

The bank has a problem

Eurozone crisis deepens as central banks intervene

September 16, 2011 – Here’s a variant on the old saying: When you owe the bank a million dollars, you have a problem; when you owe the bank five hundred billion, the bank has a problem. And, boy, do the eurozone banks, starting with the central bank, have a problem!

Last week, the European Central Bank, the US Federal Reserve, the Bank of Japan, the Swiss National Bank, and the Bank of England in essence provided a backstop of unlimited US dollar liquidity to any European financial institution that needed it. This came just a day after rating agency Moody’s Investor Services downgraded two of the largest French banks, Société Générale and Credit Agricole, and put a third, PNB Paribas on a negative watch.

At issue was a sudden, severe loss of confidence in the funding of the European financial sector, given the exposure of many of Europe’s largest financial institutions to now-worthless Greek sovereign debt. With US money market funds, still gun-shy after very nearly “breaking the buck” in 2008-09 (some did break the buck), loath to cough up more US greenbacks to euro banks that have indeterminate exposure to Greek debt, concerns about dollar liquidity rattled markets last week.

So it was that the world’s big central banks put on a show of solidarity in pledging to shore up their faltering European cousins, and thus try to avoid a repeat of the Lehman Bros. debacle that brought on the last credit crunch, recession, and bear market. There is no way that any European bank is going down, even if Ben Bernanke has to take his helicopter and shower the Champs-Élysées with thousand-dollar bills.

Equity markets were relieved to see all those greenbacks pouring into the European black hole last week, and embarked on a sturdy rally following a sluggish start on Monday. Not in Toronto, though.

As if the European debt crisis, whose tentacles are now spreading through the global financial markets, weren’t worrisome enough, jobless claims rose in the US while August retail sales were flat, fuelling concerns that stagnating growth in the US through the third quarter could be amplified into another quarter of weak growth – or even contraction – for Canada. And investor sentiment was further dampened each time a trader or analyst picked up a beeping or buzzing Blackberry smartphone.

Research In Motion is the Waterloo, Ontario-based tech company best known for its proprietary Blackberry smartphone and related communications network. The once-dominant player in the high-end mobile phone industry, and stock market darling, has fallen on hard times, as Cupertino, California-based Apple Corp. showed up one day with something called an iPhone, and asked for a bite of RIM's lunch. It then took an iPad out of its bag and left RIM with no lunch whatsoever. And increasingly, it seems, no shirt, pants, or shoes either.

RIM just reported quarterly earnings of \$0.80 per share, well below consensus estimates of \$0.89. The real trouble showed up in reported revenue, which dropped 15% from the previous quarter, and was down 10% from the same quarter a year ago. Sales of both its Blackberry smartphones and its Playbook tablet are down considerably, with smartphone sales sliding for the second consecutive quarter and tablet sales never really getting off the ground at all.

So RIM has been doing what all companies do when business starts draining away like water through a sieve. It cuts costs and denies there's any sort of problem. Analysts aren't buying it, of course, and downgrades for RIM have been coming thick and fast lately. Investors also downgraded RIM, selling shares thick and fast, as share price once again slid to around \$23, not far from its 52-week low of \$21.40.

RIM, once not too long ago a Canadian high-tech success story, looks to be foundering on the shoals of exceedingly sharp international competition. It could pull itself up by its bootstraps. It could become takeover fodder. But, while not beyond the bounds of possibility, it is unlikely to be granted a taxpayer-funded bailout should creditors come calling, in the way that, say, General Motors was back in the 2008-09 global credit crisis.

The S&P/TSX Composite Index, struggling to recover from a steep loss on Monday, had flagged again somewhat by Friday on the travails at RIM. In addition, the Paris-based International Energy Agency pared back its forecast for growth in oil demand both this year and in 2012. That, and a growing concern that Canada's economic growth could stall again in the third quarter, following a small contraction in the second, took the edge off any nascent investor exuberance in Toronto last week. The energy, materials, financials, and information technology sectors all weighed on the market on Friday, as the index posted a week-over-week loss of 0.8%.

South of the border, however, all the big indexes posted gains on the week, as investors unaccountably viewed the Fed's intervention in the European banking crisis as a net positive. The Dow Jones Industrial Average advanced 4.7% on the week, while the S&P 500 Composite Index rose 5.4%.

We remain puzzled, though not surprised, by the US markets' ebullient reaction to central bank interventions in the eurozone. The game isn't over by any means, and Greece still teeters on the edge of default, while the eurozone itself is stressed nearly to the breaking point. The provision of US dollar liquidity to eurozone banks is a temporary stop-gap,

and nothing more. As we said at the outset, the bank has a problem. And the crisis isn't over. ■

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