REUTERS

February 21, 2009

US may still prefer bank stakes to nationalization

NEW YORK: If the government gives more help to Bank of America Corp and Citigroup Inc in the near term, it will likely stop short of nationalization, even if a full takeover would be best for the banking system.

Financial markets are bracing for the US government to nationalise two of the three largest banks in the nation. Bank of America's shares fell 3.6 per cent on Friday, while Citigroup's fell 22.3 per cent, both recovering from earlier losses of more than 30 per cent.

The US government evidently has little desire to nationalise banks. But in the coming weeks or months, it will likely have to do something to further prop up the biggest banks.

Rather than opting for a sweeping takeover, the government may act more incrementally, demanding a little more control every time Bank of America or Citigroup seek more capital, analysts said.

"They'll try to do everything they can before they nationalise banks, but they may ultimately do it," said Lee Delaporte, director of research at Dreman Value Management, which has $10 billion under management.

Both Citi and Bank of America trade below $4, with Citigroup's shares at less than half that level. Both have fallen by more than 50 per cent since the beginning of last week, and their preferred shares have plummeted as well.

Bank of America and Citigroup will at some point need to raise capital to offset writedowns, and that capital is not likely coming from the private sector.

"The government has almost made it a sector you can't invest in, because the rules keep changing. Investors are just not participating now," said Blake Howells, director of equity research at Becker Capital Management in Portland, Oregon.

The US banking system needs more than $2 trillion of extra capital by some estimates as loans of all stripes suffer during the recession.

Still there is room for debate about what exactly constitutes a "nationalisation" and what classes of investor would be wiped out by such a move.

The next step for Bank of America and Citi might look more like a Lloyds Banking Group rescue, where the U.K. took a 43 per cent stake in the bank, than an American International Group transaction, where the United States took a 79.9 per cent stake in the insurer and forced out management.

One possibility that has been widely discussed on Wall Street would be for the US government to exchange its more than $45 billion of Citigroup and Bank of America preferred shares for common equity. If other holders of preferred shares did the same, the government still might not end up with a majority stake.

But to many experts, delaying nationalisation is a bad move, because these banks will only be able to raise the capital they need in the future when the government is fully supporting them.

"The best thing to do is to just get it over with. This is water torture," said Daniel Alpert, an investment banker at Westwood Capital in New York.

THE GOVERNMENT HAS PLENTY OF WATER

Although it has pumped hundreds of billions of dollars into banks, the government has made clear that it prefers to avoid nationalisation. White House spokesman Robert Gibbs said on Friday that "this administration continues to strongly believe that a privately held banking system is the correct way to go."

People close to Citigroup told Reuters that the government has not discussed nationalization with the bank. And Bank of America Chief Executive Kenneth Lewis said at a meeting on Thursday that government officials told him that nationalization is not an option on the table, according to a person familiar with the matter.

Both banks said they were well-capitalized, pointing to their Tier 1 ratios, which regulators use to assess banks' strength.

In the near term, the government may be able to get away with doing nothing. Talk of nationalization from conservative Republicans like Sen. Lindsey Graham may in fact assure depositors and clients about the ultimate stability of their banks.

But in the coming weeks or months, the government must do something, given a recession that worsens by the day, pummeling banks' balance sheets, analysts said.

The longer the administration of US President Barack Obama takes to release significant detail about its plan to rescue banks, the greater the risk of customers and investors losing faith in the largest banks.

Whatever the Obama administration is planning, stock market investors clearly fear the worst.
"There's no question, the bank stocks are telling you nationalisation is going to happen," Dreman's Delaporte said.