High-street high-roller

The bank has prospered by spurning most state aid but tougher times loom.

John Varley, the affable chief executive of Barclays, Britain's sole survivor in global investment banking, is likely to announce good quarterly results on May 7th. The boost will have come from trading in bonds and currencies, judging by the results already reported by the bank's chief international rivals, Goldman Sachs, JPMorgan and Deutsche Bank. This is hardly surprising: dealing spreads are wide and many competitors have left the table. Royal Bank of Scotland (RBS), for example, 70% of which is now in government hands, has dropped its global ambitions and is selling off chunks of ABN AMRO, a big Dutch bank that it bought in 2007.

Barclays had the good fortune to lose the bidding war for ABN AMRO, which quickly became a millstone around RBS's neck. It also escaped having to accept a slug of government money to shore up its capital last October, cobbling together a more expensive deal that gives Middle Eastern investors a potential 30% stake. (That upset many existing shareholders in the bank, who were denied an equal opportunity to put in money.) In March the bank resisted joining a government asset-protection scheme which might have capped much of the risk on its dodgy assets, though at a price. "We remain in charge of our own destiny," said Marcus Agius, chairman of Barclays, at the bank's annual general meeting on April 23rd.

The price paid by rescued banks extends beyond the 12% interest on the preference-share capital put in by government. No dividends may be paid to shareholders until the debt is repaid, and bonuses to staff are limited. The second prohibition alone would give pause to Barclays's high-rolling bosses: Bob Diamond, head of investment banking, is one of the best-paid men in British banking. They argue, though, that it is the likely constraints on their foreign business that would be the real straitjacket. Barclays earns more than 50% of its revenues offshore. Its controversial tax-avoidance schemes—some of which were leaked recently to the press—might also attract the attention of a stakeholding government, though "not a single one of the [leaked] documents has not been seen by Her Majesty's Revenue and Customs," according to Mr Varley.

Yet the bank's independence is relative, and there are those who accuse it of having its cake and eating it. Barclays has availed itself of government guarantees to issue at least £15 billion of bonds more cheaply. Until the budget on April 22nd, that guarantee was available without strings. (In order to use it in future, banks will have to give binding commitments to lend to British businesses, so Barclays will probably decide to do without it.) And, like other large banks, Barclays is widely perceived as too big to fail, which is an implicit government guarantee in itself.

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Can Varley keep pulling it off?

Against this background, Barclays appears to relish pushing the envelope. Last September, as rivals were desperately retrenching, it agreed to buy the American operations of the failed Lehman Brothers. Since then it has battled to convince the market and regulators that it has enough capital to cope. To avoid the government's asset-protection scheme, it underwent a stress test by the Financial Services Authority (FSA). It managed to convince the watchdog that even five more years of awful markets would leave it with core capital equivalent to 4% of its risk-weighted assets, an acceptable, if minimum, ratio in a downturn. Yet credit markets remain sceptical: the insurance premium against default on a five-year Barclays bond with no government guarantee is 2%. Buying cover against default by less racy HSBC, by contrast, costs a little under 1.3%.

The doubt centres mainly on the level of Barclays' toxic assets, which include £8 billion of exposure to American credit insurers and a £10 billion portfolio of leveraged loans: unlike most of its peers, it values these loans on its balance-sheet at 100%. To build its capital reserves Barclays recently sold iShares, a subsidiary that handles exchange-traded funds, for $4.4 billion. It could probably raise another £8 billion or so by selling Barclays Global Investors, its asset-management business.

But even if Barclays can brush off concerns about whether it has enough capital to mop up losses on toxic assets, its business model could well succumb to the twin assaults of regulators and investors. For Barclays is enthusiastically a universal bank, combining high-street deposit-taking with the roller-coaster of investment banking. The FSA, like regulators in other countries, is thinking of ring-fencing the former—probably by imposing much higher capital charges on trading.

That would make this quarter's extraordinary profits hard to repeat. Barclays can make a decent living from investment-banking fees: government-bond markets will need nifty prime brokers such as Barclays for many years to come. But the returns that have excited investors have mostly come from betting the bank. Under any probable future regime those bets will be rarer and smaller.

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