Philequity Corner
By Valentino Sy (December 15, 2008)

Big Brother

In recent months, as the global economy has been battered by falling asset prices, rising costs of credit, shrinking output and waning confidence, there is a renewed call for governments to assume a bigger role.

Laissez-faire appears to be taking a back seat. The "hands-off" brand of capitalism is now being blamed for the easy credit which led to the collapse of the housing market. It also allowed a freewheeling Wall Street to drown in a pool of toxic investments that has infected the global financial system.

Thus, "Big Brother" (in reference to George Orwell's 1984 classic) is left with no choice but to reassert its forceful hand. Governments are now taking a bigger role in stimulating activity, as well as stabilizing financial markets through liquidity infusions, capital injections and direct purchases in the stock market.

Capital injections

The US government made a monumental blunder when they let Lehman Brothers collapse. Since then the US government, as well as their G7 counterparts, have pledged to deploy all their tools in an effort to rekindle the credit markets.

Specifically, the US Treasury has made direct investments in financial institutions to shore up their capital bases. Under the $700 billion Troubled Asset Relief Program (TARP), the US government has infused $250 billion of capital in the banking system in return for preferred shares, following the UK model. Meanwhile, it has committed $1.5 trillion as a temporary guarantee by the FDIC to insure senior subordinated debt issued by banks.

European counterparts

Of course it's no different for the European counterparts which have also insured bank debt and partially nationalized their banks. UK injected $64 billion into Royal Bank of Scotland Group, HBOS and Lloyds TBS group while guaranteeing $434 billion of bank debt.

Germany injected $109 billion into its banks in return for stakes, while guaranteeing up to $544 billion of bank debt and setting aside $27 billion to cover for potential losses.

France created a state company with up to $54 billion in capital to recapitalize or bail out its banks, while guaranteeing $435 billion of senior bank debt.

Meanwhile, Spain guaranteed banks' new debt issues of up to $136 billion and established a $41 billion to $68 billion fund to buy bank assets.

Liquidity infusions

Under the Commercial Paper Funding Facility (CPFF), the US Fed has become the buyer of last resort in the $1.6 trillion commercial paper. This program funds purchases of commercial paper of 3 month maturity from high quality issuers.

Unlimited swap lines with major central banks (such as the ECB, Bank of England, Bank of Japan, the Swiss National Bank, etc.) were also established to provide sufficient liquidity in short-term funding markets.

Recently, the US Fed announced the creation of the Term Asset-Backed Securities Loan Facility (TALF), a facility which aims to free up the ABS market by extending loans of up to $200 billion to holders of AAA-rated consumer backed debt. The US Fed also initiated a program to purchase up to $100 billion in Fannie Mae and Freddie Mac debt, and up to $500 billion in mortgage backed securities backed by Fannie Mae, Freddie Mac.

Fiscal stimulus

Recently, Barack Obama revealed plans of a massive fiscal stimulus plan that could reach $ 1 trillion, the bulk of which is going into infrastructure outlays and tax cuts. The massive public works program is aimed to help raise employment and lift the economy out of recession.

Meanwhile, the European Union (EU) agreed last week on a $264 billion dollar fiscal stimulus package worth around 1.5 percent of EU's GDP. The fiscal stimulus will include judicious reductions in taxes and increases in public spending.

Earlier, China unveiled a $585 billion stimulus package that will be pumped into infrastructure, housing, rural reform and environmental projects. The plan also calls for tax breaks on capital investments and export rebates to stem the decline in manufacturing.

Direct purchases in the stock market

Another form of government stimulus is thru direct purchases in the stock market. This is similar to what the Hong Kong government did during the 1997 Asian financial crisis. Likewise faced with deleveraging and indiscriminate sell-off in their financial assets, the Hong Kong government bought equities straight from the stock market. These purchases later formed the HK Tracker fund, which the HK government successfully sold back to the public.

Currently, the Taiwan government is employing a similar tack. It has directed its four government funds (Pension, Labor Pension, Labor Insurance and Postal Savings) to prop up shares in the stock market. In addition it has created a National Stabilization Fund aimed at buying stocks at currently depressed levels with a goal of restoring investor confidence and making money in the long-term.

In China, the country's sovereign wealth fund has been buying in the stock market. It has been instructed by the Chinese government to provide support.

Similarly, Middle East countries such as Oman, Kuwait, UAE, Saudi Arabia and Pakistan, have outlined plans to use public funds to purchase stocks in their sagging markets.

Our own Kuya

The Philippine government started to do the same by providing its own P100 billion stimulus package which was announced last week.

Not to be outdone, majority shareholders of listed companies, company retirement funds and the company themselves follow the lead of other countries by accumulating shares at these depressed levels.

Meanwhile, the government financial institutions (GFIs) such as GSIS, SSS, DBP and Land Bank may start taking action by doing what other countries' pension funds are doing. They can buy stocks now and take advantage of the depressed price levels because of their long-term holding period. And when things become rosy and foreign funds come back, the GFIs will be able provide them the adequate liquidity.

Big Brother is helping you

Unlike Orwell's classic wherein BIG BROTHER is said to be WATCHING YOU, what's happening now is that BIG BROTHER IS HELPING YOU.

By making liquidity infusions, capital injections & taking direct equity stakes in the private sector and providing economic stimuli, the public sector aims to repair private sector balance sheets. Once health is restored to the private sector, the vicious cycle of deleveraging and indiscriminate liquidation of assets will stop, and the virtuous cycle of re-leveraging and reflation of assets will gain track.