three weeks.

Talk of a co-ordinated rate cut by central banks has gained ground as a way to try and restore confidence. Even this might not work. Ms Caron said: "With a credit crunch in place it is not clear that a rate cut will help the economy. It is difficult to see people add to their debt or lenders increase their exposure."

Fonte: Financial Times, London, October 3 2008, Companies & Markets, p. 27.

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