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Sinking rates still can't spur risk-taking

By MADLEN READ

NEW YORK (AP) — The credit markets revealed both good news and bad this week: There's finally more cash in the financial system, but people aren't putting it to use yet.

Bank-to-bank lending rates have fallen for 20 straight days — suggesting that financial institutions have grown much more willing to lend to one another. But the decline in the rate isn't being met with the market enthusiasm many thought it would; investors, understandably, still don't want to take on risk with the economy in such a perilous state. The corporate bond markets showed a few signs of thaw this week, but remained too tight for most companies to take advantage of. The securitization market — where banks repackage consumer debt into bonds that can be traded — is at a virtual halt. Meanwhile, more individuals are losing their jobs, raising the probability that people will fall further behind on their debt payments.

"There are no creditworthy borrowers," said Daniel Alpert, managing director at the investment bank Westwood Capital. "You can throw all the money you want at the banks." Central banks around the world have pumped money directly into banks, initiated currency swaps, slashed interest rates, guaranteed various types of deposits and debt, and paid interest on both required and excess funds in reserves.

Those efforts have helped the three-month London interbank offered rate tumble to a four-year low of 2.29 percent on Friday, down from 3.03 a week ago and down from 4.82 percent on Oct. 13 — when fear about lending to financial institutions was peaking in the wake of Lehman

Brothers Holding Inc.'s bankruptcy and American International Group Inc.'s takeover by the government. Bringing down this rate was necessary, analysts say. But if the first phase of the financial crisis was a credit freeze, the second phase is a business standstill — and some say that phase has begun in full force.

For all types of companies — from lenders to manufacturers to retailers — the goal right now is to **"preserve capital, above all else," Alpert said.** This is the big reason employers slashed 240,000 jobs in October, after cutting 284,000 in September.

And banks are in no hurry to take risks, given that so many sources of revenue during the housing boom have dried up. The only public term issuance of asset-backed securities in October was a $500 million deal from AmeriCredit, according to Barclays Capital's fixed income research, and there were no new issuances of securities backed by credit cards or student loans for the month.

Since the beginning of the year, issuance is down 31 percent for securities backed by cards; down 45 percent for securities backed by auto loans; and down 41 percent for securities backed by student loans, Barclays said. The commercial paper market, thanks to the Federal Reserve's decision to buy the paper starting Oct. 27, is functional again. Commercial paper is the short-term debt companies sell for financing day-to-day operations. For a tense couple of weeks, investors — mostly money market funds — were loath to buy any paper with a maturity of more than a day or two.

The amount of commercial paper in the market increased for the second straight week in the week ended Wednesday, albeit at a slower pace, to a seasonally adjusted $1.60 trillion. The Federal Reserve Bank of New York said Thursday it held $244.59 billion worth of commercial paper in its funding facility last week, above the $145.71 billion it held a week earlier.

However, few companies are able yet to go to the corporate bond markets for funding. Altria Group Inc. revived the bond market a bit this week with a big $6 billion note issuance, but companies with lower ratings are not finding conditions palatable.

According to Standard & Poor's, rates on both investment-grade and speculative-grade bonds fell modestly Thursday compared to Treasury yields — but "with speculative-grade defaults on the rise, higher preponderance of credit downgrades, and a general malaise about the future of the economy, we expect spreads to remain at their elevated levels for some time until confidence is restored to the market."

Some analysts say it will just take time for the government's efforts to work their way through the system. After all, Lehman's bankruptcy happened only about eight weeks ago, said Christopher S. Rupkey, chief financial economist in Bank of Tokyo-Mitsubishi UFJ's economic research group in New York.

"If three months from now, borrowing isn't picking up, there'd be grounds for worrying," Rupkey said. "But it's something you can't give weeks."

With investors still avoiding risk, the Treasury market would normally be a popular place to park cash. However, there are billions of dollars of Treasury supply in the offing — when supply rises, prices tend to fall.

On Friday, demand for the three-month Treasury bill, considered one of the safest assets out there, remained high, keeping its yield at a low 0.30 percent, the same as late Thursday.

But in longer-term Treasury trading, the 2-year note fell 3/32 to 100 10/32 and yielded 1.34 percent, up from 1.28 percent late Thursday. The 10-year note fell 22/32 to 101 25/32 and yielded 3.78 percent, up from 3.69 percent. The 30-year bond fell 30/32 to 104 4/32 and yielded 4.25 percent, up from 4.20 percent.