Weekend could be a long time in finance

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This column is called the Long View. It is meant to have a long time horizon and to have a broad scope. That is a problem.

This column is being written, in New York, on Friday morning. As far as many traders across the world are concerned, a "long view" at the moment is anything that goes much past Sunday evening.

As far as geography is concerned, nothing more than a few miles from the FT's office in New York much matters.

By the end of Sunday, Lehman Brothers, a fabled Wall Street institution, could know its fate. Washington Mutual, one of the biggest US retail banks, is also the subject of intense speculation.

And if the share price moves on Wall Street are anything to go by, then traders are also calling into question American International Group, the insurer, and Merrill Lynch, a huge investment bank.

So this weekend will be spent in negotiations - amply covered elsewhere in the FT - to decide Lehman's fate, and perhaps that of some other financial institutions as well.

This will not be Wall Street's first lost weekend of the year. Only last weekend, markets were hanging on the news that Fannie Mae and Freddie Mac, which back about half of all US mortgages, were to be nationalised.

In July, there was the announcement that the Federal Reserve was to start lending to Fannie and Freddie in a bail-out. And in March there was the fire sale of Bear Stearns, the investment bank. In January, the Fed announced a huge interest rate cut at the end of a long weekend, as the market swooned over the fate of the monoline bond insurers, responsible for underwriting many of the toxic mortgage-backed bonds that have been at the centre of the credit crisis.

Last August saw an emergency rate cut by the Fed, followed by the sale of Countrywide Financial, a huge mortgage lender, to Bank of America.

Each of these incidents helped stocks to bounce. But those bounces are growing more short-lived. After the Countrywide incident, the S&P 500 bounced 11 per cent and did not return to its low for five months; after Bear Stearns, the bounce was 12 per cent but it was setting a new low within four months; and after the initial bail-out for Fannie and Freddie, the bounce was only 7.4 per cent, and the market was almost back to its low within two months.

The bounce after the nationalisation of Fannie and Freddie last weekend appears to have lasted all of one day.

As for the credit markets that caused the problems in the first place, they suggest that credit grew much less risky after the first rescues. But as of yesterday, the cost of insuring against default in the US was as high as it had ever been throughout the crisis, while in Europe this cost was almost back to its highs.

There are two ways of looking at all of this. One draws an analogy with drugs. With each new shot, the dose becomes less effective. The patient needs another dose more quickly. Hence, authorities must either inject ever more money into the system, or resort to a painful "cold turkey" treatment.

Alternatively, each intervention has bought more time, and with that time everyone has been able

to deal with their risks and get ready for the next crisis.

In January, a downgrade of the credit rating of the bond insurers might have been disastrous. But by the time they did lose their triple A status, months later, the markets had had the chance to cover against the risk that it would happen. It was not good, but the world carried on.

The overall S&P 500 was yesterday down only about 3 per cent from the worst of the Bear Stearns crisis six months ago.

Over that time, the rest of the world has grasped the fact that trouble for the US financial system could mean less finance for everyone. Non-financial and non-US stocks have steadily caught up over the past few months, as the chart shows. At times last week trading in Lehman was matched almost exactly by trading in unconnected markets that are a proxy for global growth, such as Brazil.

That brings us back to this weekend. The US authorities have a strong interest in not bailing out banks. This is because they have a duty to save public money, and because bail-outs encourage a belief on Wall Street that the government will let it get away with irresponsible risk taking, a concept known as "moral hazard".

They appear to believe that it is safe now not to provide government money for whoever buys Lehman, and that the market can survive without it.

This would entail a bet that the worst scenarios of a systemic meltdown have been averted. Wall Street and the rest of the world would instead have to take the consequences, which will probably be a few years of much slower economic growth than had been hoped, and some truly horrible times for those who work in the financial services industry.

Much therefore depends on exactly what is decided over the weekend and how the market responds next week. The "long view" could change a lot in the next few days.