

# U.S. banking sector headed for meltdown, official says

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## **Banks face massive loan losses because of defaults on debts and housing-price slide**

Duncan Mavin

Toronto — The U.S. banking sector is headed for a credit downturn that will be “the worst in generations,” featuring widespread defaults on a range of debts and a national housing price slide not seen since the Great Depression, one of the most influential analysts on Wall Street says.

The banks face massive loan losses — “far more dramatic” than most bank executives and ratings agencies have forecast — as the next chapter in financial-sector turmoil unfolds, said Meredith Whitney, an analyst with Oppenheimer & Co. Inc.

“We believe loss rates will exceed the highest levels since 1990 by a significant margin,” she said in a note Monday.

“Bank losses will be the highest in the past 20-plus years as a result of greater numbers of individual defaulting on mortgages and/or other loans and from [loan balances that] are far higher than they were in the last housing cycle.”

Whitney — who is also a panellist for Fox News and the No. 2-ranked analyst on a Forbes list of top stock pickers for 2007 — shot to global infamy last year after her gloomy, but accurate, predictions about the scale of subprime problems facing Citigroup Inc. led to a worldwide sell-off of banking stocks.

In Monday’s note, the Oppenheimer analyst slashed her already-depressed forecasts of what large U.S. banks will earn in 2008 by 29 per cent and by 13 per cent for 2009, citing concerns about mortgages, credit-card balances and other loans.

In contrast to Whitney’s view, there was some good news Monday for big U.S. banks reeling from \$92 billion US in collective writedowns tied to investments in the sub-prime-mortgage market.

The U.S. financial sector was buoyed by an announcement from rating agency Standard & Poor’s that it is unlikely to downgrade bond insurer MBIA Inc. any time soon. S&P and other rating agencies have been reviewing MBIA and its peers after U.S. monolines posted record losses on collateralized debt obligations (CDOs) they guaranteed. Banks stood to lose as

much as \$70 billion US if the CDOs they owned no longer carried an automatic AAA rating because of the insurance.

Canadian banks have been praised for avoiding the worst lending excesses of their U.S. counterparts. But their first-quarter profit reports — released over the next two weeks, starting with Canadian Imperial Bank of Commerce, Toronto-Dominion Bank and National Bank, all due out on Thursday — will be scrutinized for signs of a serious spillover from deteriorating U.S. markets.

The Canadian banks have tens of billions of dollars in indirect exposure to a wide-variety of U.S. loans through various complex investments, such as CDOs and structured investment vehicles. Also, Toronto-Dominion Bank, Royal Bank of Canada and Bank of Montreal all have extensive retail-banking operations in the United States.

According to Whitney, consumer loans are now the main area of concern for the U.S banking sector.

“As far as consumer credit is concerned, we are in uncharted territory,” the outspoken analyst said. “Housing prices, now down six per cent across the United States, have begun to decline on a national level, a phenomenon not seen since the Great Depression. We are of the belief that over the next 24 months, national home prices will decline by a factor of three times such levels.”

The “sand” really hits the fan because liquidity is drying up as banks stay away from the sort of securitized structured investments that have burned them in recent months, Whitney noted. Highly leveraged loan commitments are another source of earnings pressure in early 2008, she said.

Whitney said the stock prices of big U.S. bank could fall by another 40 per cent.

In a separate note, she also predicted more woes for Citigroup. The world’s largest bank must sell \$100 billion US of assets to shore up its balance sheet, but in doing so risks losing profitable operations.

“Under duress, Citigroup will likely be forced to sell what it can and not what it should,” she said. The Oppenheimer analyst slashed her forecast for Citigroup’s earnings from \$2.70 US to 75 cents — the revised estimate “could still prove optimistic,” she said — and predicted the bank’s stock price could fall as low as \$16 US, compared with a 52-week high of \$55.55 US.

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