Pressure mounts to nationalize british banks
Mark Scott

As Royal Bank of Scotland piles up colossal losses, Gordon Brown ushers in a new bailout to stave off nationalization.

Brown: A takeover would wipe out the banks' remaining shareholders Andy Rain/Corbix

January was a wild month for the British banking sector. On Jan. 19, Prime Minister Gordon Brown announced a second bailout for the banks that would cost some $280 billion. That same day the government said it will up its stake in Royal Bank of Scotland Group, (RBS) from 58% to 70%, just when RBS announced the biggest loss in British history. Investors concluded that wholesale nationalization of the top banks was at hand and pummeled shares in Barclays (BCS), RBS, and Lloyds Banking Group (LYG).

Yet by the following week investors had warmed to the latest bailout, Barclays had soothed the market by stating it would not need government capital, and analysts had judged Lloyds oversold. A sharp rally followed.

The wild mood swings reflect the deep uncertainties that dog Britain's banks. Four months since the first bailout was unveiled, the financial-services industry, which until recently constituted a third of the country's gross domestic product, is still in tatters. Britain's credit markets are in a deep freeze. Mortgage lending in December fell 17% vs. the average for the previous six months.

The great fear now is an outright nationalization that would wipe out the banks' remaining shareholders. Brown has, in effect, already nationalized large swaths of the industry by taking huge stakes in RBS and Lloyds and acquiring several mortgage banks outright. But so far, Whitehall has been reluctant to intervene directly in the management of the banks it controls. To do that the government would have to oust executives at RBS and Lloyds, mandate new lending targets, and generally act like a socialist regime from the discredited 1970s.

Brown understands the political risk of full-blown nationalization. "The Brits don't want to be the first G7 country to nationalize a major bank," says Peter Hahn, a fellow at City University's Cass Business School in London and a former managing director at Citigroup. (C)

So Brown is trying a new approach. The government will provide insurance to underwrite further losses on the banks' riskiest loans, a move that will limit the size of the writedowns the banks will have to absorb themselves. The British central bank will swap its Treasury bills for high-quality but illiquid corporate bonds held by the banks, which then can sell the Treasuries for needed cash. Finally, the government will provide additional guarantees for interbank lending.

Extreme urgency

Brown & Co. hope the measures will unlock credit. Investors hope for a speedy rollout. "If the government doesn't move quickly, the plan won't work," says Bob McDowall, European research director at financial-services consultant TowerGroup in London. The worry is that the more the economy unravels, the sicker the banks will get.

RBS is especially at risk. Its takeover of ABN Amro left it exposed to ABN's toxic U.S. assets and created a $2.8 trillion balance sheet—larger than Britain's GDP—loaded with problems. RBS' loan write-offs are expected to increase as much as 50% this year. The bank declined to comment. "What's facing RBS in terms of the British economy is much bigger than what we saw with Fannie (FNM) and Freddie (FRE) in the U.S.," says Cass Business School's Hahn. "The scale of exposure is truly mind-boggling."

Business Week, New York, 2 fev. 2009, Financial Crisis Watch, online. Disponível em <www.businessweek.com>. Acesso em: 3 fev. 2009.